FIRST MID ILLINOIS BANCSHARES INC
Form 10-Q
August 07, 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 June 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 0-13368

FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware	37-1103704
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

1421 Charleston Avenue,	
Mattoon, Illinois	61938
(Address of principal executive offices)	(Zip code)

(217) 234-7454
(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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, 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. (Check one):

Large accelerated filer [ ]	Accelerated filer [X]

Non-accelerated filer [ ] Smaller reporting company [ ]
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). [ ] Yes [X] No

As of August 7, 2013, 5,953,369 common shares, $4.00 par value, were outstanding.

PART I

ITEM 1. FINANCIAL STATEMENTS
First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except share data)

	(Unaudited) June 30, 2013	December 31, 2012
Assets		
Cash and due from banks:		
Non-interest bearing	$29,773	$38,110
Interest bearing	1,594	24,103
Federal funds sold	498	20,499
Cash and cash equivalents	31,865	82,712
Certificates of deposit investments	1,992	6,665
Investment securities:		
Available-for-sale, at fair value	533,835	508,309
Loans held for sale	2,068	212
Loans	913,745	910,853
Less allowance for loan losses	(12,131)	(11,776)
Net loans	901,614	899,077
Interest receivable	5,986	6,775
Other real estate owned	1,003	1,187
Premises and equipment, net	29,094	29,670
Goodwill, net	25,753	25,753
Intangible assets, net	2,820	3,161
Other assets	19,085	14,511
Total assets	$1,555,115	$1,578,032
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	$231,526	$263,838
Interest bearing	1,039,608	1,010,227
Total deposits	1,271,134	1,274,065
Securities sold under agreements to repurchase	94,694	113,484
Interest payable	271	341
FHLB borrowings	12,500	5,000
Junior subordinated debentures	20,620	20,620
Other liabilities	6,949	7,835
Total liabilities	1,406,168	1,421,345
Stockholders' Equity:		
Convertible preferred stock, no par value; authorized 1,000,000 shares; issued 10,427 shares in 2013 and 2012	52,035	52,035
Common stock, $4 par value; authorized 18,000,000 shares; issued 7,734,257 shares in 2013 and 7,682,535 shares in 2012	30,937	30,730
Additional paid-in capital	32,809	31,685
Retained earnings	82,723	78,986
Deferred compensation	2,824	2,953
Accumulated other comprehensive income (loss)	(6,549)	4,544
	(45,832)	(44,246)

Less treasury stock at cost, 1,779,291 shares in 2013 and 1,711,646 shares in 2012		
Total stockholders’ equity	148,947	156,687
Total liabilities and stockholders’ equity	$1,555,115	$1,578,032

See accompanying notes to unaudited condensed consolidated financial statements.

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First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Income (unaudited)

(In thousands, except per share data)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Interest income:				
Interest and fees on loans	$10,390	$10,910	$20,825	$21,870
Interest on investment securities	2,798	3,003	5,539	5,955
Interest on certificates of deposit investments	5	16	13	34
Interest on federal funds sold	2	16	6	28
Interest on deposits with other financial institutions	11	13	25	19
Total interest income	13,206	13,958	26,408	27,906
Interest expense:				
Interest on deposits	664	1,303	1,460	2,730
Interest on securities sold under agreements to repurchase	10	30	25	75
Interest on FHLB borrowings	59	65	116	178
Interest on other borrowings	1	162	1	326
Interest on subordinated debentures	131	140	261	286
Total interest expense	865	1,700	1,863	3,595
Net interest income	12,341	12,258	24,545	24,311
Provision for loan losses	252	416	732	1,031
Net interest income after provision for loan losses	12,089	11,842	23,813	23,280
Other income:				
Trust revenues	806	752	1,699	1,612
Brokerage commissions	218	168	389	310
Insurance commissions	410	437	896	1,084
Service charges	1,215	1,188	2,355	2,289
Securities gains, net	482	439	835	823
Mortgage banking revenue, net	305	327	591	563
ATM / debit card revenue	947	812	1,830	1,691
Other	331	374	669	705
Total other income	4,714	4,497	9,264	9,077
Other expense:				
Salaries and employee benefits	5,972	5,850	11,769	11,523
Net occupancy and equipment expense	2,102	2,004	4,145	4,014
Net other real estate owned expense	46	235	162	298
FDIC insurance	213	229	435	463
Amortization of intangible assets	171	179	341	424
Stationery and supplies	121	141	262	311
Legal and professional	614	497	1,162	1,108
Marketing and donations	264	322	507	551
Other	1,415	1,325	2,747	2,707
Total other expense	10,918	10,782	21,530	21,399
Income before income taxes	5,885	5,557	11,547	10,958
Income taxes	2,220	2,078	4,354	4,089
Net income	3,665	3,479	7,193	6,869
Dividends on preferred shares	1,105	1,105	2,209	2,044
Net income available to common stockholders	$2,560	$2,374	$4,984	$4,825
Per share data:				

Basic net income per common share available to common stockholders	0.43	0.39	$0.84	$0.80
Diluted net income per common share available to common stockholders	0.43	0.39	$0.84	$0.80
Cash dividends declared per common share	0.21	0.21	$0.21	$0.21

See accompanying notes to unaudited condensed consolidated financial statements.

First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited)

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income	$3,665	$3,479	$7,193	$6,869
Other Comprehensive Income (Loss)				
Unrealized gains (losses) on available-for-sale securities, net of taxes of $6,061 and $(561) for three months ended June 30, 2013 and 2012, respectively and $6,761 and $(730) for six months ended June 30 2013 and 2012, respectively.	(9,488)	878	(10,584)	1,144
Less: reclassification adjustment for realized gains included in net income net of taxes of $188 and $171 for three months ended June 30, 2013 and 2012, respectively and $326 and $321 for six months ended June 30, 2013 and 2012, respectively.	(294)	(268)	(509)	(502)
Unrealized gains on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income, net of taxes of $0 and $2 for three months ended June 30, 2013 and 2012, respectively and $0 for six months ended June 30, 2013 and 2012, respectively.	—	4	—	—
Other comprehensive income (loss), net of taxes	(9,782)	614	(11,093)	642
Comprehensive income (loss)	$(6,117)	$4,093	$(3,900)	$7,511

See accompanying notes to unaudited condensed consolidated financial statements.

First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Cash Flows (unaudited)	Six months ended June 30,	
(In thousands)	2013	2012
Cash flows from operating activities:		
Net income	$7,193	$6,869
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	732	1,031
Depreciation, amortization and accretion, net	2,475	2,751
Stock-based compensation expense	168	111
Gains on investment securities, net	(835)	(823)
Losses on sales of other real property owned, net	59	156
Loss on write down of fixed assets	24	11
Gains on sale of loans held for sale, net	(571)	(527)
Decrease in accrued interest receivable	789	983
Decrease in accrued interest payable	(70)	(88)
Origination of loans held for sale	(41,351)	(37,885)
Proceeds from sale of loans held for sale	40,066	37,973
(Increase) decrease in other assets	2,589	(459)
Decrease in other liabilities	(975)	(986)
Net cash provided by operating activities	10,293	9,117
Cash flows from investing activities:		
Proceeds from maturities of certificates of deposit investments	4,673	6,416
Purchases of certificates of deposit investments	—	(4,922)
Proceeds from sales of securities available-for-sale	29,112	27,622
Proceeds from maturities of securities available-for-sale	103,833	147,636
Purchases of securities available-for-sale	(176,694)	(205,549)
Net (increase) decrease in loans	(3,934)	13,892
Purchases of premises and equipment	(679)	(893)
Proceeds from sales of other real property owned	790	2,200
Net cash used in investing activities	(42,899)	(13,598)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(2,931)	63,066
Decrease in repurchase agreements	(18,790)	(14,350)
Proceeds from short-term FHLB advances	10,000	—
Repayment of short-term FHLB advances	(2,500)	—
Repayment of long-term FHLB advances		(10,000)
Repayment of other borrowings	—	(8,250)
Proceeds from issuance of common stock	529	545
Proceeds from issuance of preferred stock	—	8,250
Purchase of treasury stock	(1,593)	(911)
Dividends paid on preferred stock	(2,026)	(1,766)
Dividends paid on common stock	(930)	(1,894)
Net cash (used in) provided by financing activities	(18,241)	34,690
Increase (decrease) in cash and cash equivalents	(50,847)	30,209
Cash and cash equivalents at beginning of period	82,712	73,102
Cash and cash equivalents at end of period	$31,865	$103,311

