EAGLE BANCORP INC
Form 10-Q
May 08, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 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 Number 0-25923

Eagle Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Maryland	52-2061461
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7815 Woodmont Avenue, Bethesda, Maryland	20814
(Address of principal executive offices)	(Zip Code)

(301) 986-1800
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o	Smaller Reporting Company o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of April 30, 2013, the registrant had 23,388,935 shares of Common Stock outstanding.

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Item 1 – Financial Statements (Unaudited)

EAGLE BANCORP, INC.
Consolidated Balance Sheets (Unaudited)
(dollars in thousands, except per share data)

Assets	March 31, 2013	December 31, 2012	March 31, 2012
Cash and due from banks	$7,123	$7,439	$5,838
Federal funds sold	5,811	7,852	18,990
Interest bearing deposits with banks and other short-term investments	257,957	324,043	117,326
Investment securities available for sale, at fair value	318,431	299,820	345,021
Federal Reserve and Federal Home Loan Bank stock	11,154	10,694	11,374
Loans held for sale	132,698	226,923	87,496
Loans	2,548,024	2,493,095	2,186,940
Less allowance for credit losses	(38,811)	(37,492)	(31,875)
Loans, net	2,509,213	2,455,603	2,155,065
Premises and equipment, net	16,094	15,261	12,864
Deferred income taxes	20,661	19,128	14,658
Bank owned life insurance	14,229	14,135	13,839
Intangible assets, net	3,659	3,785	4,066
Other real estate owned	9,199	5,299	3,014
Other assets	18,636	19,459	25,998
Total Assets	$3,324,865	$3,409,441	$2,815,549
Liabilities and Shareholders' Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$756,177	$881,390	$698,636
Interest bearing transaction	99,187	113,813	75,751
Savings and money market	1,456,318	1,374,869	1,084,622
Time, $100,000 or more	216,337	232,875	293,570
Other time	284,911	294,275	215,656
Total deposits	2,812,930	2,897,222	2,368,235
Customer repurchase agreements	92,664	101,338	111,580
Long-term borrowings	39,300	39,300	49,300
Other liabilities	18,119	21,605	10,426
Total Liabilities	2,963,013	3,059,465	2,539,541
Shareholders' Equity			
Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series B, $1,000 per share liquidation preference, shares issued and outstanding 56,600 at March 31, 2013, December 31, 2012 and March 31, 2012.	56,600	56,600	56,600
Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 23,389,238, 22,954,889 and 20,220,166, respectively	228	226	199

Warrant	946	946	946
Additional paid in capital	181,993	180,593	134,455
Retained earnings	117,577	106,146	78,911
Accumulated other comprehensive income	4,508	5,465	4,897
Total Shareholders' Equity	361,852	349,976	276,008
Total Liabilities and Shareholders' Equity	$3,324,865	$3,409,441	$2,815,549

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.
Consolidated Statements of Operations (Unaudited)
(dollars in thousands, except per share data)

	Three Months Ended March 31,	
	2013	2012
Interest Income		
Interest and fees on loans	$36,024	$30,723
Interest and dividends on investment securities	1,696	1,694
Interest on balances with other banks and short-term investments	209	137
Interest on federal funds sold	4	14
Total interest income	37,933	32,568
Interest Expense		
Interest on deposits	2,940	3,468
Interest on customer repurchase agreements	69	96
Interest on long-term borrowings	415	534
Total interest expense	3,424	4,098
Net Interest Income	34,509	28,470
Provision for Credit Losses	3,365	3,970
Net Interest Income After Provision For Credit Losses	31,144	24,500
Noninterest Income		
Service charges on deposits	1,285	979
Gain on sale of loans	5,649	4,139
Gain on sale of investment securities	23	153
Increase in the cash surrender value of bank owned life insurance	94	97
Other income	1,060	644
Total noninterest income	8,111	6,012
Noninterest Expense		
Salaries and employee benefits	11,200	10,424
Premises and equipment expenses	2,800	2,510
Marketing and advertising	347	286
Data processing	1,539	1,256
Legal, accounting and professional fees	893	1,101
FDIC insurance	582	489
Other expenses	3,336	2,496
Total noninterest expense	20,697	18,562
Income Before Income Tax Expense	18,558	11,950
Income Tax Expense	6,986	4,317
Net Income	11,572	7,633
Preferred Stock Dividends	141	141
Net Income Available to Common Shareholders	$11,431	$7,492
Earnings Per Common Share		
Basic	$0.49	$0.37
Diluted	$0.48	$0.36

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.
Consolidated Statements of Comprehensive Income (Unaudited)
(dollars in thousands)

