WSFS FINANCIAL CORP
Form 10-Q
August 11, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 June 30, 2014

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 0-16668

WSFS FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**22-2866913**
(State or other jurisdiction of Incorporation or organization)	**(I.R.S. Employer Identification Number)**
WSFS Bank Center, 500 Delaware Avenue, Wilmington, Delaware	**19801**
(Address of principal executive offices)	**(Zip Code)**

(302) 792-6000

Registrant s telephone number, including area code:

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

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 such shorter period that the registrant was required to submit and post such files). Yes x 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 x
Non-accelerated filer ¨ (Do not check if 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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of August 1, 2014.

Common Stock, par value $.01 per share	**8,926,544**
(Title of Class)	**(Shares Outstanding)**

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WSFS FINANCIAL CORPORATION

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PART I. Financial Information

Exhibit 101.SCH	Schema Document
Exhibit 101.CAL	Calculation Linkbase Document
Exhibit 101.LAB	Labels Linkbase Document
Exhibit 101.PRE	Presentation Linkbase Document
Exhibit 101.DEF	Definition Linkbase Document

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	**2014**	2013
	(Unaudited) (In Thousands, Except Per Share Data)			
Interest income:				
Interest and fees on loans	**$ 33,319**	$ 32,108	**$ 65,521**	$ 63,560
Interest on mortgage-backed securities	**3,564**	3,117	**6,813**	6,506
Interest on reverse mortgage related assets	**1,368**	324	**2,594**	907
Interest and dividends on investment securities	**814**	311	**1,606**	453
Other interest income	**348**	22	**664**	47
	39,413	35,882	**77,198**	71,473
Interest expense:				
Interest on deposits	**1,714**	1,821	**3,370**	3,840
Interest on Federal Home Loan Bank advances	**661**	451	**1,187**	894
Interest on federal funds purchased and securities sold under agreements to repurchase	**265**	245	**515**	494
Interest on trust preferred borrowings	**330**	337	**656**	666
Interest on senior debt	**941**	944	**1,883**	1,887
Interest on bonds payable			**15**	
Interest on other borrowings	**25**	28	**51**	56
	3,936	3,826	**7,677**	7,837
Net interest income	**35,477**	32,056	**69,521**	63,636
Provision for loan losses	**50**	1,680	**2,680**	3,911
Net interest income after provision for loan losses	**35,427**	30,376	**66,841**	59,725
Noninterest income:				
Credit/debit card and ATM income	**6,010**	6,189	**11,776**	11,857
Deposit service charges	**4,346**	4,216	**8,615**	8,230
Investment management and fiduciary revenue	**4,287**	4,059	**8,121**	7,787
Mortgage banking activities, net	**1,025**	1,193	**1,837**	1,930
Loan fee income	**556**	487	**940**	982
Security gains, net	**365**	906	**943**	2,550
Bank owned life insurance income	**143**	48	**282**	88
Other income	**2,891**	2,441	**5,473**	4,189

	19,623	19,539	**37,987**	37,613
Noninterest expenses:				
Salaries, benefits and other compensation	**18,671**	17,455	**37,145**	35,438
Occupancy expense	**3,569**	3,401	**7,298**	6,784
Professional fees	**2,345**	899	**3,695**	1,846
Equipment expense	**1,860**	2,117	**3,547**	3,946
Data processing and operations expenses	**1,531**	1,394	**3,002**	2,743
Loan workout and OREO expenses	**716**	770	**1,255**	940
FDIC expenses	**692**	942	**1,345**	2,108
Marketing expense	**464**	608	**963**	1,125
Other operating expense	**5,670**	5,566	**11,446**	10,592
	35,518	33,152	**69,696**	65,522
Income before taxes	**19,532**	16,763	**35,132**	31,816
Income tax provision	**6,807**	5,855	**5,496**	11,168
Net income	**12,725**	10,908	**29,636**	20,648
Dividends on preferred stock and accretion of discount		609		1,301
Net income allocable to common stockholders	**$ 12,725**	$ 10,299	**$ 29,636**	$ 19,347
Earnings per share:				
Basic	**$ 1.43**	$ 1.17	**$ 3.33**	$ 2.20
Diluted	**$ 1.39**	$ 1.16	**$ 3.24**	$ 2.18

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	**2014**	2013
	(Unaudited) (In Thousands)			
Net Income	**$ 12,725**	$ 10,908	**$ 29,636**	$ 20,648
Other comprehensive income (loss):				
Net change in unrealized gains (losses) on investment securities available-for-sale:				
Net Unrealized gains (losses) arising during the period, net of tax expense (benefit) of $5,932, ($11,840), $11,536 and ($14,738), respectively	**9,678**	(19,316)	**18,824**	(24,143)
Less: reclassification adjustment for net losses (gains) on sales realized in net income, net of tax (benefit) expense of $139, $344, $358 and $969, respectively	**(226)**	(562)	**(585)**	(1,581)
	9,452	(19,878)	**18,239**	(25,724)
Net change in unfunded pension liability:				
Change in unfunded pension liability related to unrealized loss, prior service cost and transition obligation, net of tax expense of $36, $0, $36 and $0, respectively	**60**		**60**	
Total other comprehensive income (loss)	**9,512**	**(19,878)**	**18,299**	**(25,724)**
Total comprehensive income (loss)	**$ 22,237**	$ (8,970)	$ 47,935	$ (5,076)