First Mid-Illinois Bancshares, Inc.	Six months ended June 30,	
	2013	2012
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$1,933	$3,683
Income taxes	5,407	6,378
Supplemental disclosures of noncash investing and financing activities		
Loans transferred to other real estate owned	665	545
Dividends reinvested in common stock	—	743
Net tax benefit related to option and deferred compensation plans	101	79

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 -- Basis of Accounting and Consolidation

The unaudited condensed consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. (“Company”) and its wholly-owned subsidiaries: First Mid-Illinois Bank & Trust, N.A. (“First Mid Bank”), Mid-Illinois Data Services, Inc. (“MIDS”) and The Checkley Agency, Inc. doing business as First Mid Insurance Group (“First Mid Insurance”). All significant intercompany balances and transactions have been eliminated in consolidation. The financial information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods ended June 30, 2013 and 2012, and all such adjustments are of a normal recurring nature. Certain amounts in the prior year’s consolidated financial statements have been reclassified to conform to the June 30, 2013 presentation and there was no impact on net income or stockholders’ equity. The results of the interim period ended June 30, 2013 are not necessarily indicative of the results expected for the year ending December 31, 2013. The Company operates as a one-segment entity for financial reporting purposes.

The 2012 year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements and related footnote disclosures although the Company believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2012 Annual Report on Form 10-K.

Website

The Company maintains a website at www.firstmid.com. All periodic and current reports of the Company and amendments to these reports filed with the Securities and Exchange Commission (“SEC”) can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

Stock Plans

At the Annual Meeting of Stockholders held May 23, 2007, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2007 Stock Incentive Plan (“SI Plan”). The SI Plan was implemented to succeed the Company’s 1997 Stock Incentive Plan, which had a ten-year term that expired October 21, 2007. The SI Plan is intended to provide a means whereby directors, employees, consultants and advisors of the Company and its subsidiaries may sustain a sense of proprietorship and personal involvement in the continued development and financial success of the Company and its subsidiaries, thereby advancing the interests of the Company and its stockholders. Accordingly, directors and selected employees, consultants and advisors may be provided the opportunity to acquire shares of common stock of the Company on the terms and conditions established in the SI Plan.

On September 27, 2011, the Board of Directors passed a resolution relating to the SI Plan whereby they authorized and approved the Executive Long-Term Incentive Plan (“LTIP”). The LTIP was implemented to provide methodology for granting Stock Awards and Stock Unit Awards to select senior executives of the Company or any Subsidiary.

A maximum of 300,000 shares of common stock may be issued under the SI Plan. As of June 30, 2013, the Company had awarded 59,500 shares as stock options under the SI plan. There were no stock options awarded in 2013 or 2012.

The Company awarded 16,182 shares and 15,162 shares during 2013 and 2012, respectively, as 50% Stock Awards and 50% Stock Unit Awards under the SI plan.

Convertible Preferred Stock

Series B Convertible Preferred Stock. During 2009, the Company sold to certain accredited investors including directors, executive officers, and certain major customers and holders of the Company's common stock, $24,635,000, in the aggregate, of a newly authorized series of its preferred stock designated as Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock (the "Series B Preferred Stock"). The Series B Preferred Stock had an issue price of $5,000 per share and no par value per share. The Series B Preferred Stock was issued in a private placement exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

The Series B Preferred Stock pays non-cumulative dividends semiannually in arrears, when, as and if authorized by the Board of Directors of the Company, at a rate of 9% per year. Holders of the Series B Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the Series B Preferred Stock and certain other matters. In addition, if dividends on the Series B Preferred Stock are not paid in full for four dividend periods, whether consecutive or not, the holders of the Series B Preferred Stock, acting as a class with any other of the Company's securities having similar voting rights, will have the right to elect two directors to the Company's Board of Directors. The terms of office of these directors will end when the Company has paid or set aside for payment full semi-annual dividends for four consecutive dividend periods.

Each share of the Series B Preferred Stock may be converted at any time at the option of the holder into shares of the Company's common stock. The number of shares of common stock into which each share of the Series B Preferred Stock is convertible is the $5,000 liquidation preference per share divided by the Conversion Price initially set at $21.94. The Conversion Price is subject to adjustment from time to time pursuant to the terms of the Certificate of Designation (the "Series B Certificate of Designation"). If at the time of conversion, there are any authorized, declared and unpaid dividends with respect to a converted share of Series B Preferred Stock, the holder will receive cash in lieu of the dividends, and a holder will receive cash in lieu of fractional shares of common stock following conversion.

After November 16, 2014, the Company may, at its option but subject to the Company's receipt of any required prior approvals from the Board of Governors of the Federal Reserve System or any other regulatory authority, redeem the Series B Preferred Stock. Any redemption will be in exchange for cash in the amount of $5,000 per share, plus any authorized, declared and unpaid dividends, without accumulation of any undeclared dividends.

The Company also has the right at any time on or after November 16, 2014 to require the conversion of all (but not less than all) of the Series B Preferred Stock into shares of common stock if, on the date notice of mandatory conversion is given to holders, the book value of the Company's common stock equals or exceeds 115% of the book value of the Company's common stock at September 30, 2008. "Book value of the Company's common stock" at any date means the result of dividing the Company's total common stockholders' equity at that date, determined in accordance with U.S. generally accepted accounting principles, by the number of shares of common stock then outstanding, net of any shares held in the treasury. The book value of the Company's common stock at September 30, 2008 was $13.03, and 115% of this amount is approximately $14.98. The book value of the Company's common stock at June 30, 2013 was $16.27.

Pursuant to Section 3(j) of the Series B Certification of Designation, the conversion price for the Series B Preferred Stock, which was initially set at $21.94, was required to be adjusted if, among other things, the initial conversion price of any subsequently issued series of preferred stock was lower than the then current conversion price of the Series B Preferred Stock. As a result of the Series C Preferred Stock (see below) having an initial conversion price of less than $21.94, the conversion price of the Series B Preferred Stock was adjusted pursuant to the terms of the Series B Certificate of Designation based on the amount of Series C Preferred Stock sold on February 11, 2011, March 2, 2011, May 13, 2011 and June 28, 2012. The new conversion price of the Series B Preferred Stock, certified by the Company's accountant pursuant to Section 3(j) of the Series B Certificate of Designation, is $21.62.

Series C Convertible Preferred Stock. On February 11, 2011, the Company accepted from certain accredited investors, including directors, executive officers, and certain major customers and holders of the Company's common stock (collectively, the "Investors"), subscriptions for the purchase of $27,500,000, in the aggregate, of a newly authorized series of preferred stock designated as Series C 8% Non-Cumulative Perpetual Convertible Preferred Stock (the "Series C Preferred Stock"). As of February 11, 2011, $11,010,000 of the Series C Preferred Stock had been issued and sold by the Company to certain Investors. On March 2, 2011, three investors subsequently completed the required bank regulatory process and an additional $2,750,000 of Series C Preferred Stock was issued and sold by the

Company to these investors. On May 13, 2011, four additional investors received the required bank regulatory approval and an additional $5,490,000 of Series C Preferred Stock was issued and sold by the Company to these investors. On June 28, 2012, the final $8,250,000 of the Company's Series C Preferred Stock was issued and sold by the Company to Investors following their receipt of the required bank regulatory approval, for a total of $27,500,000 of outstanding Series C Preferred Stock. All of the Series C Preferred Stock subscribed for by investors has been issued.

The Series C Preferred Stock has an issue price of $5,000 per share and no par value per share. The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

The Series C Preferred Stock pays non-cumulative dividends semiannually in arrears, when, as and if authorized by the Board of Directors of the Company, at a rate of 8% per year. Holders of the Series C Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the Series C Preferred Stock and certain other matters. In addition, if dividends on the Series C Preferred Stock are not paid in full for four dividend periods, whether consecutive or not, the holders of the Series C Preferred Stock, acting as a class with any other of the Company's securities having similar voting rights, including the Company's Series B Preferred Stock, will have the right to elect two directors to the Company's Board of Directors. The terms of office of these directors will end when the Company has paid or set aside for payment full semi-annual dividends for four consecutive dividend periods.