	Three Months Ended March, 31	
	2013	2012
Net Income	$11,572	$7,633
Other comprehensive income, net of tax:		
Net unrealized (loss) gain on securities available for sale	(944)	114
Reclassification adjustment for net gains included in net income	(13)	(92)
Net change in unrealized (loss) gains on securities	(957)	22
Comprehensive Income	$10,615	$7,655

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(dollars in thousands, except per share data)

	Preferred Stock	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance January 1, 2013	$ 56,600	$ 226	$ 946	$ 180,593	$ 106,146	$ 5,465	$ 349,976
Net Income	-	-	-	-	11,572	-	11,572
Net change in other comprehensive income	-	-	-	-	-	(957)	(957)
Stock-based compensation	-	-	-	710	-	-	710
Common stock issued 427,704 shares under equity compensation plans	-	2	-	467	-	-	469
Tax benefit on non-qualified options exercised	-	-	-	134	-	-	134
Employee stock purchase plan 6,645 shares	-	-	-	89	-	-	89
Preferred stock:							
Preferred stock dividends	-	-	-	-	(141)	-	(141)
Balance March 31, 2013	$ 56,600	$ 228	$ 946	$ 181,993	$ 117,577	$ 4,508	$ 361,852
Balance January 1, 2012	$ 56,600	$ 197	$ 946	$ 132,670	$ 71,423	$ 4,875	$ 266,711
Net Income	-	-	-	-	7,633	-	7,633
Net change in other comprehensive income	-	-	-	-	-	22	22
Stock-based compensation	-	-	-	1,187	(1)	-	1,186
Common stock issued 284,748 shares under equity	-	2	-	435	(1)	-	436

compensation plans							
Tax benefit on non-qualified options exercised	-	-	-	19	(2)	-	17
Employee stock purchase plan 9,516 shares	-	-	-	144	-	-	144
Preferred stock:							
Preferred stock dividends	-	-	-	-	(141)	-	(141)
Balance March 31, 2012	$ 56,600	$ 199	$ 946	$ 134,455	$ 78,911	$ 4,897	$ 276,008

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Cash Flows (Unaudited)
(dollars in thousands)

	Three Months Ended March 31,	
	2013	2012
Cash Flows From Operating Activities:		
Net Income	$11,572	$7,633
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	3,365	3,970
Depreciation and amortization	1,054	761
Gains on sale of loans	(5,649)	(4,139)
Securities premium amortization (discount accretion), net	1,011	1,288
Origination of loans held for sale	(387,351)	(278,308)
Proceeds from sale of loans held for sale	487,225	371,777
Net increase in cash surrender value of BOLI	(94)	(97)
Increase in deferred income taxes	(1,533)	(15)
Net loss on sale of other real estate owned	-	61
Net gain on sale of investment securities	(23)	(153)
Stock-based compensation expense	710	1,186
Excess tax benefit from stock-based compensation	(134)	(17)
Decrease (increase) in other assets	823	(2,743)
Increase in other liabilities	(3,486)	(9,362)
Net cash provided by operating activities	107,490	91,842
Cash Flows From Investing Activities:		
Increase (decrease) in interest bearing deposits with other banks and short-term investments	94	(131)
Purchases of available for sale investment securities	(54,783)	(56,763)
Proceeds from maturities of available for sale securities	12,079	10,520
Proceeds from sale/call of available for sale securities	22,148	13,920
Purchases of Federal Reserve and Federal Home Loan Bank stock	(613)	(1,133)
Proceeds from redemption of federal reserve and federal home loan bank stock	153	-
Net increase in loans	(60,707)	(132,432)
Proceeds from sale of other real estate owned	-	338
Bank premises and equipment acquired	(1,792)	(1,232)
Net cash used in investing activities	(83,421)	(166,913)
Cash Flows From Financing Activities:		
Increase in deposits	(84,387)	(23,860)
(Decrease) increase in customer repurchase agreements	(8,674)	8,218
Payment of dividends on preferred stock	(141)	(141)
Proceeds from exercise of stock options	467	436
Excess tax benefit from stock-based compensation	134	17
Proceeds from employee stock purchase plan	89	144
Net cash used in financing activities	(92,512)	(15,186)
Net Decrease In Cash and Cash Equivalents	(68,443)	(90,257)
Cash and Cash Equivalents at Beginning of Period	339,334	232,411
Cash and Cash Equivalents at End of Period	$270,891	$142,154
Supplemental Cash Flows Information:		
Interest paid	$3,775	$4,622

Income taxes paid	$5,875	$5,950
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$3,900	$365