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CONDITION

	June 30, 2014	December 31, 2013
	(Unaudited)	
	(In Thousands, Except Per Share Data)	
Assets		
Cash and due from banks	**$ 107,169**	$ 94,734
Cash in non-owned ATMs	**367,870**	389,360
Interest-bearing deposits in other banks	**150**	332
Total cash and cash equivalents	**475,189**	484,426
Investment securities, available-for-sale	**841,706**	817,115
Loans held-for-sale	**35,188**	31,491
Loans, net of allowance for loan losses of $41,381 at June 30, 2014 and $41,244 at December 31, 2013	**2,993,361**	2,904,976
Reverse mortgage related assets	**32,543**	37,328
Bank-owned life insurance	**63,467**	63,185
Stock in Federal Home Loan Bank of Pittsburgh, at cost	**37,587**	35,869
Assets acquired through foreclosure	**4,451**	4,532
Accrued interest receivable	**11,004**	10,798
Premises and equipment	**33,606**	35,178
Goodwill	**32,100**	32,235
Intangible assets	**6,195**	6,743
Other assets	**46,693**	51,887
Total assets	**$ 4,613,090**	$ 4,515,763
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Noninterest-bearing demand	**$ 709,186**	$ 650,256
Interest-bearing demand	**643,061**	638,403
Money market	**748,099**	887,715
Savings	**401,049**	383,731
Time	**232,241**	236,965
Jumbo certificates of deposit customer	**219,234**	221,145
Total customer deposits	**2,952,870**	3,018,215
Brokered deposits	**200,459**	168,727
Total deposits	**3,153,329**	3,186,942
Federal funds purchased and securities sold under agreements to repurchase	**86,000**	97,000

Federal Home Loan Bank advances	**758,400**	638,091
Trust preferred borrowings	**67,011**	67,011
Senior debt	**55,000**	55,000
Other borrowed funds	**18,455**	24,739
Reverse mortgage trust bonds payable		21,990
Accrued interest payable	**2,381**	838
Other liabilities	**40,559**	41,102
Total liabilities	**4,181,135**	4,132,713
Stockholders Equity:		
Common stock $0.01 par value, 20,000,000 shares authorized; issued 18,504,996 at June 30, 2014 and 18,476,003 at December 31, 2013	**185**	185
Capital in excess of par value	**181,582**	178,477
Accumulated other comprehensive loss	**(2,995)**	(21,294)
Retained earnings	**501,463**	473,962
Treasury stock at cost, 9,580,569 shares at June 30, 2014 and December 31, 2013	**(248,280)**	(248,280)
Total stockholders equity	**431,955**	383,050
Total liabilities and stockholders equity	**$ 4,613,090**	$ 4,515,763

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30, 2014	2013
	(Unaudited) (In Thousands)	
Operating activities:		
Net Income	**$ 29,636**	$ 20,648
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**2,680**	3,911
Depreciation of premises and equipment	**2,982**	2,754
Amortization, net	**5,098**	5,573
Increase in accrued interest receivable	**(206)**	(655)
Decrease in other assets	**220**	5,178
Origination of loans held-for-sale	**(105,844)**	(122,826)
Proceeds from sales of loans held-for-sale	**101,976**	122,934
Gain on mortgage banking activities, net	**(1,837)**	(1,930)
Gain on sale of securities, net	**(943)**	(2,550)
Stock-based compensation expense	**2,242**	1,646
Excess tax benefits from share-based payment arrangements	**(478)**	(112)
Increase in accrued interest payable	**1,543**	1,573
Decrease in other liabilities	**(788)**	(5,351)
Loss (gain) on sale of assets acquired through foreclosure and valuation adjustments, net	**56**	(190)
Deferred income tax (benefit) expense	**(5,722)**	1,664
Increase in value of bank-owned life insurance	**(282)**	(88)
Increase in capitalized interest for reverse mortgages, net	**(2,785)**	(520)
Net cash provided by operating activities	**$ 27,548**	$ 31,659
Investing activities:		
Maturities and Calls of investment securities	**2,305**	310
Sale of investment securities available-for-sale	**141,439**	220,331
Purchase of investment securities available-for-sale	**(168,454)**	(213,302)
Repayments of investment securities available-for-sale	**27,177**	44,422
Repayments on reverse mortgages	**8,235**	
Disbursements for reverse mortgages	**(665)**	(35)
Net increase in loans	**(93,558)**	(82,146)
Net increase in stock of Federal Home Loan Bank of Pittsburgh	**(1,718)**	(8,167)
Sales of assets acquired through foreclosure, net	**3,222**	4,178
Investment in premises and equipment, net	**(1,388)**	(1,505)
Net cash (used for) provided by investing activities	**$ (83,405)**	$ (35,914)

Financing activities:		
Net decrease in demand and saving deposits	**(65,036)**	(122,920)
Decrease in time deposits	**(6,635)**	(92,226)
Increase in brokered deposits	**31,732**	2,117
Increase in loan payable	**40**	
Repayment of reverse mortgage trust bonds payable	**(21,990)**	
Receipts from FHLB advances	**57,176,960**	11,058,000
Repayments of FHLB advances	**(57,056,651)**	(11,069,000)
Receipts from federal funds purchased and securities sold under agreement to repurchase	**12,259,350**	21,576,204
Repayments of federal funds purchased and securities sold under agreement to repurchase	**(12,270,350)**	(21,288,714)
Dividends paid	**(2,141)**	(3,425)
Issuance of common stock and exercise of common stock options	**863**	739
Redemption of preferred stock		(19,997)
Excess tax benefits from share-based payment arrangements	**478**	112
Net cash provided by (used for) financing activities	**$ 46,620**	$ 40,890
Increase (decrease) in cash and cash equivalents	**(9,237)**	36,635
Cash and cash equivalents at beginning of period	**484,426**	500,887
Cash and cash equivalents at end of period	**$ 475,189**	$ 537,522
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest during the period	**$ 6,134**	$ 6,264
Cash paid for income taxes, net	**12,231**	9,607
Loans transferred to assets acquired through foreclosure	**3,196**	6,475
Loans transferred to portfolio from HFS	**2,169**	
Other comprehensive income (loss)	**18,299**	(25,724)
Non-Cash Goodwill Adjustment, Net	**135**	

