HMN FINANCIAL INC
Form 10-Q
November 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended 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 Number 0-24100

HMN FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	41-1777397
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1016 Civic Center Drive N.W., Rochester, MN	55901
(Address of principal executive offices)	(ZIP Code)
Registrant's telephone number, including area code:	(507) 535-1200

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 company” in Rule 12b-2 of the Exchange Act.

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

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

Yes No

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

Class	Outstanding at October 16, 2013
Common stock, $0.01 par value	4,424,349

HMN FINANCIAL, INC.

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Part I – FINANCIAL INFORMATION

Item 1: Financial Statements

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollars in thousands)	September 30, 2013 (unaudited)		December 31, 2012
Assets			
Cash and cash equivalents	$	57,652	83,660
Securities available for sale:			
Mortgage-backed and related securities (amortized cost $5,625 and $9,825)		5,973	10,421
Other marketable securities (amortized cost $84,800 and $75,759)		83,714	75,470
		89,687	85,891
Loans held for sale		1,180	2,584
Loans receivable, net		393,322	454,045
Accrued interest receivable		1,817	2,018
Real estate, net		8,899	10,595
Federal Home Loan Bank stock, at cost		784	4,063
Mortgage servicing rights, net		1,769	1,732
Premises and equipment, net		6,726	7,173
Prepaid expenses and other assets		729	1,566
Total assets	$	562,565	653,327
Liabilities and Stockholders' Equity			
Deposits	$	485,921	514,951
Federal Home Loan Bank advances		0	70,000
Accrued interest payable		127	247
Customer escrows		1,328	830

Accrued expenses and other liabilities		7,813		6,465	
Total liabilities		495,189		592,493	
Commitments and contingencies					
Stockholders' equity:					
Serial preferred stock: ($.01 par value) authorized 500,000 shares; issued shares 26,000		25,778		25,336	
Common stock ($.01 par value): authorized 16,000,000; issued shares 9,128,662		91		91	
Additional paid-in capital		51,638		51,795	
Retained earnings, subject to certain restrictions		54,488		47,004	
Accumulated other comprehensive loss		(1,094	)	(49	)
Unearned employee stock ownership plan shares		(2,852	)	(2,997	)
Treasury stock, at cost 4,735,589 and 4,705,073 shares		(60,673	)	(60,346	)
Total stockholders' equity		67,376		60,834	
Total liabilities and stockholders' equity	$	562,565		653,327	

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(Dollars in thousands, except per share data)	2013	2012	2013	2012
Interest income:				
Loans receivable	$5,492	7,208	17,023	22,527
Securities available for sale:				
Mortgage-backed and related	66	133	242	490
Other marketable	156	160	443	601
Cash equivalents	12	25	80	71
Other	3	25	51	89
Total interest income	5,729	7,551	17,839	23,778
Interest expense:				
Deposits	404	804	1,426	3,082
Federal Home Loan Bank advances	0	855	1,485	2,544
Total interest expense	404	1,659	2,911	5,626
Net interest income	5,325	5,892	14,928	18,152
Provision for loan losses	(4,330)	1,584	(4,850)	2,544
Net interest income after provision for loan losses	9,655	4,308	19,778	15,608
Non-interest income:				
Fees and service charges	929	821	2,601	2,484
Mortgage servicing fees	267	245	772	713
Gain on sales of loans	433	940	1,813	2,469
Gain on sale of branch office	0	0	0	552
Other	194	110	498	398
Total non-interest income	1,823	2,116	5,684	6,616
Non-interest expense:				
Compensation and benefits	3,009	2,955	9,188	9,587
(Gain) loss on real estate owned	(282)	(172)	(607)	(75)
Occupancy	867	805	2,543	2,526
Deposit insurance	172	353	680	928
Data processing	313	333	968	1,006
Other	1,207	1,513	3,878	4,416
Total non-interest expense	5,286	5,787	16,650	18,388

Income before income tax expense	6,192	637	8,812	3,836
Income tax expense	158	0	238	0
Net income	6,034	637	8,574	3,836
Preferred stock dividends and discount	(523)	(467)	(1,546)	(1,392)
Net income for common shareholders	$5,511	170	7,028	2,444
Other comprehensive income (loss), net of tax	$473	(77)	(1,045)	(349)
Comprehensive income attributable to common shareholders	$5,984	93	5,983	2,095
Basic earnings per common share	$1.38	0.04	1.76	0.62
Diluted earnings per common share	$1.27	0.04	1.65	0.61