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the "Company"), EagleBank (the "Bank"), Eagle Commercial Ventures, LLC ("ECV"), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The consolidated financial statements of the Company included herein are unaudited. The consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2012 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company's Accounting Policies as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. Operating results for the three months ended March 31, 2013 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland; Washington, DC; City of Alexandria, Virginia and Arlington and Fairfax Counties in Virginia. The primary financial services offered by the Bank include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration ("SBA"), is typically sold to third party investors in a transaction apart from the loan's origination. The Bank offers its products and services through eighteen branch offices and various electronic capabilities, including remote deposit services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, provides subordinated financing for the acquisition, development and construction of real estate projects. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending – Revenue Recognition below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of Small Business Administration loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations.

The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of March 31, 2013, December 31, 2012, and March 31, 2012. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Other Assets in the Consolidated Balance Sheet. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in other noninterest income in the Consolidated Statement of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 30 to 90 days under current market conditions. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at a premium at the time the borrower commits to an interest rate with the intent that the buyer has assumed the interest rate risk on the loan. As a result, the Company is not exposed to losses on loans sold nor will it realize gains, related to rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

Investment Securities

The Company has no securities classified as trading, nor are any investment securities classified as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income, a separate component of shareholders' equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the Consolidated Statements of Operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayment assumptions and call optionality if any. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management's intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security.

The entire amount of an impairment loss is recognized in earnings only when (1) the Company intends to sell the security, or (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in shareholders' equity as comprehensive income, net of deferred taxes.

Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

Higher Risk Lending – Revenue Recognition

The Company has occasionally made higher risk acquisition, development, and construction ("ADC") loans that entail higher risks than ADC loans made following normal underwriting practices ("higher risk loan transactions"). These higher risk loan transactions are currently made through the Company's subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standards Executive Committee ("AcSEC") guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on certain of these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC's guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Such additional interest is included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2013 and 2012 (although normal interest income was recorded). ECV had five higher risk lending transactions with balances outstanding at March 31, 2013 and four such transactions outstanding at December 31, 2012, amounting to $7.4 million and $3.5 million, respectively.

Allowance for Credit Losses

The allowance for credit losses represents an amount which, in management's judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on

collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification ("ASC") Topic 450, "Contingencies," or ASC Topic 310, "Receivables." Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board Committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management's evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management's judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank's loan portfolio and allowance for credit losses. Such review may result in recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from five to seven years for furniture, fixtures and equipment, to three to five years for computer software and hardware, and to ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the Consolidated Statements of Operations.

Other Real Estate Owned (OREO)

Assets acquired through loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by recent appraisals. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in economic conditions or review by regulatory examiners.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company's testing of potential goodwill impairment (which is performed annually) at December 31, 2012, resulted in no impairment being recorded.

Customer Repurchase Agreements

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company's Consolidated Statement of Condition, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, "Income Taxes." Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made for either uncertain tax positions nor accompanying potential tax penalties and interest for underpayments of income taxes in the Company's tax reserves. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at either March 31, 2013 or December 31, 2012.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

Earnings per Common Share

Basic net income 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 measured. Diluted earnings per common

share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents.

Stock-Based Compensation

In accordance with ASC Topic 718, "Compensation," the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value computed at the date of grant. Compensation expense on variable stock option grants (i.e. performance based grants) is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 6 for a description of stock-based compensation awards, activity and expense.

New Authoritative Accounting Guidance

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the reporting of reclassifications out of accumulated other comprehensive income. The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the Consolidated Financial Statements, the adoption of ASU No. 2013-02 had no impact on the Company's consolidated statements of income and condition. See Note 7 to the Consolidated Financial Statements for the disclosures required by ASU No. 2013-02.

2. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2012, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest-bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

3. Investment Securities Available-for-Sale

Amortized cost and estimated fair value of securities available-for-sale are summarized as follows:

March 31, 2013 (dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U. S. Government agency securities	$ 38,902	$ 1,229	$ 7	$ 40,124
Residential mortgage backed securities	189,601	2,514	537	191,578
Municipal bonds	82,007	4,687	314	86,380
Other equity investments	407	-	58	349
	$ 310,917	$ 8,430	$ 916	$ 318,431

December 31, 2012	Amortized	Gross	Gross	Estimated

(dollars in thousands)	Cost	Unrealized Gains	Unrealized Losses	Fair Value
U. S. Government agency securities	$ 47,606	$ 1,477	$ 1	$ 49,082
Residential mortgage backed securities	170,649	2,730	296	173,083
Municipal bonds	72,050	5,314	51	77,313
Other equity investments	407	-	65	342
	$ 290,712	$ 9,521	$ 413	$ 299,820

Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in a continuous unrealized loss position are as follows:

	Less than 12 Months		12 Months or Greater		Total	
March 31, 2013 (dollars in thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U. S. Government agency securities	$ 2,999	$ 7	$ -	$ -	$ 2,999	$ 7
Residential mortgage backed securities	44,992	537	2,743	-	47,735	537
Municipal bonds	3,964	312	-	2	3,964	314
Other equity investments	-	-	120	58	120	58
	$ 51,955	$ 856	$ 2,863	$ 60	$ 54,818	$ 916

	Less than 12 Months		12 Months or Greater		Total	
December 31, 2012 (dollars in thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U. S. Government agency securities	$ 2,999	$ 1	$ -	$ -	$ 2,999	$ 1
Residential mortgage backed securities	44,992	263	2,743	33	47,735	296
Municipal bonds	3,964	51	-	-	3,964	51
Other equity investments	-	-	112	65	112	65
	$ 51,955	$ 315	$ 2,855	$ 98	$ 54,810	$ 413

The unrealized losses that exist are generally the result of changes in market interest rates and interest spread relationships since original purchases. The weighted average duration of debt securities, which comprise 99.9% of total investment securities, is relatively short at 4.2 years. The gross unrealized loss on other equity investments represents common stock of one local banking company owned by the Company, and traded on a broker “bulletin board” exchange. The estimated fair value is determined by broker quoted prices. The unrealized loss is deemed a result of generally weak valuations for many smaller community bank stocks. The individual banking company is profitable, has good financial trends and has a satisfactory capital position. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security’s credit rating, prepayment assumptions and other factors such as credit loss assumptions. The Company does not believe that the investment securities that were in an unrealized loss position as of March 31, 2013 represent an other-than-temporary impairment for the reasons noted. The Company does not intend to sell the investments and it is more likely than not that the Company will not have to sell the securities before recovery of its amortized cost basis, which may be maturity. In addition, at March 31, 2013, the Company held $11.2 million in equity securities in a combination of Federal Reserve Bank (“FRB”) and Federal Home Loan Bank (“FHLB”) stocks, which are required to be held for regulatory purposes and are not marketable.

The amortized cost and estimated fair value of investments available-for-sale by contractual maturity are shown in the table below. Expected maturities will differ from contractual maturities because borrowers may have the right to call

or prepay obligations with or without call or prepayment penalties.

	March 31, 2013		December 31, 2012	
(dollars in thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
U. S. Government agency securities maturing:				
One year or less	$3,000	$2,993	$5,038	$5,053
After one year through five years	35,902	37,131	42,568	44,029
Residential mortgage backed securities	189,601	191,578	170,649	173,083
Municipal bonds maturing:				
After one year through five years	11,219	11,678	11,469	11,978
Five years through ten years	70,788	74,702	60,581	65,335
Other equity investments	407	349	407	342
	$310,917	$318,431	$290,712	$299,820

The carrying value of securities pledged as collateral for certain government deposits, securities sold under agreements to repurchase, and certain lines of credit with correspondent banks at March 31, 2013 was $229.7 million. As of March 31, 2013 and December 31, 2012, there were no holdings of securities of any one issuer, other than the U.S. Government and U.S. Government agency securities that exceeded ten percent of shareholders' equity.

4. Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily in the Washington, DC metropolitan area and surrounding communities. A substantial portion of the Bank's loan portfolio consists of loans to businesses secured by real estate and other business assets.

Loans, net of unamortized net deferred fees, at March 31, 2013, December 31, 2012, and March 31, 2012 are summarized by type as follows:

	March 31, 2013		December 31, 2012		March 31, 2012	
(dollars in thousands)	Amount	%	Amount	%	Amount	%
Commercial	$ 579,618	23 %	$ 545,070	22 %	$ 492,824	23 %
Investment - commercial real estate (1)	910,829	36 %	914,638	37 %	829,984	38 %
Owner occupied - commercial real estate	303,561	12 %	297,857	12 %	275,723	13 %
Real estate mortgage - residential	69,256	3 %	61,871	3 %	43,057	2 %
Construction - commercial and residential (1)	538,071	21 %	533,722	21 %	417,346	19 %
Construction - C&I (owner occupied) (1)	34,002	1 %	28,808	1 %	27,412	1 %
Home equity	108,570	4 %	106,844	4 %	95,437	4 %
Other consumer	4,117	-	4,285	-	5,157	-
Total loans	2,548,024	100 %	2,493,095	100 %	2,186,940	100 %
	(38,811)		(37,492)		(31,875)	

Less: Allowance for Credit Losses			
Net loans	$ 2,509,213	$ 2,455,603	$ 2,155,065

(1) Includes loans for land acquisition and development.