Each share of the Series C Preferred Stock may be converted at any time at the option of the holder into shares of the Company's common stock. The number of shares of common stock into which each share of the Series C Preferred Stock is convertible is the $5,000 liquidation preference per share divided by the Conversion Price of $20.29. The Conversion Price is subject to adjustment from time to time pursuant to the terms of the Series C Certificate of Designation. If at the time of conversion, there are any authorized, declared and unpaid dividends with respect to a converted share of Series C Preferred Stock, the holder will receive cash in lieu of the dividends, and a holder will receive cash in lieu of fractional shares of common stock following conversion.

After May 13, 2016 the Company may, at its option but subject to the Company's receipt of any required prior approvals from the Board of Governors of the Federal Reserve System or any other regulatory authority, redeem the Series C Preferred Stock. Any redemption will be in exchange for cash in the amount of $5,000 per share, plus any authorized, declared and unpaid dividends, without accumulation of any undeclared dividends.

The Company also has the right at any time after May 13, 2016 to require the conversion of all (but not less than all) of the Series C Preferred Stock into shares of common stock if, on the date notice of mandatory conversion is given to holders, (a) the tangible book value per share of the Company's common stock equals or exceeds 115% of the tangible book value per share of the Company's common stock at December 31, 2010, and (b) the NASDAQ Bank Index (denoted by CBNK:IND) equals or exceeds 115% of the NASDAQ Bank Index at December 31, 2010. "Tangible book value per share of our common stock" at any date means the result of dividing the Company's total common stockholders equity at that date, less the amount of goodwill and intangible assets, determined in accordance with U.S. generally accepted accounting principles, by the number of shares of common stock then outstanding, net of any shares held in the treasury. The tangible book value of the Company's common stock at December 31, 2010 was $9.38, and 115% of this amount is approximately $10.79. The NASDAQ Bank Index value at December 31, 2010 was 1,847.35 and 115% of this amount is approximately 2,124.45. The tangible book value of the Company's common stock at June 30, 2013 was $11.48 and the NASDAQ Bank Index value at June 30, 2013 was 2,211.39.

Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income included in stockholders' equity as of June 30, 2013 and December 31, 2012 are as follows (in thousands):

	Unrealized Gain (Loss) on Available for Sale Securities	Securities with Other-Than-Temporary Impairment Losses	Total
June 30, 2013			
Net unrealized losses on securities available-for-sale	$(6,778)	$ —	$(6,778)
Securities with other-than-temporary impairment losses	—	(3,955)	(3,955)
Tax benefit	2,642	1,542	4,184
Balance at June 30, 2013	$(4,136)	$ (2,413)	$(6,549)

December 31, 2012			
Net unrealized gains on securities available-for-sale	$11,836	$—	$11,836
Securities with other-than-temporary impairment losses	—	(4,389)	(4,389)
Tax benefit (expense)	(4,614)	1,711	(2,903)
Balance at December 31, 2012	$7,222	$(2,678)	$4,544

Amounts reclassified from accumulated other comprehensive income and the affected line items in the statements of income during the six months ended June 30, 2013 and 2012, were as follows (in thousands):

	Amounts Reclassified from Other Comprehensive Income		Affected Line Item in the Statements of Income
	2013	2012	
Unrealized gains on available-for-sale securities	$835	$823	Securities gains, net
			(Total reclassified amount before tax)
	(326)	(321)	Tax expense
Total reclassifications out of accumulated other comprehensive income	$509	$502	Net reclassified amount

See “Note 3 – Investment Securities” for more detailed information regarding unrealized losses on available-for-sale securities.

Adoption of New Accounting Guidance

ASU 2013-02 - Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. In February 2013, the FASB issued ASU 2013-02 which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments were effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of this guidance did not have a material impact on the Company’s financial statements.

Note 2 -- Earnings Per Share

Basic net income per common share available to common stockholders is calculated as net income less preferred stock dividends divided by the weighted average number of common shares outstanding. Diluted net income per common share available to common stockholders is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company's convertible preferred stock and the Company's stock options, unless anti-dilutive.

The components of basic and diluted net income per common share available to common stockholders for the three and six-month periods ended June 30, 2013 and 2012 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Basic Net Income per Common Share Available to Common Stockholders:				
Net income	$3,665,000	$3,479,000	$7,193,000	$6,869,000
Preferred stock dividends	(1,105,000)	(1,105,000)	(2,209,000)	(2,044,000)
Net income available to common stockholders	$2,560,000	$2,374,000	$4,984,000	$4,825,000
Weighted average common shares outstanding	5,951,981	6,025,802	5,953,623	6,022,830
Basic earnings per common share	$0.43	$0.39	$0.84	$0.80
Diluted Net Income per Common Share Available to Common Stockholders:				
Net income available to common stockholders	$2,560,000	$2,374,000	$4,984,000	$4,825,000
Effect of assumed preferred stock conversion	—		—	—
Net income applicable to diluted earnings per share	$2,560,000	$2,374,000	$4,984,000	$4,825,000
Weighted average common shares outstanding	5,951,981	6,025,802	5,953,623	6,022,830
Dilutive potential common shares:				
Assumed conversion of stock options	1,118	8,826	1,124	8,504
Restricted stock awarded	9,027	413	9,027	331
Assumed conversion of preferred stock	—	—	—	—
Dilutive potential common shares	10,145	9,239	10,151	8,835
Diluted weighted average common shares outstanding	5,962,126	6,035,041	5,963,774	6,031,665
Diluted earnings per common share	$0.43	$0.39	$0.84	$0.80

The following shares were not considered in computing diluted earnings per share for the three and six-month periods ended June 30, 2013 and 2012 because they were anti-dilutive:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Stock options to purchase shares of common stock	104,750	196,220	104,750	196,220
Average dilutive potential common shares associated with convertible preferred stock	2,494,801	2,092,411	2,494,801	2,087,943

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Note 3 -- Investment Securities

The amortized cost, gross unrealized gains and losses and estimated fair values for available-for-sale and held-to-maturity securities by major security type at June 30, 2013 and December 31, 2012 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
June 30, 2013				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$213,347	$229	$(6,059)	$207,517
Obligations of states and political subdivisions	59,933	1,157	(1,697)	59,393
Mortgage-backed securities: GSE residential	260,463	3,129	(3,545)	260,047
Trust preferred securities	4,790	—	(3,955)	835
Other securities	6,035	26	(18)	6,043
Total available-for-sale	$544,568	$4,541	$(15,274)	$533,835
December 31, 2012				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$180,851	$1,321	$(3)	$182,169
Obligations of states and political subdivisions	53,064	3,163	(20)	56,207
Mortgage-backed securities: GSE residential	252,310	7,162	(12)	259,460
Trust preferred securities	4,974	—	(4,389)	585
Other securities	9,663	225	—	9,888
Total available-for-sale	$500,862	$11,871	$(4,424)	$508,309

The trust preferred securities are three trust preferred pooled securities issued by First Tennessee Financial (“FTN”). The unrealized losses of these securities, which have maturities ranging from seventeen years to twenty-four years, are primarily due to their long-term nature, a lack of demand or inactive market for these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities. See the heading “Trust Preferred Securities” for further information regarding these securities.

Realized gains and losses resulting from sales of securities were as follows during the six months ended June 30, 2013 and 2012 (in thousands):

	June 30, 2013	June 30, 2012
Gross gains	$835	$823
Gross losses	—	—

The following table indicates the expected maturities of investment securities classified as available-for-sale and held-to-maturity, presented at fair value, at June 30, 2013 and the weighted average yield for each range of maturities (dollars in thousands):

	One year or less	After 1 through 5 years	After 5 through 10 years	After ten years	Total
Available-for-sale:					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$151,994	$55,523	$—	$—	$207,517
Obligations of state and political subdivisions	1,528	29,344	24,901	3,620	59,393
Mortgage-backed securities: GSE residential	2,457	167,575	90,015	—	260,047
Trust preferred securities	688	—	—	147	835
Other securities	2,008	—	3,982	53	6,043
Total investments	$158,675	$252,442	$118,898	$3,820	$533,835
Weighted average yield	1.68 %	2.62 %	2.40 %	2.11 %	2.28 %
Full tax-equivalent yield	1.71 %	2.94 %	2.92 %	3.11 %	2.57 %

The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent yields have been calculated using a 35% tax rate. With the exception of obligations of the U.S. Treasury and other U.S. government agencies and corporations, there were no investment securities of any single issuer, the book value of which exceeded 10% of stockholders' equity at June 30, 2013.