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

For the Nine-Month Period Ended September 30, 2013

(unaudited)

(Dollars in thousands)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Stock-Holders' Equity
Balance, December 31, 2012	$ 25,336	91	51,795	47,004	(49)	(2,997)	(60,346)	60,834
Net income				8,574				8,574
Other comprehensive loss					(1,045)			(1,045)
Preferred stock discount amortization	442		(442)					0
Stock compensation tax benefits			3					3
Restricted stock awards forfeited			208				(327)	(119)
Amortization of restricted stock awards			101					101
Preferred stock dividends accrued				(1,090)				(1,090)
Earned employee stock ownership plan shares			(27)			145		118
Balance, September 30, 2013	$ 25,778	91	51,638	54,488	(1,094)	(2,852)	(60,673)	67,376

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited)

	Nine Months Ended September 30,	
(Dollars in thousands)	2013	2012
Cash flows from operating activities:		
Net income	$8,574	3,836
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	(4,850)	2,544
Depreciation	751	833
Amortization of premiums, net	67	79
Amortization of deferred loan fees	(238)	(359)
Amortization of mortgage servicing rights, net	463	548
Capitalized mortgage servicing rights	(500)	(643)
Gain on sales of real estate	(607)	(75)
Gain on sales of loans	(1,813)	(2,469)
Proceeds from sale of loans held for sale	74,298	91,025
Disbursements on loans held for sale	(60,407)	(81,510)
Amortization of restricted stock awards	101	183
Amortization of unearned ESOP shares	145	146
Cancellation of vested restricted stock awards	(119)	0
Earned employee stock ownership shares priced below original cost	(27)	(59)
Stock option compensation	3	6
Decrease in accrued interest receivable	201	314
Decrease in accrued interest payable	(120)	(543)
Decrease in other assets	830	572
Increase (decrease) in other liabilities	251	(1,375)
Other, net	221	114
Net cash provided by operating activities	17,224	13,167
Cash flows from investing activities:		
Principal collected on securities available for sale	4,206	7,963
Proceeds collected on maturities of securities available for sale	11,000	103,000
Purchases of securities available for sale	(20,092)	(44,037)
Redemption of Federal Home Loan Bank Stock	3,279	159
Proceeds from sales of real estate and premises	3,655	5,870
Net decrease in loans receivable	53,583	69,693
Gain on sale of branch office	0	(552)
Payment on sale of branch office	0	(36,981)
Purchases of premises and equipment	(310)	(221)

Net cash provided by investing activities	55,321	104,894
Cash flows from financing activities:		
Decrease in deposits	(29,051)	(109,992)
Proceeds from borrowings	12,000	0
Repayment of borrowings	(82,000)	0
Increase in customer escrows	498	491
Net cash used by financing activities	(98,553)	(109,501)
(Decrease) increase in cash and cash equivalents	(26,008)	8,560
Cash and cash equivalents, beginning of period	83,660	67,840
Cash and cash equivalents, end of period	$57,652	76,400
Supplemental cash flow disclosures:		
Cash paid for interest	$3,031	6,169
Cash paid for income taxes	205	10
Supplemental noncash flow disclosures:		
Transfer of loans to real estate	1,563	1,895
Loans transferred to loans held for sale	10,665	7,955

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(unaudited)

September 30, 2013 and 2012

(1) HMN Financial, Inc.

HMN Financial, Inc. (HMN or the Company) is a stock savings bank holding company that owns 100 percent of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production offices in Minnesota and Iowa. The Bank has one wholly owned subsidiary, Osterud Insurance Agency, Inc. (OIA), which offers financial planning products and services. HMN has another wholly owned subsidiary, Security Finance Corporation (SFC), which is currently not actively engaged in any activities.

The consolidated financial statements included herein are for HMN, SFC, the Bank and OIA. All significant intercompany accounts and transactions have been eliminated in consolidation.

(2) Basis of Preparation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and therefore, do not include all disclosures necessary for a complete presentation of the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statement of stockholders' equity and consolidated statements of cash flows in conformity with U.S. generally accepted accounting principles. However, all normal recurring adjustments which are, in the opinion of management, necessary for the fair presentation of the interim financial statements have been included. The results of operations for the nine-month period ended September 30, 2013 are not necessarily indicative of the results which may be expected for the entire year.