Unamortized net deferred fees amounted to $9.1 million and $8.8 million at March 31, 2013 and December 31, 2012, respectively.

As of March 31, 2013 and December 31, 2012, the Bank serviced $39.1 million and $41.2 million, respectively, of SBA loans participations which are not reflected as loan balances on the Consolidated Balance Sheets.

Loan Origination / Risk Management

The Company's goal is to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include: carefully enforcing loan policies and procedures, evaluating each borrower's business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for loan repayment, and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.

The composition of the Company's loan portfolio is heavily weighted toward commercial real estate, both owner occupied and investment real estate. The combination of owner occupied commercial real estate and owner occupied commercial real estate construction represent 13% of the loan portfolio. At March 31, 2013, the combination of commercial real estate and real estate construction loans represent approximately 70% of the loan portfolio. When owner occupied commercial real estate and owner occupied commercial construction loans are excluded, the percentage of commercial real estate and construction loans to total loans decreases to 57%. These loans are underwritten to mitigate lending risks typical of this type of loan such as declines in real estate values, changes in borrower cash flow and general economic conditions. The Bank typically requires a maximum loan to value of 80% and minimum cash flow debt service coverage of 1.15 to 1.00. Personal guarantees are generally required, but may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

The Company is also an active traditional commercial lender providing loans for a variety of purposes, including cash flow, equipment and account receivable financing. This loan category represents approximately 23% of the loan portfolio at March 31, 2013 and was generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited. SBA loans represent 2% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the uninsured portion of the credit. The Company generally sells the insured portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans are subject to a maximum loan size established by the SBA.

Approximately 4% of the loan portfolio at March 31, 2013 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

The remaining 3% of the loan portfolio consists of longer-term residential mortgage loans. These are typically loans underwritten to the same underwriting standards as residential loans held for sale but for shorter terms, generally less than 10 years.

Loans are secured primarily by duly recorded first deeds of trust. In some cases, the Bank may accept a recorded second trust position. In general, borrowers will have a proven ability to build, lease, manage and/or sell a commercial or residential project and demonstrate satisfactory financial condition. Additionally, an equity contribution toward the project is customarily required.

Construction loans require that the financial condition and experience of the general contractor and major subcontractors be satisfactory to the Bank. Guaranteed, fixed price contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for larger scale projects.

Loans intended for residential land acquisition, lot development and construction are made on the premise that the land: 1) is or will be developed for building sites for residential structures, and; 2) will ultimately be utilized for construction or improvement of residential zoned real properties, including the creation of housing. Residential development and construction loans will finance projects such as single family subdivisions, planned unit developments, townhouses, and condominiums. Residential land acquisition, development and construction loans generally are underwritten with a maximum term of 36 months, including extensions approved at origination.

Commercial land acquisition and construction loans are secured by real property where loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner user commercial properties. Borrowers are generally required to put equity into each project at levels determined by the appropriate Loan Committee. Commercial land acquisition and construction loans generally are underwritten with a maximum term of 24 months.

Substantially all construction draw requests must be presented in writing on American Institute of Architects documents and certified either by the contractor, the borrower and/or the borrower's architect. Each draw request shall also include the borrower's soft cost breakdown certified by the borrower or its Chief Financial Officer. Prior to an advance, the Bank or its contractor inspects the project to determine that the work has been completed, to justify the draw requisition.

Commercial permanent loans are secured by improved real property which is generating income in the normal course of operation. Debt service coverage, assuming stabilized occupancy, must be satisfactory to support a permanent loan. The debt service coverage ratio is ordinarily at least 1.15 to 1.00. As part of the underwriting process, debt service coverage ratios are stress tested assuming a 200 basis point increase in interest rates from their current levels.

Commercial permanent loans generally are underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