Investment securities carried at approximately $250 million and $267 million at June 30, 2013 and December 31, 2012, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

The following table presents the aging of gross unrealized losses and fair value by investment category as of June 30, 2013 and December 31, 2012 (in thousands):

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2013						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$184,589	$(6,059)	$—	$—	$184,589	$(6,059)
Obligations of states and political subdivisions	27,264	(1,697)	—	—	27,264	(1,697)
Mortgage-backed securities: GSE residential	131,451	(3,545)	—	—	131,451	(3,545)
Trust preferred securities	—	—	835	(3,955)	835	(3,955)
Other securities	3,982	(18)	—	—	3,982	(18)
Total	$347,286	$(11,319)	$835	$(3,955)	$348,121	$(15,274)
December 31, 2012						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$10,997	$(3)	$—	$—	$10,997	$(3)
Obligations of states and political subdivisions	1,969	(20)	—	—	1,969	(20)
Mortgage-backed securities: GSE residential	697	(12)	—	—	697	(12)
Trust preferred securities	—	—	585	(4,389)	585	(4,389)
Other securities	—	—	—	—	—	—
Total	$13,663	$(35)	$585	$(4,389)	$14,248	$(4,424)

U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies. At June 30, 2013 and December 31, 2012, there were no U.S. Treasury securities and obligations of U.S. government corporations and agencies in a continuous unrealized loss position for twelve months or more.

Obligations of states and political subdivisions. At June 30, 2013 and December 31, 2012, there were no obligations of states and political subdivisions in a continuous unrealized loss position for twelve months or more.

Mortgage-backed Securities: GSE Residential. At June 30, 2013 and December 31, 2012, there were no mortgage-backed securities in a continuous unrealized loss position for twelve months or more.

Trust Preferred Securities. At June 30, 2013, there were three trust preferred securities with a fair value of $835,000 and unrealized losses of $3,955,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2012, there were three trust preferred securities with a fair value of $585,000 and unrealized losses of $4,389,000 in a continuous unrealized loss position for twelve months or more. These unrealized losses were primarily due to the long-term nature of the trust preferred securities, a lack of demand or inactive market for these securities, the impending change to the regulatory treatment of these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities. The Company recorded no other-than-temporary impairment (OTTI) for these securities during 2013 or 2012. Because it is not more-likely-than-not that the Company will be required to sell these securities before recovery of their new, lower amortized cost basis, which may be maturity, the Company does not consider the remainder of the investment in these securities to be other-than-temporarily impaired at June 30, 2013. However, future downgrades or additional deferrals and defaults in these securities, in particular PreTSL XXVIII, could result in additional OTTI and consequently, have a material impact on future earnings.

Following are the details for each of the three currently impaired trust preferred securities (in thousands):

	Book Value	Market Value	Unrealized Gains (Losses)	Other-than-temporary Impairment Recorded To-date
PreTSL I	$400	$428	$28	$691
PreTSL II	738	260	(478)	2,187
PreTSL XXVIII	3,652	147	(3,505)	1,111
Total	$4,790	$835	$(3,955)	$3,989

Other securities. At June 30, 2013 and December 31, 2012, there were no corporate bonds in a continuous unrealized loss position for twelve months or more.

The Company does not believe any other individual unrealized loss as of June 30, 2013 represents OTTI. However, given the continued disruption in the financial markets, the Company may be required to recognize OTTI losses in future periods with respect to its available for sale investment securities portfolio. The amount and timing of any additional OTTI will depend on the decline in the underlying cash flows of the securities. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in the period the other-than-temporary impairment is identified.

Other-than-temporary Impairment. Upon acquisition of a security, the Company decides whether it is within the scope of the accounting guidance for beneficial interests in securitized financial assets or will be evaluated for impairment under the accounting guidance for investments in debt and equity securities.

The accounting guidance for beneficial interests in securitized financial assets provides incremental impairment guidance for a subset of the debt securities within the scope of the guidance for investments in debt and equity securities. For securities where the security is a beneficial interest in securitized financial assets, the Company uses the beneficial interests in securitized financial asset impairment model. For securities where the security is not a beneficial interest in securitized financial assets, the Company uses debt and equity securities impairment model.

The Company routinely conducts periodic reviews to identify and evaluate each investment security to determine whether OTTI has occurred. Economic models are used to determine whether OTTI has occurred on these securities. While all securities are considered, the securities primarily impacted by OTTI testing are pooled trust preferred securities. For each pooled trust preferred security in the investment portfolio, an extensive, regular review is conducted to determine if any additional OTTI has occurred. Various inputs to the economic models are used to determine if an unrealized loss is other-than-temporary. The most significant inputs are prepayments, defaults and loss severity.

These pooled trust preferred securities relate to trust preferred securities issued by financial institutions. The pools typically consist of financial institutions throughout the United States. Other inputs to the economic models may include the actual collateral attributes, which include credit ratings and other performance indicators of the underlying financial institutions including profitability, capital ratios, and asset quality.

To determine if the unrealized losses for pooled trust preferred securities is other-than-temporary, the Company considers the impact of each of these inputs. The Company considers the likelihood that issuers will prepay their securities. During the third quarter of 2010, the Dodd-Frank Act eliminated Tier 1 capital treatment for trust preferred securities issued by holding companies with consolidated assets greater than $15 billion. As a result, issuers may prepay their securities which reduces the amount of expected cash flows. Additionally, the Company projects total estimated defaults of the underlying assets (financial institutions) and multiplies that calculated amount by an estimate of realizable value upon sale in the marketplace (severity) in order to determine the projected collateral loss. The Company also evaluates the current credit enhancement underlying the security to determine the impact on cash flows. If the Company determines that a given pooled trust preferred security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

Credit Losses Recognized on Investments. As described above, some of the Company’s investments in trust preferred securities have experienced fair value deterioration due to credit losses but are not otherwise other-than-temporarily impaired. The following table provides information about those trust preferred securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income (loss) for the six months ended June 30, 2013 and 2012 (in thousands).

	Accumulated Credit Losses	
	June 30, 2013	June 30, 2012
Credit losses on trust preferred securities held		
Beginning of period	$3,989	$4,116
Additions related to OTTI losses not previously recognized	—	—
Reductions due to sales / (recoveries)	—	—
Reductions due to change in intent or likelihood of sale	—	—
Additions related to increases in previously recognized OTTI losses	—	—
Reductions due to increases in expected cash flows	—	—
End of period	$3,989	$4,116

Subsequently, on July 22, 2013, the Company sold two of its trust preferred securities (PreTSL I and PreTSL II). This sale resulted in recovery of all of the book value of these securities. The net proceeds exceeded the aggregate book value of these securities by approximately $1.4 million and this amount will be recorded as a security gain during the third quarter of 2013.

Note 4 – Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding net of unearned discounts, unearned income and allowance for loan losses. Unearned income includes deferred loan origination fees reduced by loan origination costs and is amortized to interest income over the life of the related loan using methods that approximated the effective interest rate method. Interest on substantially all loans is credited to income based on the principal amount outstanding. A summary of loans at June 30, 2013 and December 31, 2012 follows (in thousands):

	June 30, 2013	December 31, 2012
Construction and land development	$22,602	$31,341
Agricultural real estate	95,255	86,256
1-4 Family residential properties	186,104	186,205
Multifamily residential properties	44,207	44,863
Commercial real estate	335,628	317,321
Loans secured by real estate	683,796	665,986
Agricultural loans	51,864	60,948
Commercial and industrial loans	152,955	160,193
Consumer loans	15,814	16,264
All other loans	9,849	8,206
Gross loans	914,278	911,597
Less:		
Net deferred loan fees, premiums and discounts	533	744
Allowance for loan losses	12,131	11,776
Net loans	$901,614	$899,077

Loans expected to be sold are classified as held for sale in the consolidated financial statements and are recorded at the lower of aggregate cost or market value, taking into consideration future commitments to sell the loans. These loans are primarily for 1-4 family residential properties. The balance of loans held for sale, excluded from the balances above, were $2,068,000 and $212,000 at June 30, 2013 and December 31, 2012, respectively.