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014

(UNAUDITED)

1. BASIS OF PRESENTATION

Our Consolidated Financial Statements include the accounts of WSFS Financial Corporation (the Company , our Company , we , our or us), Wilmington Savings Fund Society, FSB (WSFS Bank or the Bank) and Cypress Cap Management, LLC (Cypress). We also have one unconsolidated affiliate, WSFS Capital Trust III (the Trust). WSFS Bank has two fully-owned subsidiaries, WSFS Investment Group, Inc. (WIG) and Monarch Entity Services LLC (Monarch).

Founded in 1832, the Bank is one of the ten oldest banks continuously operating under the same name in the United States. We provide residential and commercial real estate, commercial and consumer lending services, as well as retail deposit and cash management services. Lending activities are funded primarily with customer deposits and borrowings. In addition, we offer a variety of wealth management and trust services to personal and corporate customers through our Trust and Wealth Management division. The Federal Deposit Insurance Corporation (FDIC) insures our customers deposits to their legal maximums. We serve our customers primarily from our 52 offices located in Delaware (42), Pennsylvania (8), Virginia (1) and Nevada (1) and through our website at www.wsfsbank.com. Information on our website is not incorporated by reference into this quarterly report.

Amounts subject to significant estimates are items such as the allowance for loan losses and reserves for lending related commitments, goodwill, intangible assets, post-retirement benefit obligations, the fair value of financial instruments, reverse mortgage related assets, income taxes and other-than-temporary impairments (OTTI). Among other effects, changes to such estimates could result in future impairments of investment securities, goodwill and intangible assets and establishment of allowances for loan losses and lending related commitments as well as increased post-retirement benefits expense.

Our accounting and reporting policies conform with U.S. generally accepted accounting principles and prevailing practices within the banking industry for interim financial information and Rule 10-01 of the Securities and Exchange Commission (SEC) Regulation S-X. Rule 10-01 of Regulation S-X does not require us to include all information and notes that would be required in audited financial statements. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for any future quarters or for the year ending December 31, 2014. For further information, refer to the Consolidated Financial Statements and the accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the SEC.

Whenever necessary, reclassifications have been made to prior period Consolidated Financial Statements to conform to the current period s presentation. All significant intercompany transactions were eliminated in consolidation.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2014, the FASB issued ASU No. 2014-01, *Investments - Equity Method and Joint Ventures (Topic 323) - Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task*

Force). The ASU permits an entity to make an accounting policy election to account for its investment in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportionate amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The decision to apply the proportionate amortization method of accounting should be applied consistently to all qualifying affordable housing project investments. A reporting entity that uses the effective yield or other method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply such method to those preexisting investments. The amendments are effective for annual and interim periods beginning after December 15, 2014. The Company does not expect the application of this guidance to have a material impact on the Company s financial statements.

In January 2014, the FASB issued ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The objective of this guidance is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU No. 2014-04 states that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU No. 2014-04 requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company s Consolidated Financial Statements.

In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. This ASU includes amendments that change the requirements for reporting discontinued operations and disposals of components of an entity. Under the new guidance, only disposals representing a strategic shift that has (or will have) a major effect on the organization s operations and financial results should be presented as discontinued operations. Additionally, the ASU requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. These amendments are effective prospectively for fiscal years and interim reporting periods within those years, beginning after December 15, 2014. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The ASU introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This standard is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently evaluating the new guidance to determine the impact it will have on its Consolidated Financial Statements.

2. BUSINESS COMBINATIONS

First Wyoming Financial Corporation

On November 25, 2013, the Company announced an Agreement and Plan of Reorganization, with First Wyoming Financial Corporation, the parent company of The First National Bank of Wyoming (First Wyoming), pursuant to which First Wyoming Financial Corporation will merge with the company in a cash and stock transaction valued at approximately $64 million. As of December 31, 2013, First Wyoming operated 6 banking offices in Kent County, Delaware with $302.8 million in total assets and $244.5 million in total deposits. This business combination has received required regulatory and stockholder approvals and is expected to close in September 2014.

Array Financial Group, Inc. and Arrow Land Transfer Company Acquisition

On July 31, 2013, WSFS Bank completed the purchase of Array Financial Group, Inc. (Array), a Delaware Valley mortgage banking company, specializing in a variety of residential mortgage and refinancing solutions, and Arrow Land Transfer Company (Arrow), an abstract and title company that is a related entity to Array. All Array and Arrow employees are now WSFS Associates.

These companies were acquired through an asset purchase transaction for the purchase price of $8.0 million (including a $1.4 million payment for the working capital of the two companies), $4.0 million of which can be earned through a five-year earn out based on achieved earnings contribution targets, the fair value of which is $2.6 million at June 30, 2014. Operating results of Array and Arrow are included in the Consolidated Financial Statements since the date of acquisition.