(3) New Accounting Standards

In January 2013, the Financial Accounting Standards Board (the FASB) issued ASU 2013-01, *Balance Sheet (Topic 210).* The objective of this ASU is to clarify that the scope of ASU 2011-11, *Balance Sheet (Topic 210),* applies to derivatives 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 are subject to a master netting arrangement or similar agreement. This ASU is the final version of proposed ASU 2011-11, *Balance Sheet (Topic 210),* which has been deleted. 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.

The adoption of this ASU did not have any impact on the Company’s consolidated financial statements as the Company has no outstanding rights of setoff.

In February 2013, the FASB issued ASU 2013-02, *Other Comprehensive Income (Topic 220)*. The amendments in the ASU supersede and replace the presentation requirements of reclassifications out of accumulated other comprehensive income in ASUs 2011-05 (issued in June 2011) and 2011-12 (issued in December 2011) for all public and private organizations. The amendments require an entity to provide additional information about reclassifications out of accumulated other comprehensive income. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

(4) Derivative Instruments and Hedging Activities

The Company has commitments outstanding to extend credit to future borrowers that have not closed prior to the end of the quarter. The Company intends to sell these commitments, which are referred to as its “mortgage pipeline.” As commitments to originate loans enter the mortgage pipeline, the Company generally enters into commitments to sell the mortgage pipeline into the secondary market on a firm commitment or best efforts basis. The commitments to originate, purchase or sell loans on a firm commitment basis are derivatives. As a result of marking to market the mortgage pipeline and the related firm commitments to sell at September 30, 2013, the Company recorded an increase in other assets of $22,000 and an increase in other liabilities of $22,000.

The current commitments to sell loans held for sale are derivatives that do not qualify for hedge accounting. As a result, these derivatives are marked to market and the related loans held for sale are recorded at the lower of cost or market. The Company recorded an increase in other liabilities of $25,000 and a loss included in the gain on sales of loans of $25,000 at ended September 30, 2013.

(5) Fair Value Measurements

ASC 820, *Fair Value Measurements* establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system consisting of three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.

Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following table summarizes the assets and liabilities of the Company for which fair values are determined on a recurring basis as of September 30, 2013 and December 31, 2012.

	Carrying value at September 30, 2013			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Securities available for sale	$89,687	0	89,687	0
Mortgage loan commitments	22	0	22	0
Total	$89,709	0	89,709	0

(Dollars in thousands)	Carrying value at December 31, 2012 Total	Level 1	Level 2	Level 3
Securities available for sale	$85,891	81	85,810	0
Mortgage loan commitments	27	0	27	0
Total	$85,918	81	85,837	0

There were no transfers between Levels 1, 2, or 3 during the three or nine month periods ended September 30, 2013.

The Company may also be required, from time to time, to measure certain other financial assets at fair value on a nonrecurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis in the third quarter of 2013 that were still held at September 30, 2013, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related individual assets or portfolios at September 30, 2013 and December 31, 2012.

(Dollars in thousands)	Carrying value at September 30, 2013 Total	Level 1	Level 2	Level 3	Three months ended September 30, 2013 Total gains (losses)	Nine months ended September 30, 2013 Total gains (losses)
Loans held for sale	$1,180	0	1,180	0	48	10
Mortgage servicing rights	1,769	0	1,769	0	0	0
Loans (1)	21,585	0	21,585	0	614	(4,252)
Real estate, net (2)	8,899	0	8,899	0	(14)	(327)
Total	$33,433	0	33,433	0	648	(4,569)

(Dollars in thousands)	Carrying value at December 31, 2012 Total	Level 1	Level 2	Level 3	Year ended December 31, 2012 Total gains (losses)
Loans held for sale	$2,584	0	2,584	0	15
Mortgage servicing rights	1,732	0	1,732	0	0
Loans (1)	32,287	0	32,287	0	(2,307)
Real estate, net (2)	10,595	0	10,595	0	(569)
Total	$47,198	0	47,198	0	(2,861)

(1) Represents the carrying value and related specific reserves on loans for which adjustments are based on the appraised value of the collateral. The carrying value of loans fully charged-off is zero.

(2) Represents the fair value and related losses of foreclosed real estate and other collateral owned that were measured at fair value subsequent to their initial classification as foreclosed assets.

