FIRST MERCHANTS CORP
Form 10-Q
November 08, 2013

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _______ to _______

Commission File Number 0-17071

FIRST MERCHANTS CORPORATION
(Exact name of registrant as specified in its charter)

Indiana	35-1544218
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 East Jackson Street, Muncie, IN	47305-2814
(Address of principal executive offices)	(Zip code)

(Registrant's telephone number, including area code): (765) 747-1500

Not Applicable
(Former name, former address and former fiscal year,
if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (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, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ] (Do not check if smaller reporting company) Smaller reporting company [ ]

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

As of October 31, 2013, there were 28,825,706 outstanding common shares of the registrant.

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED BALANCE SHEETS

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Cash and cash equivalents	$92,341	$101,460
Interest-bearing time deposits	18,875	38,443
Investment securities available for sale	606,341	513,343
Investment securities held to maturity (fair value of $314,383 and $378,174)	307,794	361,020
Mortgage loans held for sale	5,312	22,300
Loans, net of allowance for loan losses of $66,224 and $69,366	2,859,233	2,832,843
Premises and equipment	54,386	52,749
Federal Reserve and Federal Home Loan Bank stock	32,790	32,785
Interest receivable	16,171	16,367
Core deposit intangibles	7,001	8,154
Goodwill	141,375	141,375
Cash surrender value of life insurance	127,322	125,397
Other real estate owned	12,052	13,263
Tax asset, deferred and receivable	31,385	30,867
Other assets	13,533	14,455
TOTAL ASSETS	$4,325,911	$4,304,821
LIABILITIES		
Deposits:		
Noninterest-bearing	$790,174	$801,597
Interest-bearing	2,465,672	2,544,786
Total Deposits	3,255,846	3,346,383
Borrowings:		
Federal funds purchased	115,938	18,862
Securities sold under repurchase agreements	123,935	141,828
Federal Home Loan Bank advances	172,292	94,238
Subordinated debentures and term loans	111,849	112,161
Total Borrowings	524,014	367,089
Interest payable	1,155	1,841
Other liabilities	31,427	37,272
Total Liabilities	3,812,442	3,752,585
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Preferred Stock, no-par value, $1,000 liquidation value:		
Authorized - 500,000 shares		
Senior Non-Cumulative Perpetual Preferred Stock, Series B		
Issued and outstanding - 34,043 and 90,782.94 shares	34,043	90,783
Cumulative Preferred Stock, $1,000 par value, $1,000 liquidation value:		
Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125

Common Stock, $.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 28,825,465 and 28,692,616 shares	3,603	3,587
Additional paid-in capital	258,350	256,843
Retained earnings	233,546	206,397
Accumulated other comprehensive loss	(16,198)	(5,499)
Total Stockholders' Equity	513,469	552,236
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$4,325,911	$4,304,821

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CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
INTEREST INCOME				
Loans receivable:				
Taxable	$33,548	$38,160	$104,725	$110,660
Tax exempt	85	118	315	358
Investment securities:				
Taxable	3,876	4,176	11,071	13,218
Tax exempt	2,840	2,532	7,809	7,645
Deposits with financial institutions	18	16	99	69
Federal Reserve and Federal Home Loan Bank stock	369	345	1,108	1,035
Total Interest Income	40,736	45,347	125,127	132,985
INTEREST EXPENSE				
Deposits	2,213	3,517	7,703	11,566
Federal funds purchased	72	38	84	62
Securities sold under repurchase agreements	192	211	594	703
Federal Home Loan Bank advances	506	492	1,427	2,123
Subordinated debentures and term loans	731	1,187	2,189	4,460
Total Interest Expense	3,714	5,445	11,997	18,914
NET INTEREST INCOME	37,022	39,902	113,130	114,071
Provision for loan losses	1,533	4,609	5,632	14,029
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	35,489	35,293	107,498	100,042
OTHER INCOME				
Service charges on deposit accounts	3,120	2,913	8,761	8,625
Fiduciary activities	1,986	1,986	6,357	5,907
Other customer fees	2,899	2,740	8,495	8,476
Commission income	1,636	1,618	5,556	4,770
Earnings on cash surrender value of life insurance	611	685	1,921	2,725
Net gains and fees on sales of loans	1,673	2,849	6,508	7,115
Net realized gains on sales of available for sale securities		843	487	2,134
Gain on FDIC modified whole bank transaction				9,124
Other income	(125)	639	1,651	1,220
Total Other Income	11,800	14,273	39,736	50,096
OTHER EXPENSES				
Salaries and employee benefits	20,616	20,083	61,943	59,078
Net occupancy	2,430	2,568	7,299	7,692
Equipment	1,852	1,798	5,368	5,259
Marketing	559	536	1,561	1,542
Outside data processing fees	1,515	1,413	4,386	4,295
Printing and office supplies	320	287	962	848
Core deposit amortization	383	489	1,153	1,438