The Company's loan portfolio includes loans made for real estate Acquisition, Development and Construction ("ADC") purposes, including both investment and owner occupied projects. ADC loans amounted to $572.1 million at March 31, 2013. The majority of the ADC portfolio, both speculative and non-speculative, includes loan funded interest reserves at origination. ADC loans containing loan funded interest reserves represent approximately 33% of the outstanding ADC loan portfolio at March 31, 2013. The decision to establish a loan-funded interest reserve is made upon origination of the ADC loan and is based upon a number of factors considered during underwriting of the credit including: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) the level of collateral protection. When appropriate, an interest reserve provides an effective means of addressing the cash flow characteristics of a properly underwritten ADC loan. The Company does not significantly utilize interest reserves in other loan products. The Company recognizes that one of the risks inherent in the use of interest reserves is the potential masking of underlying problems with the project and/or the borrower's ability to repay the loan. In order to mitigate this inherent risk, the Company employs a series of reporting and monitoring mechanisms on all ADC loans, whether or not an interest reserve is provided, including: (i) construction and development timelines which are monitored on an ongoing basis which track the progress of a given project to the timeline projected at origination; (ii) a construction loan administration department independent of the lending function; (iii) third party independent construction loan inspection reports; (iv) monthly interest reserve monitoring reports detailing the balance of the interest reserves approved at origination and the days of interest carry represented by the reserve balances as compared to the then current anticipated time to completion and/or sale of speculative projects; and (v) quarterly commercial real estate construction meetings among senior Company management, which includes monitoring of current and projected real estate market conditions. If a project has not performed as expected, it is not the customary practice of the Company to increase loan funded interest reserves.

From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, ECV. Such loans, which are made to finance projects (which may also be financed at the Bank level), may have higher risk characteristics than loans made by the Bank, such as lower priority interests and/or higher loan to value ratios. The Company seeks an overall financial return on these transactions commensurate with the risks and structure of each individual loan. Certain transactions bear current interest at a rate with a significant premium to normal market rates.

Other loan transactions carry a standard rate of current interest, but also earn additional interest based on a percentage of the profits of the underlying project or a fixed accrued rate of interest.

The following table details activity in the allowance for credit losses by portfolio segment for the three months ended March 31, 2013 and 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
March 31, 2013								
Allowance for credit losses:								
Balance at beginning of period	$ 9,412	$ 9,148	$ 2,781	$ 659	$ 13,391	$ 1,730	$ 371	$ 37,492
Loans charged-off	(1,184)	(109)	-	-	(719)	(29)	(42)	(2,083)
Recoveries of loans previously charged-off	26	-	-	-	6	-	5	37
Net loans charged-off	(1,158)	(109)	-	-	(713)	(29)	(37)	(2,046)
Provision for credit losses	2,821	(32)	23	218	267	51	17	3,365
Ending balance	$ 11,075	$ 9,007	$ 2,804	$ 877	$ 12,945	$ 1,752	$ 351	$ 38,811
For the Period Ended March 31, 2013								
Allowance for credit losses:								
Individually evaluated for impairment	$ 2,360	$ 818	$ 704	$ -	$ 3,358	$ 218	$ -	$ 7,458
Collectively evaluated for impairment	8,715	8,189	2,100	877	9,587	1,534	351	31,353
Ending balance	$ 11,075	$ 9,007	$ 2,804	$ 877	$ 12,945	$ 1,752	$ 351	$ 38,811
March 31, 2012								
Allowance for credit losses:								
Balance at beginning of period	$ 9,609	$ 7,304	$ 1,898	$ 399	$ 8,546	$ 1,528	$ 369	$ 29,653
Loans charged-off	(773)	(291)	-	(300)	(240)	(244)	(5)	(1,853)
Recoveries of loans previously charged-off	7	2	-	-	94	1	1	105
Net loans charged-off	(766)	(289)	-	(300)	(146)	(243)	(4)	(1,748)

Provision for credit losses	(306)	1,130	248	(99)	3,260	44	(307)	3,970
Ending balance	$ 8,537	$ 8,145	$ 2,146	$ -	$ 11,660	$ 1,329	$ 58	$ 31,875
For the Period Ended March 31, 2012								
Allowance for credit losses:								
Individually evaluated for impairment	$ 1,874	$ 829	$ 201	$ -	$ 2,899	$ 138	$ 4	$ 5,945
Collectively evaluated for impairment	6,663	7,316	1,945	-	8,761	1,191	54	25,930
Ending balance	$ 8,537	$ 8,145	$ 2,146	$ -	$ 11,660	$ 1,329	$ 58	$ 31,875

The Company’s recorded investments in loans as of March 31, 2013, December 31, 2012 and March 31, 2012 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company’s impairment methodology was as follows:

(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
March 31, 2013								
Recorded investment in loans:								
Individually evaluated for impairment	$ 14,395	$ 5,564	$ 6,449	$ -	$ 30,972	$ 538	$ -	$ 57,918
Collectively evaluated for impairment	565,223	905,265	297,112	69,256	541,101	108,032	4,117	2,490,106
Ending balance	$ 579,618	$ 910,829	$ 303,561	$ 69,256	$ 572,073	$ 108,570	$ 4,117	$ 2,548,024
December 31, 2012								
Recorded investment in loans:								
Individually evaluated for impairment	$ 15,177	$ 11,401	$ 8,723	$ -	$ 36,502	$ 510	$ 43	$ 72,356
Collectively evaluated for impairment	529,893	903,237	289,134	61,871	526,028	106,334	4,242	2,420,739
Ending balance	$ 545,070	$ 914,638	$ 297,857	$ 61,871	$ 562,530	$ 106,844	$ 4,285	$ 2,493,095
March 31, 2012								
Recorded investment in loans:								
Individually evaluated for impairment	$ 9,395	$ 9,880	$ 2,895	$ -	$ 24,358	$ 512	$ 8	$ 47,048
Collectively evaluated for impairment	483,429	820,104	272,828	43,057	420,400	94,925	5,149	2,139,892
Ending balance	$ 492,824	$ 829,984	$ 275,723	$ 43,057	$ 444,758	$ 95,437	$ 5,157	$ 2,186,940

At March 31, 2013, the nonperforming loans acquired in 2008 from Fidelity & Trust Financial Corporation ("Fidelity") have a carrying value of $2.0 million and an unpaid principal balance of $11.7 million and were evaluated separately in accordance with ASC Topic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality." The various impaired loans were recorded at estimated fair value with any excess being charged-off or treated as a non-accretable discount. Subsequent downward adjustments to the valuation of impaired loans acquired will result in

additional loan loss provisions and related allowance for credit losses. Subsequent upward adjustments to the valuation of impaired loans acquired will result in accretable discount.

Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans into pass, watch, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company's credit quality indicators:

Pass: Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.

Watch: Loan paying as agreed with generally acceptable asset quality; however Borrower’s performance has not met expectations. Balance sheet and/or income statement has shown deterioration to the point that the company could not sustain any further setbacks. Credit is expected to be strengthened through improved company performance and/or additional collateral within a reasonable period of time.

Special Mention:	Loans in the classes that comprise the commercial portfolio segment that have potential weaknesses that deserve management's close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan. The special mention credit quality indicator is not used for classes of loans that comprise the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans that are considered special mention.
Classified:	Classified (a) Substandard - Loans inadequately protected by the current sound 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 bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard. Classified (b) Doubtful - Loans that have all the weaknesses inherent in a loan classified 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. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

The Company's credit quality indicators are periodically updated on a case-by-case basis. The following table presents by class and by credit quality indicator, the recorded investment in the Company's loans and leases as of March 31, 2013, December 31, 2012 and March 31, 2012.

(dollars in thousands)	Pass	Watch and Special Mention	Substandard	Doubtful	Total Loans
March 31, 2013					
Commercial	$532,391	$32,832	$14,395	$-	$579,618
Investment - commercial real estate	886,172	19,093	5,564	-	910,829
Owner occupied - commercial real estate	281,632	15,480	6,449	-	303,561
Real estate mortgage – residential	68,521	735	-	-	69,256
Construction - commercial and residential	523,535	17,566	30,972	-	572,073
Home equity	105,857	2,175	538	-	108,570
Other consumer	4,106	11	-	-	4,117
Total	$2,402,214	$87,892	$57,918	$-	$2,548,024
December 31, 2012					
Commercial	$495,072	$34,821	$15,170	$7	$545,070
Investment - commercial real estate	892,569	10,668	11,401	-	914,638
Owner occupied - commercial real estate	275,864	13,270	8,723	-	297,857
Real estate mortgage – residential	61,134	737	-	-	61,871
Construction - commercial and residential	508,166	17,862	36,502	-	562,530
Home equity	104,302	2,032	510	-	106,844
Other consumer	4,230	12	43	-	4,285
Total	$2,341,337	$79,402	$72,349	$7	$2,493,095
March 31, 2012					
Commercial	$454,373	$29,019	$9,395	$37	$492,824
Investment - commercial real estate	815,951	4,902	9,131	-	829,984
Owner occupied - commercial real estate	254,405	18,423	2,895	-	275,723
Real estate mortgage – residential	42,308	-	749	-	43,057
Construction - commercial and residential	387,770	32,631	24,357	-	444,758
Home equity	94,925	-	512	-	95,437
Other consumer	5,149	-	8	-	5,157
Total	$2,054,881	$84,975	$47,047	$37	$2,186,940

Nonaccrual and Past Due Loans

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

The following table presents by class of loan, information related to nonaccrual loans as of the periods ended March 31, 2013, December 31, 2012 and March 31, 2012.