(6) Fair Value of Financial Instruments

Generally accepted accounting principles require interim reporting period disclosure about the fair value of financial instruments, including assets, liabilities and off-balance sheet items for which it is practicable to estimate fair value. The fair value hierarchy level for each asset and liability, as defined in note 5, have been included in the following table for September 30, 2013. The fair value estimates are made based upon relevant market information, if available, and upon the characteristics of the financial instruments themselves. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based upon judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. The estimated fair value of the Company's financial instruments as of September 30, 2013 and December 31, 2012 are shown below.

	September 30, 2013						December 31, 2012					
			Fair value hierarchy						Fair value hierarchy			
(Dollars in thousands)	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3	Contract amount	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3	Contra amoun
Financial assets:												
Cash and cash equivalents	$57,652	57,652	57,652	0	0		83,660	83,660	83,660	0	0	
Securities available for sale	89,687	89,687	0	89,687	0		85,891	85,891	81	85,810	0	
Loans held for sale	1,180	1,180	0	1,180	0		2,584	2,584	0	2,584	0	
Loans receivable, net	393,322	397,827	0	397,827	0		454,045	459,177	0	459,177	0	
Accrued interest receivable	1,817	1,817	0	1,817	0		2,018	2,018	0	2,018	0	
Financial liabilities:												
Deposits	485,921	485,921	0	485,921	0		514,951	514,951	0	514,951	0	
Federal Home Loan Bank advances	0	0	0	0	0		70,000	71,623	0	71,623	0	
Accrued interest payable	127	127	0	127	0		247	247	0	247	0	
Off-balance sheet financial instruments:												

Commitments to extend credit	22	22	119,398	27	27	84,877
Commitments to sell loans	(46)	(46)	2,533	(40)	(40)	7,046

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents approximates their fair value.

Securities Available for Sale

The fair values of securities were based upon quoted market prices for identical or similar instruments in active markets.

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Loans Held for Sale

The fair values of loans held for sale were based upon quoted market prices for loans with similar interest rates and terms to maturity.

Loans Receivable, net

The fair value of the loan portfolio, with the exception of the adjustable rate portfolio, was calculated by discounting the scheduled cash flows through the estimated maturity using anticipated prepayment speeds and using discount rates that reflect the credit and interest rate risk inherent in each loan portfolio. The fair value of the adjustable loan portfolio was estimated by grouping the loans with similar characteristics and comparing the characteristics of each group to the prices quoted for similar types of loans in the secondary market. This method of estimating fair value does not incorporate the exit-price concept of fair value perscribed by ASC 820, Fair Value Measurements and Disclosures.

Accrued Interest Receivable

The carrying amount of accrued interest receivable approximates its fair value since it is short-term in nature and does not present unanticipated credit concerns.

Deposits

The fair value of demand deposits, savings accounts and certain money market account deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. If the fair value of the fixed maturity certificates of deposit is calculated at less than the carrying amount, the carrying value of these deposits is reported as the fair value.

The fair value estimate for deposits does not include the benefit that results from the low cost funding provided by the Company's existing deposits and long-term customer relationships compared to the cost of obtaining different sources of funding. This benefit is commonly referred to as the core deposit intangible.

Federal Home Loan Bank Advances

The fair values of advances with fixed maturities are estimated based on discounted cash flow analysis using as discount rates the interest rates charged by the FHLB for borrowings of similar remaining maturities.

Accrued Interest Payable

The carrying amount of accrued interest payable approximates its fair value since it is short-term in nature.

Commitments to Extend Credit

The fair values of commitments to extend credit are estimated using the fees normally charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counter parties.

Commitments to Sell Loans

The fair values of commitments to sell loans are estimated using the quoted market prices for loans with similar interest rates and terms to maturity.

(7) Comprehensive Income (Loss)

Other comprehensive income (loss) is defined as the change in equity during a period from transactions and other events from nonowner sources. Comprehensive income (loss) is the total of net income (loss) and other comprehensive income (loss), which for the Company is comprised of unrealized gains and losses on securities available for sale. The components of other comprehensive income (loss) and the related tax effects for the quarter and nine-months ended September 30, 2013 and 2012 were as follows:

(Dollars in thousands)	For the three months ended September 30, 2013			2012		
Securities available for sale:	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Net unrealized gains (losses) arising during the period	$473	0	473	(77)	0	(77)
Other comprehensive income (loss)	$473	0	473	(77)	0	(77)

(Dollars in thousands)	For the nine months ended September 30, 2013			2012		
Securities available for sale:	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Net unrealized losses arising during the period	$(1,045)	0	(1,045)	(349)	0	(349)
Other comprehensive loss	$(1,045)	0	(1,045)	(349)	0	(349)

There is no tax effect shown in the above schedule at September 30, 2013 or 2012 since no regular income tax expense was recorded during these periods.

