

PARKE BANCORP, INC.
Form 10-Q
November 14, 2013

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 the quarterly period ended: September 30, 2013.

or

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

For the transition period from _____ to _____

Commission File No. 000-51338

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

New Jersey
(State or other jurisdiction of incorporation or organization)

65-1241959
(IRS Employer Identification No.)

601 Delsea Drive, Washington Township, New Jersey
(Address of principal executive offices)

08080
(Zip Code)

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

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

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Yes [] No [X]

As of November 14, 2013, there were issued and outstanding 5,982,810 shares of the registrant's common stock.

PARKE BANCORP, INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

(in thousands except share and per share data)

	September 30, 2013		December 31, 2012
Assets			
Cash and due from financial institutions	\$ 3,040		\$ 2,601
Federal funds sold and cash equivalents	18,526		74,265
Cash and cash equivalents	21,566		76,866
Investment securities available for sale, at fair value	16,573		19,340
Investment securities held to maturity (fair value of \$2,144 at September 30, 2013 and \$2,239 at December 31, 2012)	2,093		2,066
Total investment securities	18,666		21,406
Loans held for sale	3,443		495
Loans, net of unearned income	660,670		629,712
Less: Allowance for loan losses	(19,680))	(18,936)
Net loans	640,990		610,776
Accrued interest receivable	2,596		2,727
Premises and equipment, net	3,945		3,989
Other real estate owned (OREO)	27,871		26,057
Restricted stock, at cost	2,495		2,223
Bank owned life insurance (BOLI)	11,024		10,743
Deferred tax asset	4,812		4,696
Other assets	9,721		10,499
Total Assets	\$ 747,129		\$ 770,477
Liabilities and Equity			
Liabilities			
Deposits			
Noninterest-bearing deposits	\$ 31,308		\$ 30,342
Interest-bearing deposits	580,108		606,865
Total deposits	611,416		637,207
FHLB NY borrowings	30,322		20,448
Other borrowed funds	—		10,000
Subordinated debentures	13,403		13,403
Accrued interest payable	422		537
Other liabilities	4,875		5,339
Total liabilities	660,438		686,934
Equity			
Preferred stock, cumulative perpetual, \$1,000 liquidation value; authorized 1,000,000 shares; Issued: 16,288 shares at September 30, 2013 and December 31, 2012	16,228		16,065

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Common stock, \$.10 par value; authorized 10,000,000 shares; Issued 6,193,710 shares at September 30, 2013 and 5,594,793 shares at December 31, 2012	619		560	
Additional paid-in capital	52,665		48,869	
Retained earnings	21,233		21,068	
Accumulated other comprehensive loss	(818)	(745)
Treasury stock, 210,900 shares at September 30, 2013 and December 31, 2012, at cost	(2,180)	(2,180)
Total shareholders' equity	87,747		83,637	
Noncontrolling interest in consolidated subsidiaries	(1,056)	(94)
Total equity	86,691		83,543	
Total liabilities and equity	\$ 747,129		\$ 770,477	

See accompanying notes to consolidated financial statements

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

	For the nine months ended		For the three months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
	(in thousands except share data)		(in thousands except share data)	
Interest income:				
Interest and fees on loans	\$26,632	\$27,637	\$8,821	\$8,766
Interest and dividends on investments	551	800	168	259
Interest on federal funds sold and cash equivalents	92	178	19	59
Total interest income	27,275	28,615	9,008	9,084
Interest expense:				
Interest on deposits	3,849	5,011	1,184	1,552
Interest on borrowings	582	709	156	234
Total interest expense	4,431	5,720	1,340	1,786
Net interest income	22,844	22,895	7,668	7,298
Provision for loan losses	2,200	5,800	200	1,500
Net interest income after provision for loan losses	20,644	17,095	7,468	5,798
Noninterest income:				
Gain on sale of SBA loans	2,225	2,057	757	700
Loan fees	523	251	200	91
Net income from BOLI	281	138	95	47
Service fees on deposit accounts	188	166	73	62
Loss on sale and write-down of real estate owned	(508)	(757)	(53)	(132)
Other	710	712	387	184
Total noninterest income	3,419	2,567	1,459	952
Noninterest expense:				
Compensation and benefits	5,035	4,267	1,653	1,415
Professional services	1,211	1,065	456	288
Occupancy and equipment	770	776	287	244
Data processing	363	307	120	103
FDIC insurance	801	824	257	278
OREO expense	2,807	1,025	2,019	339
Other operating expense	2,374	2,704	615	803
Total noninterest expense	13,361	10,968	5,407	3,470
Income before income tax expense	10,702	8,694	3,520	3,280
Income tax expense	4,187	2,895	1,377	1,365
Net income attributable to Company and noncontrolling interest	6,515	5,799	2,143	1,915
Net income attributable to noncontrolling interest	(358)	(442)	(110)	(194)
Net income attributable to Company	6,157	5,357	2,033	1,721
Preferred stock dividend and discount accretion	773	758	263	253
Net income available to common shareholders	\$5,384	\$4,599	\$1,770	\$1,468