Most of the Company's business activities are with customers located within central Illinois. At June 30, 2013, the Company's loan portfolio included $147.1 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, $123.6 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture decreased $0.1 million from $147.2 million at December 31, 2012 while loans concentrated in other grain farming decreased $0.8 million from $124.4 million at December 31, 2012 due to seasonal paydowns based upon timing of cash flow requirements. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, drought conditions, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has $45.3 million of loans to motels and hotels. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in nonperforming loans to this business segment and potentially in loan losses. The Company also has $96.5 million of loans to lessors of non-residential buildings and $56.5 million of loans to lessors of residential buildings and dwellings.

The structure of the Company's loan approval process is based on progressively larger lending authorities granted to individual loan officers, loan committees, and ultimately the Board of Directors. Outstanding balances to one borrower or affiliated borrowers are limited by federal regulation; however, limits well below the regulatory thresholds are generally observed. The vast majority of the Company's loans are to businesses located in the geographic market areas served by the Company's branch bank system. Additionally, a significant portion of the collateral securing the loans in the portfolio is located within the Company's primary geographic footprint. In general, the Company adheres to loan underwriting standards consistent with industry guidelines for all loan segments.

The Company's lending can be summarized into the following primary areas:

Commercial Real Estate Loans. Commercial real estate loans are generally comprised of loans to small business entities to purchase or expand structures in which the business operations are housed, loans to owners of real estate who lease space to non-related commercial entities, loans for construction and land development, loans to hotel operators, and loans to owners of multi-family residential structures, such as apartment buildings. Commercial real estate loans are underwritten based on historical and projected cash flows of the borrower and secondarily on the underlying real estate pledged as collateral on the debt. For the various types of commercial real estate loans, minimum criteria have been established within the Company's loan policy regarding debt service coverage while maximum limits on loan-to-value and amortization periods have been defined. Maximum loan-to-value ratios range from 65% to 80% depending upon the type of real estate collateral, while the desired minimum debt coverage ratio is 1.20x. Amortization periods for commercial real estate loans are generally limited to twenty years. The Company's commercial real estate portfolio is well below the thresholds that would designate a concentration in commercial real estate lending, as established by the federal banking regulators.

Commercial and Industrial Loans. Commercial and industrial loans are primarily comprised of working capital loans used to purchase inventory and fund accounts receivable that are secured by business assets other than real estate. These loans are generally written for one year or less. Also, equipment financing is provided to businesses with these loans generally limited to 80% of the value of the collateral and amortization periods limited to seven years. Commercial loans are often accompanied by a personal guaranty of the principal owners of a business. Like commercial real estate loans, the underlying cash flow of the business is the primary consideration in the underwriting process. The financial condition of commercial borrowers is monitored at least annually with the type of financial information required determined by the size of the relationship. Measures employed by the Company for businesses with higher risk profiles include the use of government-assisted lending programs through the Small Business Administration and U.S. Department of Agriculture.

Agricultural and Agricultural Real Estate Loans. Agricultural loans are generally comprised of seasonal operating lines to cash grain farmers to plant and harvest corn and soybeans and term loans to fund the purchase of equipment. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Specific underwriting standards have been established for agricultural-related loans including the establishment of projections for each operating year based on industry developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop. Loan-to-value ratios on loans secured by farmland generally do not exceed 65% and have amortization periods limited to twenty five years. Federal government-assistance lending programs through the Farm Service Agency are used to mitigate the level of credit risk when deemed appropriate.

Residential Real Estate Loans. Residential real estate loans generally include loans for the purchase or refinance of residential real estate properties consisting of one-to-four units and home equity loans and lines of credit. The Company sells the vast majority of its long-term fixed rate residential real estate loans to secondary market investors. The Company also releases the servicing of these loans upon sale. The Company retains all residential real estate loans with balloon payment features. Balloon periods are limited to five years. Residential real estate loans are typically underwritten to conform to industry standards including criteria for maximum debt-to-income and loan-to-value ratios as well as minimum credit scores. Loans secured by first liens on residential real estate held in the portfolio typically do not exceed 80% of the value of the collateral and have amortization periods of twenty five years or less. The Company does not originate subprime mortgage loans.

Consumer Loans. Consumer loans are primarily comprised of loans to individuals for personal and household purposes such as the purchase of an automobile or other living expenses. Minimum underwriting criteria have been established that consider credit score, debt-to-income ratio, employment history, and collateral coverage. Typically, consumer loans are set up on monthly payments with amortization periods based on the type and age of the collateral.

Other Loans. Other loans consist primarily of loans to municipalities to support community projects such as infrastructure improvements or equipment purchases. Underwriting guidelines for these loans are consistent with those established for commercial loans with the additional repayment source of the taxing authority of the municipality.

Allowance for Loan Losses

The allowance for loan losses represents the Company's best estimate of the reserve necessary to adequately account for probable losses existing in the current portfolio. The provision for loan losses is the charge against current earnings that is determined by the Company as the amount needed to maintain an adequate allowance for loan losses.

In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, the Company relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company's credit exposure. The review process is directed by the overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Once identified, the magnitude of exposure to individual borrowers is quantified in the form of specific allocations of the allowance for loan losses. The Company considers collateral values and guarantees in the determination of such specific allocations. Additional factors considered by the Company in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and troubled debt restructurings, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates.

The Company estimates the appropriate level of allowance for loan losses by separately evaluating large impaired loans, large adversely classified loans and nonimpaired loans.

Impaired loans
The Company individually evaluates certain loans for impairment. In general, these loans have been internally identified via the Company's loan grading system as credits requiring management's attention due to underlying problems in the borrower's business or collateral concerns. This evaluation considers expected future cash flows, the value of collateral and also other factors that may impact the borrower's ability to make payments when due. For loans greater than $100,000 in the commercial, commercial real estate, agricultural, agricultural real estate segments, impairment is individually measured each quarter using one of three alternatives: (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price, if available; or (3) the fair value of the collateral less costs to sell for collateral dependent loans and loans for which foreclosure is deemed to be probable. A specific allowance is assigned when expected cash flows or collateral do not justify the carrying amount of the loan. The carrying value of the loan reflects reductions from prior charge-offs.

Adversely classified loans
A detailed analysis is also performed on each adversely classified (substandard or doubtful rated) borrower with an aggregate, outstanding balance of $100,000 or more. This analysis includes commercial, commercial real estate, agricultural, and agricultural real estate borrowers who are not currently identified as impaired but pose sufficient risk to warrant in-depth review. Estimated collateral shortfalls are then calculated with allocations for each loan segment based on the five-year historical average of collateral shortfalls adjusted for environmental factors including changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is periodically assessed and adjusted when appropriate. Consumer loans are evaluated for adverse classification based primarily on the Uniform Retail Credit Classification and Account Management Policy established by the federal banking regulators. Classification standards are generally based on delinquency status, collateral coverage, bankruptcy and the presence of fraud.

Non-classified and Watch loans
For loans, in all segments of the portfolio, that are considered to possess levels of risk commensurate with a pass rating, management establishes base loss estimations which are derived from historical loss experience. Use of a five-year historical loss period eliminates the effect of any significant losses that can be attributed to a single event or borrower during a given reporting period. The base loss estimations for each loan segment are adjusted after consideration of several environmental factors influencing the level of credit risk in the portfolio. In addition, loans rated as watch are further segregated in the commercial / commercial real estate and agricultural / agricultural real estate segments. These loans possess potential weaknesses that, if unchecked, may result in deterioration to the point

of becoming a problem asset. Due to the elevated risk inherent in these loans, an allocation of twice the adjusted base loss estimation of the applicable loan segment is determined appropriate.