(dollars in thousands)	March 31, 2013	December 31, 2012	March 31, 2012
Commercial	$4,039	$4,799	$3,565
Investment - commercial real estate	3,269	3,458	7,013
Owner occupied - commercial real estate	2,368	2,578	277
Real estate mortgage - residential	691	699	731
Construction - commercial and residential	17,318	18,594	24,591
Home equity	481	513	530
Other consumer	-	43	8
Total nonaccrual loans (1)(2)	$28,166	$30,684	$36,715

(1) Excludes performing troubled debt restructurings ("TDRs") totaling $14.8 million at March 31, 2013, $15.3 million at December 31, 2012 and $11.4 million at March 31, 2012.

(2) Gross interest income that would have been recorded in 2013 if nonaccrual loans shown above had been current and in accordance with their original terms was $507 thousand, while interest actually recorded on such loans was zero for the three months ended March 31, 2013. See Note 1 to the Consolidated Financial Statements for a description of the Company's policy for placing loans on nonaccrual status.

The following table presents by class, an aging analysis and the recorded investments in loans past due as of March 31, 2013.

(dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Recorded Investment in Loans
March 31, 2013						
Commercial	$ 3,826	$ 3,358	$ 4,039	$ 11,223	$ 568,395	$ 579,618
Investment - commercial real estate	2,635	820	3,269	6,724	904,105	910,829
Owner occupied - commercial real estate	367	4,081	2,368	6,816	296,745	303,561
Real estate mortgage – residential	-	107	691	798	68,458	69,256
Construction - commercial and residential	10,642	-	17,318	27,960	544,113	572,073
Home equity	1,344	795	481	2,620	105,950	108,570
Other consumer	-	15	-	15	4,102	4,117
Total	$ 18,814	$ 9,176	$ 28,166	$ 56,156	$ 2,491,868	$ 2,548,024

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

The following table presents by class, information related to impaired loans for the periods ended March 31, 2013, December 31, 2012 and March 31, 2012.

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2013							
Commercial	$ 8,493	$ 4,821	$ 3,172	$ 7,993	$ 2,360	$ 8,621	$ 42
Investment - commercial real estate	5,407	3,821	1,586	5,407	818	5,504	37
Owner occupied - commercial	6,449	5,538	911	6,449	704	6,554	56
Real estate mortgage – residential	691	691	-	691	-	695	-
Construction - commercial and residential	21,959	13,611	8,348	21,959	3,358	22,597	42
Home equity	481	132	349	481	218	497	-
Other consumer	-	-	-	-	-	22	-
Total	$ 43,480	$ 28,614	$ 14,366	$ 42,980	$ 7,458	$ 44,490	$ 177
December 31, 2012							
Commercial	$ 9,461	$ 5,767	$ 3,481	$ 9,248	$ 2,158	$ 7,772	$ 245
Investment - commercial real estate	5,600	3,830	1,770	5,600	1,201	6,609	152
Owner occupied - commercial	6,659	5,602	1,057	6,659	753	2,746	252
Real estate mortgage – residential	699	699	-	699	-	714	-
Construction - commercial and residential	25,347	14,727	8,508	23,235	3,718	26,430	202
Home equity	513	134	379	513	243	534	9
Other consumer	43	1	42	43	41	17	2
Total	$ 48,322	$ 30,760	$ 15,237	$ 45,997	$ 8,114	$ 44,822	$ 862
March 31, 2012							
Commercial	$ 8,382	$ 5,226	$ 1,891	$ 7,117	$ 1,265	$ 9,539	$ 43
Investment - commercial real estate	9,155	6,277	2,157	8,434	821	10,330	39
Owner occupied - commercial	277	-	207	207	70	280	-
Real estate mortgage – residential	731	731	-	731	-	886	-
Construction - commercial and residential	29,013	20,299	5,914	26,213	2,800	26,372	42

Home equity	530	307	85	392	138	577	-
Other consumer	8	-	4	4	4	8	-
Total	$ 48,096	$ 32,840	$ 10,258	$ 43,098	$ 5,098	$ 47,992	$ 124

Modifications

A modification of a loan constitutes a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying a loan. Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Construction loans modified in a TDR may also involve extending the interest-only payment period.

Loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance associated with the loan. An allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

The following table presents the TDR loan modifications by portfolio segment outstanding as of March 31, 2013 and December 31, 2012:

(dollars in thousands)	Number of Contracts	TDRs Performing to Modified Terms	TDRs Not Performing to Modified Terms	Total TDRs
March 31, 2013				
Commercial	3	$ 3,954	$ 495	$ 4,449
Investment - commercial real estate	2	2,138	217	2,355
Owner occupied - commercial real estate	1	4,081	-	4,081