Earnings per common share:

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Basic	\$0.90	\$0.78	\$0.30	\$0.25
Diluted	\$0.90	\$0.78	\$0.30	\$0.25
Weighted average shares outstanding:				
Basic	5,957,685	5,919,429	5,982,810	5,925,219
Diluted	5,958,801	5,919,429	5,989,183	5,925,219
See accompanying notes to consolidated financial statements				

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

	For the nine months ended September 30,		For the three months ended September 30,	
	2013	2012	2013	2012
	(in thousands)		(in thousands)	
Net income attributable to Company	\$ 6,157	\$ 5,357	\$ 2,033	\$ 1,721
Unrealized (losses) gains on securities:				
Non-credit related unrealized gains (losses) on securities with OTTI	34	20	19	(12)
Unrealized losses on securities without OTTI	(329)	(46)	(25)	(96)
Tax Impact	118	10	3	43
Total unrealized losses on securities	(177)	(16)	(3)	(65)
Gross pension liability adjustments	172	18	72	10
Tax Impact	(68)	(7)	(29)	(3)
Total pension liability adjustment	104	11	43	7
Total other comprehensive (loss) income	(73)	(5)	40	(58)
Total comprehensive income	\$ 6,084	\$ 5,352	\$ 2,073	\$ 1,663
See accompanying notes to consolidated financial statements				

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

	Preferred Stock	Shares of Common Stock	Additional Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholder Equity	Non- Controlling Interest	Total Equity
	(in thousands except share data)									
Balance, December 31, 2012	\$16,065	5,594,793	\$560	\$48,869	\$21,068	\$(745)	\$(2,180)	\$83,637	\$(94)	\$83,543
Capital withdrawals by noncontrolling interest									(1,320)	(1,320)
Stock options exercised		57,591	6	284				290		290
Redemption of Warrant				(930)	(720)			(1,650)		(1,650)
10% common stock dividend		541,326	53	4,442	(4,497)			(2)		(2)
Net income					6,157			6,157	358	6,515
Changes in other comprehensive income						(73)		(73)		(73)
Dividend on preferred stock (5% annually)					(612)			(612)		(612)
Accretion of discount on preferred stock	163				(163)			—		—
Balance, September 30, 2013	\$16,228	6,193,710	\$619	\$52,665	\$21,233	\$(818)	\$(2,180)	\$87,747	\$(1,056)	\$86,691

See accompanying notes to consolidated financial statements

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

	For the nine months ended September 30,	
	2013	2012
	(Amounts in thousands)	
Cash Flows from Operating Activities		
Net income	\$6,515	\$5,799
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	253	267
Provision for loan losses	2,200	5,800
Provision for OREO	1,200	—
Bank owned life insurance	(281)	(138)
Supplemental executive retirement plan expense	17	102
Gain on sale of SBA loans	(2,225)	(2,057)
SBA loans originated for sale	(20,822)	(18,679)
Proceeds from sale of SBA loans originated for sale	20,122	19,210
Loss on sale & write down of other real estate owned	507	895
Net accretion of purchase premiums and discounts on securities	30	(10)
Deferred income tax benefit	(117)	—
Changes in operating assets and liabilities:		
Decrease (increase) in accrued interest receivable and other assets	910	(448)
(Decrease) increase in accrued interest payable and other accrued liabilities	(493)	316
Net cash provided by operating activities	7,816	11,057
Cash Flows from Investing Activities		
Purchases of investment securities available for sale	(2,022)	(4,148)
(Purchases) redemptions of restricted stock	(272)	1,340
Proceeds from sale and call of securities available for sale	1,000	—
Proceeds from maturities and principal payments on mortgage backed securities	3,434	5,039
Proceeds from sale of other real estate owned	3,572	1,331
Advances on other real estate owned	(168)	(227)
Net (increase) decrease in loans	(39,339)	3,230
Purchases of bank premises and equipment	(110)	(217)
Net cash (used in) provided by investing activities	(33,905)	6,348
Cash Flows from Financing Activities		
Payment of dividend on preferred stock	(612)	(610)
Cash payment of fractional shares on 10% stock dividend	(2)	(1)
Minority interest capital withdrawal, net	(1,320)	(900)
Proceeds from exercise of stock options	290	35
Redemption payment for TARP Warrant	(1,650)	—
Net increase (decrease) in FHLBNY and short term borrowings	9,874	(30,119)
Net decrease in other borrowed funds	(10,000)	—
Net increase (decrease) in noninterest-bearing deposits	966	(2,754)
Net (decrease) increase in interest-bearing deposits	(26,757)	7,599
Net cash used in financing activities	(29,211)	(26,750)
Decrease in cash and cash equivalents	(55,300)	(9,345)
Cash and Cash Equivalents, January 1,	76,866	110,228
Cash and Cash Equivalents, September 30,	\$21,566	\$100,883