The transaction was accounted for as a business combination using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration paid were recorded at their estimated fair values as of the acquisition date. The excess of consideration paid over the fair value of net assets acquired was recorded as goodwill, which will not be amortizable for book purposes, however will be deductible for tax purposes. We allocated the total balance of goodwill to our WSFS Bank segment. We also recognized $2.4 million in intangible assets which will be amortized over 7 years utilizing the straight-line method.

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The following table details the effect on goodwill from the changes in the derivative assets and liabilities relating to the loan commitment pipeline at acquisition from the amounts originally reported on the Form 10-K for the year ended December 31, 2013.

(In Thousands)	
Goodwill resulting from acquisition of Array and Arrow reported on Form 10-K for the year ended December 31, 2013	$ 4,089
Effect of adjustments to:	
Other assets	(338)
Other liabilities	203
Adjusted goodwill resulting from acquisition of Array & Arrow as of June 30, 2014	$ 3,954

The fair values listed above are estimates and are subject to adjustment. However, while they are not expected to be materially different than those shown, any material adjustments to the estimates will be reflected retroactively as of the date of the transaction.

3. EARNINGS PER SHARE

The following table shows the computation of basic and diluted earnings per share:

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	**2014**	2013
	(In Thousands, Except Per Share Data)			
Numerator:				
Net income allocable to common stockholders	**$ 12,725**	$ 10,299	**$ 29,636**	$ 19,347
Denominator:				
Denominator for basic earnings per share - weighted average shares	**8,915**	8,802	**8,910**	8,792
Effect of dilutive employee stock options and warrants	**228**	95	**230**	89
Denominator for diluted earnings per share - adjusted weighted average shares and assumed exercise	**9,143**	8,897	**9,140**	8,881
Earnings per share:				
Basic:				
Net income allocable to common stockholders	**$ 1.43**	$ 1.17	**$ 3.33**	$ 2.20
Diluted:				

Net income allocable to common stockholders	**$**	**1.39**	$	1.16	**$**	**3.24**	$	2.18
Outstanding common stock equivalents having no dilutive effect		**44**		548		**44**		637

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4. INVESTMENT SECURITIES

The following tables detail the amortized cost and the estimated fair value of our available-for-sale investment securities. None of our investment securities is classified as trading or held-to-maturity.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available-for-sale securities:				
June 30, 2014:				
State and political subdivisions	**$ 111,256**	**$ 2,484**	**$ (1,159)**	**$ 112,581**
U.S. Government and government sponsored enterprises (GSE)	**36,986**	**55**	**(20)**	**37,021**
Collateralized Mortgage Obligation (CMO)	**163,781**	**482**	**(2,185)**	**162,078**
Federal National Mortgage Association (FNMA) Mortgage-Backed Securities (MBS)	**321,960**	**735**	**(3,371)**	**319,324**
Federal Home Loan Mortgage Corporation MBS (FHLMC)	**127,454**	**244**	**(1,406)**	**126,292**
Government National Mortgage Association MBS (GNMA)	**84,436**	**499**	**(525)**	**84,410**
	$ 845,873	**$ 4,499**	**$ (8,666)**	**$ 841,706**
December 31, 2013				
State and political subdivisions	$ 105,354	$ 257	$ (5,426)	$ 100,185
GSE	32,082	93	(17)	32,158
CMO	103,064	28	(5,535)	97,557
FNMA MBS	382,909	20	(15,801)	367,128
FHLMC MBS	129,460	29	(4,994)	124,495
GNMA MBS	97,830	743	(2,981)	95,592
	$ 850,699	$ 1,170	$ (34,754)	$ 817,115

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The scheduled maturities of investment securities available-for-sale at June 30, 2014 and December 31, 2013 were as follows:

	Available-for-Sale	
	Amortized Cost	Fair Value
	(In Thousands)	
June 30, 2014		
Within one year	**$ 23,178**	**$ 23,224**
After one year but within five years	**38,821**	**39,376**
After five years but within ten years	**235,509**	**233,595**
After ten years	**548,365**	**545,511**
	$ 845,873	**$ 841,706**
December 31, 2013		
Within one year	$ 16,319	$ 16,378
After one year but within five years	19,761	19,986
After five years but within ten years	229,033	217,911
After ten years	585,586	562,840
	$ 850,699	$ 817,115

MBS have expected maturities that differ from their contractual maturities. These differences arise because borrowers may have the right to call or prepay obligations with or without a prepayment penalty.

At June 30, 2014, investment securities with market values aggregating $504.7 million were pledged as collateral for retail customer repurchase agreements, municipal deposits, and other obligations. From time to time, investment securities are also pledged as collateral for FHLB borrowings. There were $11.0 million of FHLB pledged investment securities at June 30, 2014.

During the first six months of 2014, we sold $140.9 million of investment securities during the period categorized as available-for-sale for net gains of $943,000 (no losses were incurred). In the first six months of 2013, we sold $220.3 million of investment securities available-for-sale which resulted in net gains of $2.5 million.

As of June 30, 2014, our investment securities portfolio had remaining unamortized premiums of $23.1 million and $220,000 of unaccreted discounts.

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The tables below show our investment securities gross unrealized losses and fair value by investment category and length of time that individual securities were in a continuous unrealized loss position at June 30, 2014 and December 31, 2013.