(8) Securities Available For Sale

The following table shows the gross unrealized losses and fair value for the securities available for sale portfolio, 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.

	September 30, 2013							
	Less than twelve months			Twelve months or more			Total	
(Dollars in thousands)	# of Investments	Fair Value	Unrealized Losses	# of Investments	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other marketable securities:								
U.S. Government agency obligations	15	$68,386	(643)	0	$0	0	$68,386	(643)
Corporate preferred stock	0	0	0	1	245	(455)	245	(455)

Total temporarily impaired securities	15	$68,386	(643	)	1	$245	(455	)	$68,631	(1,098	)

	December 31, 2012										
	Less than twelve months				Twelve months or more				Total		
(Dollars in thousands)	# of Investments	Fair Value	Unrealized Losses		# of Investments	Fair Value	Unrealized Losses		Fair Value	Unrealized Losses	
Other marketable securities:											
U.S. Government agency obligations	1	$4,996	(4	)	0	$0	0		$4,996	(4	)
Corporate preferred stock	0	0	0		1	245	(455	)	245	(455	)
Total temporarily impaired securities	1	$4,996	(4	)	1	$245	(455	)	$5,241	(459	)

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the market liquidity for the investment, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer, and our intent and ability to hold the investment for a period of time sufficient to recover the temporary loss.

The unrealized losses reported for corporate preferred stock at September 30, 2013 related to a single trust preferred security that was issued by the holding company of a small community bank. Typical of most trust preferred issuances, the issuer has the ability to defer interest payments for up to five years with interest payable on the deferred balance. In October 2009, the issuer elected to defer its scheduled interest payments as allowed by the terms of the security agreement. The issuer's subsidiary bank has incurred operating losses due to increased provisions for loan losses but still meets the regulatory requirements to be considered "well capitalized" based on its most recent regulatory filing. Based on a review of the issuer, it was determined that the trust preferred security was not other-than-temporarily impaired at September 30, 2013. The Company does not intend to sell the preferred stock and has the intent and ability to hold it for a period of time sufficient to recover the temporary loss. Management believes that the Company will receive all principal and interest payments contractually due on the security and that the decrease in the market value is primarily due to a lack of liquidity in the market for trust preferred securities and the deferral of interest by the issuer. Management will continue to monitor the credit risk of the issuer and may be required to recognize other-than-temporary impairment charges on this security in future periods.

A summary of securities available for sale at September 30, 2013 and December 31, 2012 is as follows:

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2013:				
Mortgage-backed securities:				
FHLMC	$ 2,431	144	0	2,575
FNMA	3,194	204	0	3,398
	5,625	348	0	5,973
Other marketable securities:				
U.S. Government agency obligations	84,042	3	(643)	83,402
Common stock	58	9	0	67
Corporate preferred stock	700	0	(455)	245
	84,800	12	(1,098)	83,714
	$ 90,425	360	(1,098)	89,687

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2012:				
Mortgage-backed securities:				
FHLMC	$ 5,669	294	0	5,963
FNMA	4,076	301	0	4,377
Collateralized mortgage obligations:				
FNMA	80	1	0	81
	9,825	596	0	10,421

Other marketable securities:				
U.S. Government agency obligations	75,059	170	(4)	75,225
Corporate preferred stock	700	0	(455)	245
	75,759	170	(459)	75,470
	$ 85,584	766	(459)	85,891

The following table indicates amortized cost and estimated fair value of securities available for sale at September 30, 2013 based upon contractual maturity adjusted for scheduled repayments of principal and projected prepayments of principal based upon current economic conditions and interest rates.

(Dollars in thousands)	Amortized Cost	Fair Value
Due less than one year	$ 56,147	55,792
Due after one year through five years	33,520	33,583
Due after five years through ten years	0	0
Due after ten years	758	312
Total	$ 90,425	89,687

The allocation of mortgage-backed securities in the table above is based upon the anticipated future cash flow of the securities using estimated mortgage prepayment speeds. The allocation of other marketable securities that have call features is based on the anticipated cash flows to the call date that it is anticipated that the security will be called, or to the maturity date if it is not anticipated to be called.