FDIC assessments	677	792	2,095	2,771
Other real estate owned and credit-related expenses	1,648	2,104	4,993	6,412
Other expenses	4,219	4,334	12,901	13,277
Total Other Expenses	34,219	34,404	102,661	102,612
INCOME BEFORE INCOME TAX	13,070	15,162	44,573	47,526
Income tax expense	2,667	3,926	11,490	12,714
NET INCOME	10,403	11,236	33,083	34,812
Preferred stock dividends	(430)	(1,134)	(2,139)	(3,404)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$9,973	$10,102	$30,944	$31,408
Per Share Data:				
Basic Net Income Available to Common Stockholders	$0.35	$0.35	$1.08	$1.09
Diluted Net Income Available to Common Stockholders	$0.35	$0.35	$1.07	$1.09
Cash Dividends Paid	$0.05	$0.03	$0.13	$0.07
Average Diluted Shares Outstanding (in thousands)	29,081	28,888	29,026	28,819

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CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$10,403	$11,236	$33,083	$34,812
Other comprehensive income net of tax:				
Unrealized holding gain (loss) on securities available for sale arising during the period, net of income tax of $470, $1,018, $6,810, and $1,670	(873)	1,891	(12,646)	3,102
Unrealized gain (loss) on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of $103, $12, $48, and $43	(192)	(22)	89	(80)
Unrealized gain (loss) on cash flow hedges arising during the period, net of income tax of $86, $131, $543, and $535	(162)	(244)	1,007	(994)
Amortization of items previously recorded in accumulated other comprehensive income, net of income tax of $39, $113, $423, and $506	73	210	786	940
Reclassification adjustment for gains included in net income net of income tax expense of $72, $294, $35, and $747	135	(549)	65	(1,387)
	(1,019)	1,286	(10,699)	1,581
Comprehensive income	$9,384	$12,522	$22,384	$36,393

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CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred		Common Stock		Additional		Accumulated Other	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Loss	Total
Balances, December 31, 2012	90,908	$90,908	28,692,616	$3,587	$256,843	$206,397	$ (5,499)	$552,236
Comprehensive Income								
Net Income						33,083		33,083
Other Comprehensive Loss, net of tax							(10,699)	(10,699)
Cash Dividends on Common Stock ($.13 per Share)						(3,795)		(3,795)
Cash Dividends on Preferred Stock under Small Business Lending Fund						(2,139)		(2,139)
Preferred Stock Redeemed under Small Business Lending Fund	(56,740)	(56,740)						(56,740)
Share-based Compensation			111,761	14	1,271			1,285
Stock Issued under Employee Benefit Plans			28,158	4	385			389
Stock Issued under Dividend Reinvestment and Stock Purchase Plan			14,213	2	234			236
Stock Options Exercised			11,250	1	96			97
Stock Redeemed			(32,533)	(5)	(479)			(484)
Balances, September 30, 2013	34,168	$34,168	28,825,465	$3,603	$258,350	$233,546	$ (16,198)	$513,469