Supplemental Disclosure of Cash Flow Information:

Cash paid during the year for:

Interest on deposits and borrowed funds	\$4,546	\$5,707
Income taxes	\$3,908	\$4,015
Supplemental Schedule of Noncash Activities:		
Real estate acquired in settlement of loans	\$6,925	\$10,691

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

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

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

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

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

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

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

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the nine months and three months ended September 30, 2013 and 2012 are unaudited. The balance sheet as of December 31, 2012, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the nine months ended September 30, 2013 are not necessarily indicative of the results for the full year.

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

Recently Issued Accounting Pronouncements:

In January 2013, the FASB issued ASU 2013-01, “Balance Sheet, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities (Topic 210)”. The amendments in this update clarify that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. An entity is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. Adoption of this update did not have a material impact on the Company’s financial position or results of operations.

In February 2013, the FASB issued ASU 2013-02, “Comprehensive Income, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (Topic 220)”. The amendments in this update aim to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income

in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted the amendments of ASU 2011-12 effective January 1, 2013 and has applied the amendments retrospectively. Adoption of this update did not have a material impact on the Company's financial position or results of operations.

ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." The amendments in ASU 2013-11 include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this Update are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Bank is currently evaluating the impact of these amendments.

NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of September 30, 2013 and December 31, 2012:

As of September 30, 2013	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than- temporary impairments in OCI	Fair value
	(Amounts in thousands)				
Available for sale:					
U.S. Government sponsored entities	\$7	\$—	\$—	\$—	\$7
Corporate debt obligations	500	7	—	—	507
Residential mortgage-backed securities	11,182	315	116	—	11,381
Collateralized mortgage obligations	621	32	—	—	653
Collateralized debt obligations	5,556	—	1,066	465	4,025
Total available for sale	\$17,866	\$354	\$1,182	\$465	\$16,573
Held to maturity:					
States and political subdivisions	\$2,093	\$51	\$—	\$—	\$2,144
As of December 31, 2012	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than- temporary impairments in OCI	Fair value
	(Amounts in thousands)				
Available for sale:					
U.S. Government sponsored entities	\$7	\$—	\$—	\$—	\$7
Corporate debt obligations	1,500	24	—	—	1,524
Residential mortgage-backed securities	12,359	540	—	—	12,899
Collateralized mortgage obligations	916	58	—	—	974
Collateralized debt obligations	5,556	—	1,121	499	3,936
Total available for sale	\$20,338	\$622	\$1,121	\$499	\$19,340
Held to maturity:					
States and political subdivisions	\$2,066	\$173	\$—	\$—	\$2,239

The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of September 30, 2013 are as follows:

	Amortized Cost	Fair Value
	(Amounts in thousands)	
Available for sale:		
Due within one year	\$—	\$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	6,062	4,539
Residential mortgage-backed securities and collateralized mortgage obligations	11,804	12,034
Total available for sale	\$17,866	\$16,573
Held to maturity:		
Due within one year	\$—	\$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	2,093	2,144
Total held to maturity	\$2,093	\$2,144