(9) Loans Receivable, Net

A summary of loans receivable at September 30, 2013 and December 31, 2012 is as follows:

(Dollars in thousands)	September 30, 2013	December 31, 2012
1-4 family	$ 78,581	97,037
Commercial real estate:		
Residential developments	37,425	46,343
Other	170,036	198,564
	207,461	244,907
Consumer	53,414	53,975
Commercial business:		
Construction industry	6,680	2,666
Other	63,703	77,188
	70,383	79,854
Total loans	409,839	475,773
Less:		
Unamortized discounts	37	33
Net deferred loan fees (costs)	(25)	87
Allowance for loan losses	16,505	21,608
Total loans receivable, net	$ 393,322	454,045

(10) Allowance for Loan Losses and Credit Quality Information

The allowance for loan losses is summarized as follows:

(Dollars in thousands)	1-4 Family	Commercial Real Estate	Consumer	Commercial Business	Total
For the three months ended September 30, 2013:					
Balance, June 30, 2013	$2,059	14,089	1,431	2,780	20,359
Provision for losses	(675)	(3,512)	(58)	(85)	(4,330)
Charge-offs	0	(2)	(374)	(50)	(426)
Recoveries	0	711	14	177	902
Balance, September 30, 2013	$1,384	11,286	1,013	2,822	16,505
For the nine months ended September 30, 2013:					
Balance, December 31, 2012	$2,821	13,588	1,146	4,053	21,608
Provision for losses	(1,250)	(2,646)	256	(1,210)	(4,850)
Charge-offs	(200)	(911)	(475)	(606)	(2,192)
Recoveries	13	1,255	86	585	1,939
Balance, September 30, 2013	$1,384	11,286	1,013	2,822	16,505
Allocated to:					
Specific reserves	$571	2,591	537	1,114	4,813
General reserves	2,250	10,997	609	2,939	16,795
Balance, December 31, 2012	$2,821	13,588	1,146	4,053	21,608
Allocated to:					
Specific reserves	$309	5,218	335	690	6,552
General reserves	1,075	6,068	678	2,132	9,953
Balance, September 30, 2013	$1,384	11,286	1,013	2,822	16,505
Loans receivable at December 31, 2012:					
Individually reviewed for impairment	$4,687	28,195	1,823	2,395	37,100
Collectively reviewed for impairment	92,350	216,712	52,152	77,459	438,673
Ending balance	$97,037	244,907	53,975	79,854	475,773

Loans receivable at September 30, 2013:					
Individually reviewed for impairment	$3,423	22,569	746	1,399	28,137
Collectively reviewed for impairment	75,158	184,892	52,668	68,984	381,702
Ending balance	$78,581	207,461	53,414	70,383	409,839

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(Dollars in thousands)	1-4 Family	Commercial Real Estate	Consumer	Commercial Business	Total
For the three months ended September 30, 2012:					
Balance, June 30, 2012	$ 3,665	11,553	1,268	4,033	20,519
Provision for losses	(621)	2,246	4	(45)	1,584
Charge-offs	0	(1,535)	(164)	(167)	(1,866)
Recoveries	0	47	94	84	225
Balance, September 30, 2012	$ 3,044	12,311	1,202	3,905	20,462
For the nine months ended September 30, 2012:					
Balance, December 31, 2011	$ 3,718	13,622	1,159	5,389	23,888
Provision for losses	(674)	3,037	851	(670)	2,544
Charge-offs	0	(5,719)	(921)	(1,996)	(8,636)
Recoveries	0	1,371	113	1,182	2,666
Balance, September 30, 2012	$ 3,044	12,311	1,202	3,905	20,462

The following table summarizes the amount of classified and unclassified loans at September 30, 2013 and December 31, 2012:

	September 30, 2013						
	Classified					Unclassified	
(Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total	Total	Total Loans
1-4 family	$746	8,904	0	0	9,650	68,931	78,581
Commercial real estate:							
	0	26,094	0	0	26,094	11,331	37,425

Residential developments							
Other	17,513	22,038	0	0	39,551	130,485	170,036
Consumer	0	439	60	247	746	52,668	53,414
Commercial business:							
Construction industry	0	325	0	0	325	6,355	6,680
Other	574	8,711	0	0	9,285	54,418	63,703
	$18,833	66,511	60	247	85,651	324,188	409,839