June 30, 2014	**Less than 12 months Fair Value**	**Less than 12 months Unrealized Loss**	**12 months or longer Fair Value**	**12 months or longer Unrealized Loss**	**Total Fair Value**	**Total Unrealized Loss**
			(In Thousands)			
Available-for-sale						
State and political subdivisions	**$ 5,727**	**$ 19**	**$ 44,075**	**$ 1,140**	**$ 49,802**	**$ 1,159**
GSE	**10,951**	**20**			**10,951**	**20**
CMO	**16,488**	**23**	**73,140**	**2,162**	**89,628**	**2,185**
FNMA MBS	**27,205**	**234**	**195,763**	**3,137**	**222,968**	**3,371**
FHLMC MBS	**3,798**	**6**	**96,077**	**1,400**	**99,875**	**1,406**
GNMA MBS			**52,020**	**525**	**52,020**	**525**
Total temporarily impaired investments	**$ 64,169**	**$ 302**	**$ 461,075**	**$ 8,364**	**$ 525,244**	**$ 8,666**

December 31, 2013	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or longer Fair Value	12 months or longer Unrealized Loss	Total Fair Value	Total Unrealized Loss
			(In Thousands)			
Available-for-sale						
State and political subdivisions	$ 83,036	$ 5,426	$	$	$ 83,036	$ 5,426
GSE	3,972	13	2,001	4	5,973	17
CMO	73,109	4,173	21,590	1,362	94,699	5,535
FNMA MBS	346,266	14,386	17,800	1,415	364,066	15,801
FHLMC MBS	116,732	4,548	7,307	446	124,039	4,994
GNMA MBS	57,076	1,897	18,829	1,084	75,905	2,981
Total temporarily impaired investments	$ 680,191	$ 30,443	$ 67,527	$ 4,311	$ 747,718	$ 34,754

All securities were AAA-rated at the time of purchase and remained at investment grade at both June 30, 2014 and December 31, 2013. All securities were re-evaluated for OTTI at June 30, 2014. The result of this evaluation showed no OTTI during the first six months of 2014. The weighted average duration of MBS was 5.2 years at June 30, 2014.

At June 30, 2014, we owned investment securities totaling $525.2 million in which the amortized cost basis exceeded fair value. Total unrealized losses on those securities were $8.7 million at June 30, 2014. At December 31, 2013, we owned investment securities totaling $747.7 million in which the amortized cost basis exceeded fair value. Total unrealized loss at December 31, 2013 on those securities was $34.8 million. The temporary impairment is the result of changes in market interest rates subsequent to the purchase of the securities. Our investment portfolio is reviewed each quarter 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 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 allow for any anticipated recovery in the market. We evaluate our intent and ability to hold securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, we do not have the intent to sell, nor is it more likely-than-not we will be required to sell these securities before we are able to recover the amortized cost basis.

5. ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY INFORMATION

Allowance for Loan Losses

We maintain an allowance for loan losses and charge losses to this allowance when such losses are realized. We established our allowance for loan losses in accordance with guidance provided in the SEC s Staff Accounting Bulletin 102 (SAB 102). The determination of the allowance for loan losses requires significant judgment reflecting our best estimate of impairment related to specifically identified impaired loans, as well as probable loan losses in the remaining loan portfolio. Our evaluation is based upon a continuing review of these portfolios. The following are included in our allowance for loan losses:

- Specific reserves for impaired loans
- Allowances for pools of homogenous loans based on historical net loss experience
- Adjustments for qualitative and environmental factors allocated to pools of homogenous loans
- Allowance for model estimation and complexity risk

Specific reserves are established for impaired loans where we have identified significant conditions or circumstances related to specific credits that indicate losses are probable. Unless loans are well-secured and collection is imminent, all loans that are 90 days past due are deemed impaired. Reserves for impaired loans are generally charged-off within 90 days of impairment recognition. Estimated losses are based on collateral values, estimates of future cash flows or market valuations. During the six months ended June 30, 2014, net charge-offs totaled $2.5 million or 0.17% of average loans annualized, compared to $6.3 million, or 0.45%, of average loans during the six months ended June 30, 2013. We charge loans off when they are deemed to be uncollectible.

Allowances for pooled homogeneous loans, that are not deemed impaired, are based on historical net loss experience. Estimated losses for pooled portfolios are determined differently for commercial loan pools and retail loan pools. Commercial loans are pooled into the following segments: Business Loans (Commercial and Industrial Loans), Commercial Real Estate Owner-Occupied, Commercial Real Estate Investor, and Construction Loans. Each pool is further segmented by internally assessed risk ratings. Loan losses for commercial loans are estimated by determining the probability of default and expected loss severity upon default. Probability of default is calculated based on the historical rate of migration to impaired status during the last 16 quarters. Loss severity is calculated as the actual loan losses (net of recoveries) on impaired loans in the respective pool during the same time frame. Retail loans are pooled into the following segments: residential mortgage loans, home equity secured loans, and all other consumer loans. Pooled reserves for retail loans are calculated based solely on the previous three year average net loss rate.

Qualitative and environmental adjustment factors are taken into consideration when determining the above reserve estimates or core reserves. These adjustment factors are based upon our evaluation of various current internal and external conditions and are allocated among loan types and take into consideration the following:

- Assessment of current underwriting policies, staff, and portfolio mix
- Internal trends of delinquency, nonaccrual and criticized loans by segment
- Assessment of risk rating accuracy, control and regulatory assessments/environment
- General economic conditions locally and nationally
- Market trends impacting collateral values
- Competitive environment as it could impact loan structure and underwriting

The above factors are based on their relative standing compared to the period which historic losses are used in core reserve estimates and current directional trends. Each individual qualitative and environmental factor in our model can add or subtract to core reserves. During the quarter ended June 30, 2014 the allowance methodology was updated to reflect a loss emergence period (LEP) of nine quarters based on the generally improving economic conditions. Industry and historical data indicates that the LEP lengthens in an improving economy as the length of time between an adverse financial event and subsequent loss is extended. In addition, a 10 basis point consideration was given to the C&I loan portfolio due to the assessment of qualitative factors on three lending relationships.