Due to weakened economic conditions during recent years, the Company established allocations for each of the loan segments at levels above the base loss estimations. Some of the economic factors included the potential for reduced cash flow for commercial operating loans from reduction in sales or increased operating costs, decreased occupancy rates for commercial buildings, reduced levels of home sales for commercial land developments, the uncertainty regarding grain prices and increased operating costs for farmers, and increased levels of unemployment and bankruptcy impacting consumer’s ability to pay. Each of these economic uncertainties was taken into consideration in developing the level of the reserve. The Company has not materially changed any aspect of its overall approach in the determination of the allowance for loan losses. However, on an on-going basis the Company continues to refine the methods used in determining management’s best estimate of the allowance for loan losses.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method for the three and six-months ended June 30, 2013 and 2012 and for the year ended December 31, 2012 (in thousands):

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Three months ended June 30, 2013						
Allowance for loan losses:						
Balance, beginning of period	$9,341	$417	$719	$422	$1,085	$11,984
Provision charged to expense	40	(3)	92	(15)	138	252
Losses charged off	(98)	—	(19)	(51)	—	(168)
Recoveries	21	—	1	41	—	63
Balance, end of period	$9,304	$414	$793	$397	$1,223	$12,131
Ending balance:						
Individually evaluated for impairment	$439	$—	$—	$—	$—	$439
Collectively evaluated for impairment	$8,865	$414	$793	$397	$1,223	$11,692
Three months ended June 30, 2012						
Allowance for loan losses:						
Balance, beginning of period	$8,810	$570	$710	$386	$817	$11,293
Provision charged to expense	453	76	68	27	(208)	416
Losses charged off	(295)	(12)	(44)	(47)		(398)
Recoveries	39	67	9	29		144
Balance, end of period	$9,007	$701	$743	$395	$609	$11,455
Ending balance:						
Individually evaluated for impairment	$645	$89	$—	$—	$—	$734
Collectively evaluated for impairment	$8,362	$612	$743	$395	$609	$10,721
Six months ended June 30, 2013						
Allowance for loan losses:						
Balance, beginning of year	$9,301	$558	$726	$403	$788	$11,776
Provision charged to expense	284	(145)	144	14	435	732
Losses charged off	(367)	—	(86)	(97)	—	(550)
Recoveries	86	1	9	77	—	173
Balance, end of period	$9,304	$414	$793	$397	$1,223	$12,131
Ending balance:						
Individually evaluated for impairment	$439	$—	$—	$—	$—	$439
Collectively evaluated for impairment	$8,865	$414	$793	$397	$1,223	$11,692
Loans:						
Ending balance	$564,526	$147,218	$188,255	$15,814	$—	$915,813
Ending balance:						
Individually evaluated for impairment	$5,232	$312	$—	$—	$—	$5,544
Collectively evaluated for impairment	$559,294	$146,906	$188,255	$15,814	$—	$910,269

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Six months ended June 30, 2012						
Allowance for loan losses:						
Balance, beginning of year	$8,791	$546	$636	$378	$769	$11,120
Provision charged to expense	748	100	291	52	(160)	1,031
Losses charged off	(598)	(12)	(205)	(95)	—	(910)
Recoveries	66	67	21	60	—	214
Balance, end of period	$9,007	$701	$743	$395	$609	$11,455
Ending balance:						
Individually evaluated for impairment	$645	$89	$—	$—	$—	$734
Collectively evaluated for impairment	$8,362	$612	$743	$395	$609	$10,721
Loans:						
Ending balance	$517,406	$132,611	$179,577	$15,600	$731	$845,925
Ending balance:						
Individually evaluated for impairment	$4,487	$947	$—	$—	$—	$5,434
Collectively evaluated for impairment	$512,919	$131,664	$179,577	$15,600	$731	$840,491
Year ended December 31, 2012						
Allowance for loan losses:						
Balance, beginning of year	$8,791	$546	$636	$378	$769	$11,120
Provision charged to expense	1,979	(47)	580	116	19	2,647
Losses charged off	(1,586)	(12)	(524)	(249)	—	(2,371)
Recoveries	117	71	34	158	—	380
Balance, end of year	$9,301	$558	$726	$403	$788	$11,776
Ending balance:						
Individually evaluated for impairment	$457	$54	$—	$—	$—	$511
Collectively evaluated for impairment	$8,844	$504	$726	$403	$788	$11,265
Loans:						
Ending balance	$569,717	$145,695	$179,309	$16,066	$278	$911,065
Ending balance:						
Individually evaluated for impairment	$5,334	$1,230	$—	$—	$—	$6,564
Collectively evaluated for impairment	$564,383	$144,465	$179,309	$16,066	$278	$904,501

Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company’s policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except 1-4 family residential properties and consumer, the Company promptly charges-off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower’s ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges-off 1-4 family residential and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down of 1-4 family first and junior lien mortgages to the net realizable value less costs to sell when the loan is 180 days past due, charge-off of unsecured open-end loans when the loan is 180 days past due, and charge down to the net realizable value when other secured loans are 120 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection will occur regardless of delinquency status, need not be charged off.

Credit Quality

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, collateral support, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $100,000 and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a continuous basis. The Company uses the following definitions for risk ratings:

Watch. Loans classified as watch have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution’s credit position at some future date.

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered pass rated loans.

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of June 30, 2013 and December 31, 2012 (in thousands):

	Construction & Land Development		Agricultural Real Estate		1-4 Family Residential Properties		Multifamily Residential Properties	
	2013	2012	2013	2012	2013	2012	2013	2012
Pass	$18,737	$27,217	$93,283	$82,516	$185,885	$183,880	$44,207	$44,863
Watch	2,099	2,135	1,225	2,662	275	424	—	—
Substandard	1,766	1,989	769	1,093	2,095	2,194	—	—
Doubtful	—	—	—	—	—	—	—	—
Total	$22,602	$31,341	$95,277	$86,271	$188,255	$186,498	$44,207	$44,863

	Commercial Real Estate (Nonfarm/Nonresidential)		Agricultural Loans		Commercial & Industrial Loans		Consumer Loans	
	2013	2012	2013	2012	2013	2012	2013	2012
Pass	$ 308,675	$ 287,794	$51,111	$56,899	$141,874	$157,461	$15,774	$16,236
Watch	22,636	24,213	—	958	10,073	1,588	—	14
Substandard	3,493	4,315	830	3,157	1,128	1,250	40	14
Doubtful	—	—	—	—	—	—	—	—
Total	$ 334,804	$ 316,322	$51,941	$61,014	$153,075	$160,299	$15,814	$16,264

	All Other Loans		Total Loans	
	2013	2012	2013	2012
Pass	$9,838	$8,193	$869,384	$865,059
Watch	—	—	36,308	31,994
Substandard	—	—	10,121	14,012
Doubtful	—	—	—	—
Total	$9,838	$8,193	$915,813	$911,065

The following table presents the Company's loan portfolio aging analysis at June 30, 2013 and December 31, 2012 (in thousands):

	30-59 days Past Due	60-89 days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 days & Accruing
June 30, 2013							
Construction and land development	$—	$—	$13	$13	$22,589	$22,602	$—
Agricultural real estate	153	—	103	256	95,021	95,277	—
1-4 Family residential properties	523	310	478	1,311	186,944	188,255	—
Multifamily residential properties	—	—	—	—	44,207	44,207	—
Commercial real estate	195	388	215	798	334,006	334,804	—
Loans secured by real estate	871	698	809	2,378	682,767	685,145	—
Agricultural loans	50	—	209	259	51,682	51,941	—
Commercial and industrial loans	83	254	163	500	152,575	153,075	—
Consumer loans	81	36	24	141	15,673	15,814	—
All other loans	—	—	—	—	9,838	9,838	—
Total loans	$1,085	$988	$1,205	$3,278	$912,535	$915,813	$—
December 31, 2012							
Construction and land development	$—	$53	$—	$53	$31,288	$31,341	$—
Agricultural real estate	592	—	293	885	85,386	86,271	—
1-4 Family residential properties	1,351	40	944	2,335	184,163	186,498	—
Multifamily residential properties	—	—	—	—	44,863	44,863	—
Commercial real estate	262	911	255	1,428	314,894	316,322	—
Loans secured by real estate	2,205	1,004	1,492	4,701	660,594	665,295	—
Agricultural loans	—	—	620	620	60,394	61,014	—
Commercial and industrial loans	413	275	53	741	159,558	160,299	—
Consumer loans	119	24	39	182	16,082	16,264	—
All other loans	—	—	—	—	8,193	8,193	—
Total loans	$2,737	$1,303	$2,204	$6,244	$904,821	$911,065	$—

Impaired Loans

Within all loan portfolio segments, loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date. Impaired loans, excluding certain troubled debt restructured loans, are placed on nonaccrual status. Impaired loans include nonaccrual loans and loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. It is the Company’s policy to have any restructured loans which are on nonaccrual status prior to being modified remain on nonaccrual status until, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. If the restructured loan is on accrual status prior to being modified, the loan is reviewed to determine if the modified loan should remain on accrual status.