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

As of September 30, 2013, there were no securities pledged as collateral for borrowed funds. As of December 31, 2012, \$10.3 million of investment securities were pledged as collateral for borrowed funds. In addition, securities with a carrying value of \$6.3 million and \$4.2 million were pledged to secure public deposits at September 30, 2013 and December 31, 2012, respectively.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired ("OTTI"), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2013 and December 31, 2012:

As of September 30, 2013	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
	(Amounts in thousands)					
Available for sale:						
Residential mortgage backed securities and collateralized mortgage obligations	4,770	116	—	—	4,770	116
Collateralized debt obligations	—	—	3,684	1,066	3,684	1,066
Total available for sale	\$ 4,770	\$ 116	\$ 3,684	\$ 1,066	\$ 8,454	\$ 1,182
Held to maturity:						

States and political
subdivisions

\$ — \$ — \$ — \$ — \$ — \$ —

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As of December 31, 2012 Description of Securities	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Amounts in thousands)			
Available for sale:						
Collateralized debt obligations	—	—	3,629	1,121	3,629	1,121
Total available for sale	\$ —	\$ —	\$ 3,629	\$ 1,121	\$ 3,629	\$ 1,121
Held to maturity:						
States and political subdivisions	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

Residential Mortgage-Backed Securities and Collateralized Mortgage Obligations: The unrealized losses on the Company's investment in mortgage-backed securities relates to four securities. The losses were caused by movement in interest rates. The securities were issued by FNMA, a government sponsored entity. It is expected that the U.S. government will guarantee all contractual cash flows. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider the investment in these securities to be other-than-temporarily impaired at September 30, 2013.

Collateralized Debt Obligations: The Company's unrealized loss on investments in collateralized debt obligations ("CDOs") relates to three securities issued by financial institutions, totaling \$3.7 million. CDOs are pooled securities primarily secured by trust preferred securities ("TruPS"), subordinated debt and surplus notes issued by small and mid-sized banks and insurance companies. These securities are generally floating rate instruments with 30-year maturities, and are callable at par by the issuer after five years. The economic downturn and continued uncertainty in the economy amid a slow and inconsistent recovery has had a significant adverse impact on the financial services industry; consequently, TruPS CDOs do not have an active trading market. With the assistance of competent third-party valuation specialists, the Company utilized the following methodology to determine the fair value:

Cash flows were developed based on the estimated speeds at which the TruPS are expected to prepay (a range of 1% to 2%), the estimated rates at which the TruPS are expected to defer payments, the estimated rates at which the TruPS are expected to default (a range of 0.57% to 0.66%), and the severity of the losses on securities which default (95%). TruPS generally allow for prepayment by the issuer without a prepayment penalty any time after five years. Due to the lack of new TruPS issuances and the relatively poor conditions of the financial institution industry, a relatively modest rate of prepayment was assumed going forward. Estimates for conditional default rates ("CDR") are based on the payment characteristics of the TruPS themselves (e.g. current, deferred, or defaulted) as well as the financial condition of the TruPS issuers in the pool. Estimates for the near-term rates of deferral and CDR are based on key financial ratios relating to the financial institutions' capitalization, asset quality, profitability and liquidity. Finally, we consider whether or not the financial institution has received TARP funding, and if it has, the amount. Longer-term rates of deferral and defaults are based on historical averages. The fair value of each bond was assessed by discounting its projected cash flows by a discount rate. The discount rates were based on the yields of publicly traded TruPS and preferred stock issued by comparably rated banks (3 month LIBOR plus a spread of 400 to 959 basis points). The fair value for previous reporting periods was based on indicative market bids and resulted in much lower values due to the inactive trading market.

The underlying issuers have been analyzed, and projections have been made regarding the future performance, considering factors including defaults and interest deferrals. The analysis indicates that the

Company should expect to receive all contractual cash flows. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, it does not consider these investments to be other than temporarily impaired at September 30, 2013.

Other Than Temporarily Impaired Debt Securities

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

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

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

The following table presents a roll-forward of the credit loss component of the amortized cost of debt securities that we have written down for OTTI and the credit component of the loss that is recognized in earnings. OTTI recognized in earnings for credit-impaired debt securities is presented as additions in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairments). The credit loss component is reduced if we sell, intend to sell or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive cash flows in excess of what we expected to receive over the remaining life of the credit-impaired debt security, the security matures or is fully written down. Changes in the credit loss component of credit-impaired debt securities were as follows for the periods ended September 30, 2013 and 2012:

For the Nine Months Ended
September 30,
2013 2012