The final component of the allowance is a reserve for model estimation and complexity risk. The calculation of reserves is generally quantitative; however, qualitative estimates of valuations and risk assessment are necessary. We review the qualitative estimates of valuation factors quarterly and management uses its judgement to make adjustments based on current trends.

Our loan officers and risk managers meet at least quarterly to discuss and review the conditions and risks associated with individual problem loans. In addition, various regulatory agencies and loan review consultants periodically review our loan ratings and allowance for loan losses.

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The following tables provide the activity of our allowance for loan losses and loan balances for the three and six months ended June 30, 2014 and 2013:

	Commercial	Owner - Occupied Commercial	Commercial Mortgages	Construction	Residential	Consumer	Estimation/ Complexity Risk (1)	Total
				(in thousands)				
Three months ended June 30, 2014								
Allowance for loan losses								
Beginning balance	$ 12,404	$ 8,789	$ 7,363	$ 2,716	$ 2,765	$ 6,249	$ 1,042	$ 41,328
Charge-offs	(382)	(124)			(163)	(490)		(1,159)
Recoveries	483	161	2	177	25	314		1,162
Provision (credit)	841	(840)	252	(574)	132	226	13	50
Ending balance	$ 13,346	$ 7,986	$ 7,617	$ 2,319	$ 2,759	$ 6,299	$ 1,055	$ 41,381
Six months ended June 30, 2014								
Allowance for loan losses								
Beginning balance	$ 12,751	$ 7,638	$ 6,932	$ 3,326	$ 3,078	$ 6,494	$ 1,025	$ 41,244
Charge-offs	(1,495)	(321)	(160)	(88)	(527)	(1,723)		(4,314)
Recoveries	807	167	39	184	43	531		1,771
Provision (credit)	1,283	502	806	(1,103)	165	997	30	2,680
Ending balance	$ 13,346	$ 7,986	$ 7,617	$ 2,319	$ 2,759	$ 6,299	$ 1,055	$ 41,381
Period-end allowance allocated to:								
Loans individually evaluated for	$ 1,881	$ 1,157	$ 307	$	$ 872	$ 184	$	$ 4,401

impairment								
Loans collectively evaluated for impairment	11,465	6,829	7,310	2,319	1,887	6,115	1,055	36,980
Ending balance	$ 13,346	$ 7,986	$ 7,617	$ 2,319	$ 2,759	$ 6,299	$ 1,055	$ 41,381
Period-end loan balances evaluated for:								
Loans individually evaluated for impairment	$ 4,109	$ 4,928	$ 13,483	$	$ 17,743	$ 5,577	$	$ 45,840 (2)
Loans collectively evaluated for impairment	853,245	773,329	749,607	119,333	193,180	306,943		$ 2,995,637
Ending balance	$ 857,354	$ 778,257	$ 763,090	$ 119,333	$ 210,923	$ 312,520	$	$ 3,041,477 (3)

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	Commercial	Owner - Occupied Commercial	Commercial Mortgages	Construction	Residential	Consumer	Estimation/ Complexity Risk (1)	Total
				(in thousands)				
Three months ended June 30, 2013								
Allowance for loan losses								
Beginning balance	$ 12,768	$ 6,338	$ 7,193	$ 6,785	$ 3,281	$ 5,741	$ 842	$ 42,948
Charge-offs	(883)	(36)	(24)	(1,321)	(255)	(1,516)		(4,035)
Recoveries	401	33	106	70	23	268		901
Provision (credit)	681	1,714	(930)	(1,582)	181	1,644	(28)	1,680
Ending balance	$ 12,967	$ 8,049	$ 6,345	$ 3,952	$ 3,230	$ 6,137	$ 814	$ 41,494
Six months ended June 30, 2013								
Allowance for loan losses								
Beginning balance	$ 13,663	$ 6,108	$ 8,079	$ 6,456	$ 3,124	$ 5,631	$ 861	$ 43,922
Charge-offs	(1,139)	(37)	(1,721)	(1,340)	(695)	(2,810)		(7,742)
Recoveries	627	45	109	85	41	496		1,403
Provision (credit)	(184)	1,933	(122)	(1,249)	760	2,820	(47)	3,911
Ending balance	$ 12,967	$ 8,049	$ 6,345	$ 3,952	$ 3,230	$ 6,137	$ 814	$ 41,494
Period-end allowance allocated to:								
Loans individually evaluated for impairment	$ 2,171	$ 977	$ 1,995	$	$ 1,006	$ 12	$	$ 6,161
Loans collectively evaluated for impairment	10,796	7,072	4,350	3,952	2,224	6,125	814	35,333
Ending balance	$ 12,967	$ 8,049	$ 6,345	$ 3,952	$ 3,230	$ 6,137	$ 814	$ 41,494

Period-end loan balances evaluated for:								
Loans individually evaluated for impairment	$ 6,048	$ 12,681	$ 10,791	$ 646	$ 16,961	$ 4,925	$	$ 52,052 (2)
Loans collectively evaluated for impairment	733,581	755,261	677,442	124,892	216,755	280,314		2,788,245
Ending balance	$ 739,629	$ 767,942	$ 688,233	$ 125,538	$ 233,716	$ 285,239	$	$ 2,840,297 (3)

(1) Represents the portion of the allowance for loan losses established to account for the inherent complexity and uncertainty of estimates.