	December 31, 2012						
	Classified					Unclassified	
(Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total	Total	Total Loans
1-4 family	$1,004	13,915	33	0	14,952	82,085	97,037
Commercial real estate:							
Residential developments	744	36,210	0	0	36,954	9,389	46,343
Other	17,170	30,365	0	0	47,535	151,029	198,564
Consumer	0	1,543	123	157	1,823	52,152	53,975
Commercial business:							
Construction industry	0	320	0	0	320	2,346	2,666
Other	1,224	12,628	134	0	13,986	63,202	77,188
	$20,142	94,981	290	157	115,570	360,203	475,773

Classified loans represent special mention, substandard, doubtful and loss loans. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard 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. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. A loan classified as loss is considered uncollectible and of such little value that continuance as an asset on the balance sheet is not warranted. Loans classified as substandard or doubtful require the Bank to perform an analysis of the individual loan and charge-off any loans, or portion thereof, that are deemed uncollectible.

The aging of past due loans at September 30, 2013 and December 31, 2012 is summarized as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Loans	Total Loans	Loans 90 Days or More Past Due and Still Accruing
September 30, 2013							
1-4 family	$878	930	0	1,808	76,773	78,581	0
Commercial real estate:							
Residential developments	256	0	739	995	36,430	37,425	0
Other	101	0	0	101	169,935	170,036	0
Consumer	355	98	3	456	52,958	53,414	0
Commercial business:							
Construction industry	0	0	0	0	6,680	6,680	0
Other	0	0	0	0	63,703	63,703	0
	$1,590	1,028	742	3,360	406,479	409,839	0
December 31, 2012							
1-4 family	$1,172	240	0	1,412	95,625	97,037	0
Commercial real estate:							
Residential developments	0	0	0	0	46,343	46,343	0
Other	49	0	289	338	198,226	198,564	0
Consumer	591	80	0	671	53,304	53,975	0
Commercial business:							
Construction industry	45	0	79	124	2,542	2,666	0

Other	1,441	106	7,467	9,014	68,174	77,188	7,423
	$3,298	426	7,835	11,559	464,214	475,773	7,423

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Impaired loans include loans that are non-performing (non-accruing) and loans that have been modified in a troubled debt restructuring (TDR). The following table summarizes impaired loans and related allowances as of September 30, 2013 and December 31, 2012:

	September 30, 2013			December 31, 2012		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Loans with no related allowance recorded:						
1-4 family	$1,583	1,583	0	1,617	1,617	0
Commercial real estate:						
Residential developments	8,754	11,946	0	10,714	15,530	0
Other	335	335	0	640	640	0
Consumer	287	293	0	393	400	0
Commercial business:						
Construction industry	96	171	0	102	1,038	0
Other	0	0	0	34	534	0
Loans with an allowance recorded:						
1-4 family	1,840	1,884	309	3,070	3,114	571
Commercial real estate:						
Residential developments	12,109	14,400	4,943	14,061	16,545	1,669
Other	1,371	1,454	275	2,780	3,133	921
Consumer	459	459	335	1,430	1,430	537
Commercial business:						
Construction industry	0	0	0	74	74	62
Other	1,303	2,055	690	2,185	2,936	1,053
Total:						

1-4 family	3,423	3,467	309	4,687	4,731	571
Commercial real estate:						
Residential developments	20,863	26,346	4,943	24,775	32,075	1,669
Other	1,706	1,789	275	3,420	3,773	921
Consumer	746	752	335	1,823	1,830	537
Commercial business:						
Construction industry	96	171	0	176	1,112	62
Other	1,303	2,055	690	2,219	3,470	1,053
	$28,137	34,580	6,552	37,100	46,991	4,813

The following tables summarize average recorded investment and interest income recognized on impaired loans during the three and nine months ended September 30, 2013 and 2012.

	For the three months ended		For the nine months ended	
	September 30, 2013		September 30, 2013	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded:				
1-4 family	$1,589	31	1,608	46
Commercial real estate:				
Residential developments	9,127	29	9,338	43
Other	335	16	424	18
Consumer	309	5	315	8
Commercial business:				
Construction industry	98	0	90	0
Other	0	0	9	0
Loans with an allowance recorded:				
1-4 family	2,272	6	2,571	19
Commercial real estate:				
Residential developments	12,031	27	13,519	41
Other	1,856	228	2,249	232
Consumer	998	7	1,221	18
Commercial business:				
Construction industry	0	0	36	0
	1,332	17	1,791	

Other