The Company’s policy is to discontinue the accrual of interest income on all loans for which principal or interest is ninety days past due. The accrual of interest is discontinued earlier when, in the opinion of management, there is reasonable doubt as to the timely collection of interest or principal. Once interest accruals are discontinued, accrued but uncollected interest is charged against current year income. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Interest on loans determined to be troubled debt restructurings is recognized on an accrual basis in accordance with the restructured terms if the loan is in compliance with the modified terms.

Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

The following tables present impaired loans as of June 30, 2013 and December 31, 2012 (in thousands):

	June 30, 2013			December 31, 2012		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans with a specific allowance:						
Construction and land development	$1,408	$2,109	$181	$1,114	$1,529	$295
Agricultural real estate	—	—	—	—	—	—
1-4 Family residential properties	—	—	—	636	723	162
Multifamily residential properties	—	—	—	—	—	—
Commercial real estate	819	819	89	—	—	—
Loans secured by real estate	2,227	2,928	270	1,750	2,252	457
Agricultural loans	—	—	—	310	310	54
Commercial and industrial loans	812	812	167	—	—	—
Consumer loans	12	12	2	—	—	—
All other loans	—	—	—	—	—	—
Total loans	$3,051	$3,752	$439	$2,060	$2,562	$511
Loans without a specific allowance:						
Construction and land development	$13	$21	$—	$408	$694	$—
Agricultural real estate	216	226	—	418	429	—
1-4 Family residential properties	1,191	1,796	—	1,269	1,792	—
Multifamily residential properties	—	—	—	—	—	—
Commercial real estate	1,515	1,575	—	2,063	2,253	—
Loans secured by real estate	2,935	3,618	—	4,158	5,168	—
Agricultural loans	209	209	—	620	1,568	—
Commercial and industrial loans	597	898	—	704	—	—
Consumer loans	44	83	—	51	58	—
All other loans	—	—	—	—	—	—
Total loans	$3,785	$4,808	$—	$5,533	$6,794	$—
Total loans:						
Construction and land development	$1,421	$2,130	$181	$1,522	$2,223	$295
Agricultural real estate	216	226	—	418	429	—
1-4 Family residential properties	1,191	1,796	—	1,905	2,515	162
Multifamily residential properties	—	—	—	—	—	—
Commercial real estate	2,334	2,394	89	2,063	2,253	—
Loans secured by real estate	5,162	6,546	270	5,908	7,420	457
Agricultural loans	209	209	—	930	1,878	54
Commercial and industrial loans	1,409	1,710	167	704	—	—
Consumer loans	56	95	2	51	58	—
All other loans	—	—	—	—	—	—
Total loans	$6,836	$8,560	$439	$7,593	$9,356	$511

The following tables present average recorded investment and interest income recognized on impaired loans for the three and six-month periods ended June 30, 2013 and 2012 (in thousands):

	For the three months ended			
	June 30, 2013		June 30, 2012	
	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
Construction and land development	$1,425	$—	$1,014	$—
Agricultural real estate	216	—	206	—
1-4 Family residential properties	1,283	1	1,621	—
Multifamily residential properties	—	—		—
Commercial real estate	2,353	—	2,437	7
Loans secured by real estate	5,277	1	5,278	7
Agricultural loans	229	—	864	—
Commercial and industrial loans	1,430	—	780	3
Consumer loans	57	1	15	—
All other loans	—	—	—	—
Total loans	$6,993	$2	$6,937	$10

	For the six months ended			
	June 30, 2013		June 30, 2012	
	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
Construction and land development	$1,445	$—	$1,014	$—
Agricultural real estate	217	—	206	—
1-4 Family residential properties	1,414	2	1,632	—
Multifamily residential properties	—	—	—	—
Commercial real estate	2,389	—	2,349	14
Loans secured by real estate	5,465	2	5,201	14
Agricultural loans	253	—	883	—
Commercial and industrial loans	1,482	—	834	7
Consumer loans	59	1	17	—
All other loans	—	—	—	—
Total loans	$7,259	$3	$6,935	$21

The amount of interest income recognized by the Company within the periods stated above was due to loans modified in a troubled debt restructuring that remained on accrual status. The balance of loans modified in a troubled debt restructuring included in the impaired loans stated above that were still accruing was $103,000 of 1-4 Family residential properties and $22,000 of consumer loans at June 30, 2013 and $7,000 of 1-4 family residential properties, $389,000 of commercial real estate and $304,000 of commercial and industrial at June 30, 2012. For the six months ended June 30, 2013 and 2012, the amount of interest income recognized using a cash-basis method of accounting during the period that the loans were impaired was not material.

Non Accrual Loans

The following table presents the Company's recorded balance of nonaccrual loans as June 30, 2013 and December 31, 2012 (in thousands). This table excludes purchased impaired loans and performing troubled debt restructurings.

	June 30, 2013	December 31, 2012
Construction and land development	$1,421	$1,522
Agricultural real estate	216	418
1-4 Family residential properties	1,088	1,899
Multifamily residential properties	—	—
Commercial real estate	2,334	2,063
Loans secured by real estate	5,059	5,902
Agricultural loans	209	930
Commercial and industrial loans	1,409	704
Consumer loans	34	37
All other loans	—	—
Total loans	$6,711	$7,573

Interest income that would have been recorded under the original terms of such nonaccrual loans totaled $72,000 and $130,000 for the six months ended June 30, 2013 and 2012, respectively.

Troubled Debt Restructuring

The balance of troubled debt restructurings at June 30, 2013 and December 31, 2012 was $3,285,000 and $3,339,000, respectively. Approximately $352,000 and $295,000 in specific reserves have been established with respect to these loans as of June 30, 2013 and December 31, 2012, respectively. As troubled debt restructurings, these loans are included in nonperforming loans and are classified as impaired which requires that they be individually measured for impairment. The modification of the terms of these loans included one or a combination of the following: a reduction of stated interest rate of the loan; an extension of the maturity date and change in payment terms; or a permanent reduction of the recorded investment in the loan.

The following table presents the Company's recorded balance of troubled debt restructurings at June 30, 2013 and December 31, 2012 (in thousands).

Troubled debt restructurings:	June 30, 2013	December 31, 2012
Construction and land development	$1,409	$1,522
1-4 Family residential properties	511	445
Commercial real estate	898	950
Loans secured by real estate	2,818	2,917
Commercial and industrial loans	446	408
Consumer loans	21	14
Total	$3,285	$3,339
Performing troubled debt restructurings:		
1-4 Family residential properties	$103	$6
Commercial real estate	—	—
Loans secured by real estate	103	6

Commercial and industrial loans	—	—
Consumer loans	22	14
Total	$125	$20

The following table presents loans modified as TDRs during the six months ended June 30, 2013 and 2012, as a result of various modified loan factors (in thousands):

	June 30, 2013			June 30, 2012		
	Number of Modifications	Recorded Investment	Type of Modifications	Number of Modifications	Recorded Investment	Type of Modifications
Construction and land development	—	$—		3	$1,014	(a)
1-4 Family residential properties	3	98	(a)(b)(c)	2	94	(b)
Commercial real estate	—	—		5	296	(b)
Loans secured by real estate	3	98		10	1,404	
Commercial and industrial loans	1	56	(a)(b)	1	16	(a)(b)
Consumer Loans	1	8	(c)	—	—	
Total	5	$162		11	$1,420	

Type of modifications:
(a) Reduction of stated interest rate of loan
(b) Change in payment terms
(c) Extension of maturity date

A loan is considered to be in payment default once it is 90 days past due under the modified terms. There were no loans modified as troubled debt restructurings during the prior twelve months that experienced defaults during the six months ended June 30, 2013 or the year ended December 31, 2012.