(2) The difference between this amount and nonaccruing loans at June 30, 2014, represents accruing troubled debt restructured (TDR) loans which are considered to be impaired loans.

(3) Ending loan balances do not include deferred costs.

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Nonaccrual and Past Due Loans

The following tables show our nonaccrual and past due loans at the dates indicated:

June 30, 2014 (In Thousands)	**30 59 Days Past Due and Still Accruing**	**60 89 Days Past Due and Still Accruing**	**Greater Than 90 Days Past Due and Still Accruing**	**Total Past Due And Still Accruing**	**Accruing Current Balances**	**Nonaccrual Loans**	**Total Loans**
Commercial	**$ 560**	**$**	**$**	**$ 560**	**$ 853,283**	**$ 3,511**	**$ 857,354**
Owner-Occupied commercial	**1,953**			**1,953**	**771,376**	**4,928**	**778,257**
Commercial mortgages					**749,699**	**13,391**	**763,090**
Construction					**119,333**		**119,333**
Residential	**2,395**	**41**		**2,436**	**200,002**	**8,485**	**210,923**
Consumer	**616**	**134**		**750**	**308,024**	**3,746**	**312,520**
Total	**$ 5,524**	**$ 175**	**$**	**$ 5,699**	**$ 3,001,717**	**$ 34,061**	**$ 3,041,477**
% of Total Loans	**0.18%**	**0.01%**	**%**	**0.19%**	**98.69%**	**1.12%**	**100%**

December 31, 2013 (In Thousands)	30 59 Days Past Due and Still Accruing	60 89 Days Past Due and Still Accruing	Greater Than 90 Days Past Due and Still Accruing	Total Past Due And Still Accruing	Accruing Current Balances	Nonaccrual Loans	Total Loans
Commercial	$ 1,447	$	$	$ 1,447	$ 805,132	$ 4,303	$ 810,882
Owner-Occupied commercial	538			538	780,625	5,197	786,360
Commercial mortgages	83	1,049		1,132	715,496	8,565	725,193
Construction					104,916	1,158	106,074
Residential	1,952	1,348	533	3,833	209,255	8,432	221,520
Consumer	1,095	177		1,272	297,669	3,293	302,234
Total	$ 5,115	$ 2,574	$ 533	$ 8,222	$ 2,913,093	$ 30,948	$ 2,952,263
% of Total Loans	0.17%	0.09%	0.02%	0.28%	98.67%	1.05%	100%

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Impaired Loans

The following tables provide an analysis of our impaired loans at June 30, 2014 and December 31, 2013:

June 30, 2014 (In Thousands)	**Ending Loan Balances**	**Loans with No Specific Reserve (1)**	**Loans with Specific Reserve**	**Related Specific Reserve**	**Contractual Principal Balances**	**Average Loan Balances**
Commercial	**$ 4,109**	**$ 1,592**	**$ 2,517**	**$ 1,881**	**$ 5,131**	**$ 5,115**
Owner-Occupied commercial	**4,928**	**2,615**	**2,313**	**1,157**	**5,718**	**8,338**
Commercial mortgages	**13,483**	**8,210**	**5,273**	**307**	**18,268**	**11,523**
Construction						**630**
Residential	**17,743**	**10,090**	**7,653**	**872**	**20,220**	**17,666**
Consumer	**5,577**	**4,399**	**1,178**	**184**	**6,348**	**5,170**
Total	**$ 45,840**	**$ 26,906**	**$ 18,934**	**$ 4,401**	**$ 55,685**	**$ 48,442**

December 31, 2013 (In Thousands)	Ending Loan Balances	Loans with No Specific Reserve (1)	Loans with Specific Reserve	Related Specific Reserve	Contractual Principal Balances	Average Loan Balances
Commercial	$ 5,003	$ 2,362	$ 2,641	$ 1,781	$ 13,013	$ 5,347
Owner-Occupied commercial	5,197	5,184	12	12	8,293	11,542
Commercial mortgages	8,661	2,784	5,877	1,987	16,566	10,444
Construction	1,158	1,158			1,563	968
Residential	17,852	9,750	8,103	989	20,153	18,047
Consumer	5,411	4,767	644	134	6,056	5,455
Total	$ 43,282	$ 26,005	$ 17,277	$ 4,903	$ 65,644	$ 51,803

(1) Reflects loan balances at or written down to their remaining book balance.

Interest income of $393,000 and $747,000 was recognized on impaired loans during the three and six months ended June 30, 2014, respectively. Interest income of $235,000 and $473,000 was recognized on impaired loans during the three and six months ended June 30, 2013, respectively.

Credit Quality Indicators

Below is a description of each of our risk ratings for all commercial loans:

Pass. These borrowers presently show no current or potential problems and their loans are considered fully collectible.

Special Mention. Borrowers have potential weaknesses that deserve management s close attention. Borrowers in this category may be experiencing adverse operating trends, for example, declining revenues or margins, high leverage, tight liquidity, or increasing inventory without increasing sales. These adverse trends can have a potential negative effect on the borrower s repayment capacity. These assets are not adversely classified and do not expose the Bank to significant risk that would warrant a more severe rating. Borrowers in this category may also be experiencing significant management problems, pending litigation, or other structural credit weaknesses.