Note 5 -- Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase had a decrease of $18.8 million during the first six months of 2013 primarily due to the seasonal declines in balances of various customers.

Note 6 -- Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1	Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
Level 2	Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use

	observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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Following is a description of the inputs and valuation methodologies used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Available-for-Sale Securities. The fair value of available-for-sale securities is determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independent sources of market parameters, including but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include subordinated tranches of collateralized mortgage obligations and investments in trust preferred securities.

Fair value determinations for Level 3 measurements of securities are the responsibility of the Treasury function of the Company. The Company contracts with a pricing specialist to generate fair value estimates on a monthly basis. The Treasury function of the Company challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States, analyzes the changes in fair value and compares these changes to internally developed expectations and monitors these changes for appropriateness.

The trust preferred securities are collateralized debt obligation securities that are backed by trust preferred securities issued by banks, thrifts, and insurance companies. The market for these securities at June 30, 2013 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which trust preferred securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive and will continue to be, as a result of the Dodd-Frank Act's elimination of trust preferred securities from Tier 1 capital for certain holding companies. There are currently very few market participants who are willing and or able to transact for these securities. The market values for these securities are very depressed relative to historical levels.

Given conditions in the debt markets today and the absence of observable transactions in the secondary and new issue markets, we determined:

- The few observable transactions and market quotations that are available are not reliable for purposes of determining fair value at June 30, 2013,

- An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than the market approach valuation technique used at prior measurement dates, and

- The trust preferred securities held by the Company will be classified within Level 3 of the fair value hierarchy because we determined that significant adjustments are required to determine fair value at the measurement date.

The following table presents the Company’s assets that are measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall as of June 30, 2013 and December 31, 2012 (in thousands):

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2013				
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$207,517	$—	$207,517	$—
Obligations of states and political subdivisions	59,393	—	59,393	—
Mortgage-backed securities	260,047	—	260,047	—
Trust preferred securities	835	—	—	835
Other securities	6,043	53	5,990	—
Total available-for-sale securities	$533,835	$53	$532,947	$835
December 31, 2012				
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$182,169	$—	$182,169	$—
Obligations of states and political subdivisions	56,207	—	56,207	—
Mortgage-backed securities	259,460	—	259,460	—
Trust preferred securities	585	—	—	585
Other securities	9,888	60	9,828	—
Total available-for-sale securities	$508,309	$60	$507,664	$585

The change in fair value of assets measured on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2013 and 2012 is summarized as follows (in thousands):

	Available-for-Sale Securities		
June 30, 2013	Mortgage-backed Securities	Trust Preferred Securities	Total
Beginning balance	$—	$585	$585
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	—	—
Total gains or losses			
Included in net income	—	—	—
Included in other comprehensive income (loss)	—	434	434
Purchases, issuances, sales and settlements			
Purchases	—	—	—
Issuances	—	—	—
Sales	—	—	—
Settlements	—	(184)	(184)
Ending balance	$—	$835	$835
Total gains or losses for the period included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date	$—	$—	$—

	Available-for-Sale Securities		
June 30, 2012	Mortgage-backed Securities	Trust Preferred Securities	Total
Beginning balance	$58	$719	$777
Transfers into Level 3	—	—	—
Transfers out of Level 3	(58)	—	(58)
Total gains or losses			
Included in net income	—	—	—
Included in other comprehensive income (loss)	—	182	182
Purchases, issuances, sales and settlements			
Purchases	—	—	—
Issuances	—	—	—
Sales	—	—	—
Settlements	—	(253)	(253)
Ending balance	$—	$648	$648
Total gains or losses for the period included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date	$—	$—	$—

Following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans (Collateral Dependent). Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment and estimating fair value include using the fair value of the collateral for collateral dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

Management establishes a specific allowance for impaired loans that have an estimated fair value that is below the carrying value. The total carrying amount of loans for which a specific allowance has been established as of June 30, 2013 was $2,479,000 and a fair value of $2,040,000 resulting in specific loss exposures of $439,000.

When there is little prospect of collecting principal or interest, loans, or portions of loans, may be charged-off to the allowance for loan losses. Losses are recognized in the period an obligation becomes uncollectible. The recognition of a loss does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be affected in the future.

Foreclosed Assets Held For Sale. Other real estate owned acquired through loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other noninterest expense. The total carrying amount of other real estate owned as of June 30, 2013 was $1,003,000. Other real estate owned included in the total carrying amount and measured at fair value on a nonrecurring basis during the period amounted to $297,000.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2013 and December 31, 2012 (in thousands):

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2013				
Impaired loans (collateral dependent)	$2,040	$—	$—	$2,040
Foreclosed assets held for sale	297	—	—	297
December 31, 2012				
Impaired loans (collateral dependent)	$2,681	$—	$—	$2,681
Foreclosed assets held for sale	70	—	—	70

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Trust Preferred Securities. The significant unobservable inputs used in the fair value measurement of the Company's trust preferred securities are offered quotes and comparability adjustments. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, changes in either of those inputs will not affect the other input.

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill.

	Fair Value at June 30, 2013	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Trust Preferred Securities	$835	Discounted cash flow	Discount rate	8.7 %- 18.5% (16.8 %)
			Constant prepayment rate (1)	1.34 %
			Cumulative projected prepayments	22.9 %- 53.8% (28.1 %)
			Probability of default	0.4 %- 7.3% (1.5 %)
			Projected cures given deferral	0 %- 11.5% (10.5 %)
			Loss severity	95.0 %- 100.0% (95.9 %)
Impaired loans (collateral dependent)	$2,040	Third party valuations	Discount to reflect realizable value	0 %- 40% (20 %)
Foreclosed assets held for sale	$297	Third party valuations	Discount to reflect realizable value less estimated selling costs	0 %- 40% (35 %)

(1) Every five years

Other. The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value.

Cash and Cash Equivalents and Federal Reserve and Federal Home Loan Bank Stock
The carrying amount approximates fair value.

Certificates of Deposit Investments
The fair value of certificates of deposit investments is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

Held-to-maturity Securities
Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans
For loans with floating interest rates, it is assumed that the estimated fair values generally approximate the carrying amount balances. Fixed rate loans have been valued using a discounted present value of projected cash flow. The discount rate used in these calculations is the current rate at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amount of accrued interest approximates its fair value.

Deposits
Deposits include demand deposits, savings accounts, NOW accounts and certain money market deposits. The carrying amount of these deposits approximates fair value. The fair value of fixed-maturity time deposits is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

Securities Sold Under Agreements to Repurchase
The fair value of securities sold under agreements to repurchased is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

Short-term Borrowings and Interest Payable
The carrying amount approximates fair value.

Long-term Debt and Federal Home Loan Bank Advances
Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt.

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The following tables present estimated fair values of the Company's financial instruments at June 30, 2013 and December 31, 2012 in accordance with FAS 107-1 and APB 28-1, codified with ASC 805 (in thousands):

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
June 30, 2013					
Financial Assets					
Cash and due from banks	$31,367	$31,367	$31,367	$—	$—
Federal funds sold	498	498	498	—	—
Certificates of deposit investments	1,992	1,992	1,992	—	—
Available-for-sale securities	533,835	533,835	53	532,947	835
Loans held for sale	2,068	2,068	—	2,068	—
Loans net of allowance for loan losses	901,614	914,278	—	—	914,278
Interest receivable	5,986	5,986	—	5,986	—
Federal Reserve Bank stock	1,522	1,522	—	1,522	—
Federal Home Loan Bank stock	3,391	3,391	—	3,391	—
Financial Liabilities					
Deposits	$1,271,134	$1,266,715	$—	$1,071,703	$195,012
Securities sold under agreements to repurchase	94,694	94,699	—	94,699	—
Interest payable	271	271	—	271	—
Federal Home Loan Bank borrowings	12,500	13,071	—	13,071	—
Junior subordinated debentures	20,620	12,078	—	12,078	—
December 31, 2012					
Financial Assets					
Cash and due from banks	$62,213	$62,213	$62,213	$—	$—
Federal funds sold	20,499	20,499	20,499	—	—
Certificates of deposit investments	6,665	6,669	6,669	—	—
Available-for-sale securities	508,309	508,309	60	507,664	585
Loans held for sale	212	212	—		