Substandard. Borrowers have well-defined weaknesses that require extensive oversight by management. Borrowers in this category may exhibit one or more of the following: inadequate debt service coverage, unprofitable operations, insufficient liquidity, high leverage, and weak or inadequate capitalization. Relationships in this category are not adequately protected by the sound financial worth and paying capacity of the obligor or the collateral pledged on the loan, if any. The distinct possibility exists that the Bank will sustain some loss if the deficiencies are not corrected.

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Doubtful. Borrowers have well-defined weaknesses inherent in the Substandard category with the added characteristic that the possibility of loss is extremely high. Current circumstances in the credit relationship make collection or liquidation in full highly questionable. A doubtful asset has some pending event that may strengthen the asset that defers the loss classification. Such impending events include: perfecting liens on additional collateral, obtaining collateral valuations, an acquisition or liquidation preceding, proposed merger, or refinancing plan.

Loss. Borrowers are uncollectible or of such negligible value that continuance as a bankable asset is not supportable. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical to defer writing off this asset even though partial recovery may be recognized sometime in the future.

Residential and Consumer Loans

The residential and consumer loan portfolios are monitored on an ongoing basis using delinquency information and loan type as credit quality indicators. These credit quality indicators are assessed in the aggregate in these relatively homogeneous portfolios. Loans that are greater than 90 days past due are generally considered nonperforming and placed on nonaccrual status.

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The following tables provide an analysis of loans by credit risk profile using internally assigned risk ratings, as of June 30, 2014 and December 31, 2013

	Commercial		Owner-Occupied Commercial		Commercial Mortgages		Construction		Total Commercial		
	June 30, 2014	Dec. 31 2013	**June 30, 2014**	Dec. 31 2013	**June 30, 2014**	Dec. 31 2013	**June 30, 2014**	Dec. 31 2013	**June 30, 2014** Amount	%	Decemb 201 Amount
g:											
d:	**$ 10,037**	$ 12,566	**$ 7,186**	$ 4,747	**$ 9,249**	$ 2,092	**$ 300**	$ 226	**$ 26,772**		$ 19,631
	63,462	56,806	**45,524**	45,181	**13,881**	8,146	**2,130**	3,599	**124,997**		113,732
l	**1,592**	2,362	**2,615**	5,185	**8,210**	2,784		1,158	**12,417**		11,489
l	**2,517**	2,641	**2,313**	12	**5,273**	5,877			**10,103**		8,530
al d ful	**77,608**	74,375	**57,638**	55,125	**36,613**	18,899	**2,430**	4,983	**174,289**	**7%**	153,382
	779,746	736,507	**720,619**	731,235	**726,477**	706,294	**116,903**	101,091	**2,343,745**	**93%**	2,275,127
al	**$ 857,354**	$ 810,882	**$ 778,257**	$ 786,360	**$ 763,090**	$ 725,193	**$ 119,333**	$ 106,074	**$ 2,518,034**	**100%**	$ 2,428,509

Consumer credit exposure credit risk profile based on payment activity:

	Residential		Consumer		Total Residential and Consumer			
(in thousands)	**June 30, 2014**	Dec. 31 2013	**June 30, 2014**	Dec. 31 2013	**June 30, 2014 Amount**	Percent	December 31, 2013 Amount	Percent
Nonperforming (1)	**$ 17,743**	$ 17,852	**$ 5,577**	$ 5,411	**$ 23,320**	**4%**	$ 23,263	4 %
Performing	**193,180**	203,668	**306,943**	296,823	**500,123**	**96%**	500,491	96
Total	**$ 210,923**	$ 221,520	**$ 312,520**	$ 302,234	**$ 523,443**	**100%**	$ 523,754	100 %

(1) Includes $11.1 million as of June 30, 2014 and $11.5 million as of December 31, 2013 of troubled debt restructured mortgages and home equity installment loans that are performing in accordance with modified terms and are accruing interest.

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Troubled Debt Restructurings (TDR)

The balance of TDRs at June 30, 2014 and December 31, 2013 was $26.2 million and $27.6 million, respectively. The balance at June 30, 2014 included approximately $14.4 million in nonaccrual status and $11.8 million in accrual status compared to $15.3 million in nonaccrual status and $12.3 million in accrual status at December 31, 2013. Approximately $2.3 million and $4.1million in related reserves have been established for these loans at June 30, 2014 and December 31, 2013, respectively.

A modification is classified as a TDR if both of the following exist: (1) the borrower is experiencing financial difficulty and (2) the Bank has granted a concession to the borrower. Many aspects of the borrower s financial situation are assessed when determining whether they are experiencing financial difficulty. Concessions may include the reduction of an interest rate at a rate lower than current market rate for a new loan with similar risk, extension of the maturity date, reduction of accrued interest, or principal forgiveness. The assessments of whether a borrower is experiencing (or is likely to experience) financial difficulty and whether a concession has been granted is subjective in nature and management s judgment is required when determining whether a modification is a TDR.

During the six months ended June 30, 2014, the terms of 13 loans were modified in TDRs, Comprising of one commercial loan with the remaining being residential and consumer loans. Our concessions on restructured loans consisted mainly of forbearance agreements, reduction in interest rates or extensions of maturities. Principal balances are generally not forgiven by us when a loan is modified as a TDR. Nonaccruing restructured loans remain in nonaccrual status until there has been a period of sustained repayment performance, typically six months.

The following table presents loans identified as TDRs during the six months ended June 30, 2014 and 2013:

(In Thousands)	**Three Months Ended June 30, 2014**	Three Months Ended June 30, 2013	**Six Months Ended June 30, 2014**	Six Months Ended June 30, 2013
Commercial	**$ 121**	$ 24	**$ 121**	$ 24
Commercial mortgages		826		