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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	September 30, 2013	2012
Cash Flow From Operating Activities:		
Net income	$33,083	$34,812
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	5,632	14,029
Depreciation and amortization	3,932	3,432
Change in deferred taxes	12,647	11,239
Share-based compensation	1,285	1,101
Mortgage loans originated for sale	(242,014)	(314,240)
Proceeds from sales of mortgage loans	259,002	304,393
Gain on acquisition		(9,124)
Gains on sales of securities available for sale	(487)	(2,134)
Change in interest receivable	196	732
Change in interest payable	(686)	(1,701)
Other adjustments	(6,329)	4,650
Net cash provided by operating activities	$66,261	$47,189
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	$19,568	$17,527
Purchases of:		
Securities available for sale	(216,731)	(129,297)
Securities held to maturity	(9,026)	(566)
Proceeds from sales of securities available for sale	25,222	43,147
Proceeds from maturities of:		
Securities available for sale	79,209	77,898
Securities held to maturity	59,642	49,073
Change in Federal Reserve and Federal Home Loan Bank stock	(5)	207
Net change in loans	(37,528)	(52,442)
Net cash received from acquisition		29,113
Proceeds from the sale of other real estate owned	5,574	4,295
Other adjustments	(5,569)	351
Net cash provided (used) by investing activities	$(79,644)	$39,306
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	$69,475	$42,994
Certificates of deposit and other time deposits	(160,012)	(108,807)
Proceeds from borrowings	215,923	138,127
Repayment of borrowings	(58,686)	(169,988)
Cash dividends on common stock	(3,795)	(2,031)
Cash dividends on preferred stock	(2,139)	(3,404)
Stock issued under employee benefit plans	389	354
Stock issued under dividend reinvestment and stock purchase plans	236	143

Stock options exercised	97	67
Stock redeemed	(484)	(235)
Preferred stock redeemed (SBLF)	(56,740)	
Net cash provided (used) by financing activities	$4,264	$(102,780)
Net Change in Cash and Cash Equivalents	(9,119)	(16,285)
Cash and Cash Equivalents, January 1	101,460	73,312
Cash and Cash Equivalents, September 30	$92,341	$57,027
Additional cash flow information:		
Interest paid	$12,683	$20,248
Income tax paid	$5,378	$5,988
Loans transferred to other real estate owned	$5,045	$4,364
Fixed assets transferred to other real estate owned	$461	
Non-cash investing activities using trade date accounting	$713	$3,043
Liabilities assumed, net of cash		$166,112

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(Unaudited)

NOTE 1

GENERAL

Financial Statement Preparation

The significant accounting policies followed by First Merchants Corporation (the “Corporation”) and its wholly owned subsidiaries for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments, which are of a normal recurring nature and are in the opinion of management necessary for a fair statement of the results for the periods reported, have been included in the accompanying consolidated condensed financial statements.

The consolidated condensed balance sheet of the Corporation as of December 31, 2012, has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation’s annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation’s Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the nine months ended September 30, 2013, are not necessarily indicative of the results to be expected for the year.

NOTE 2

PURCHASE AND ASSUMPTION

Effective February 10, 2012, First Merchants Bank, National Association (the “Bank”) assumed substantially all of the deposits and certain other liabilities and acquired certain assets of SCB Bank, a federal savings bank headquartered in Shelbyville, Indiana, from the Federal Deposit Insurance Corporation (“FDIC”), as receiver for SCB Bank (the “Acquisition”), pursuant to the terms of the Purchase and Assumption Agreement – Modified Whole Bank; All Deposits (the “Agreement”), entered into by the Bank, the FDIC as receiver of SCB Bank and the FDIC.

Under the terms of the Agreement, the Bank acquired $147.7 million in assets, including approximately $11.9 million of cash and cash equivalents, $18.9 million of marketable securities, $1.8 million in Federal Home Loan Bank stock, $113.0 million in loans and $2.1 million of premises and other assets. The Bank assumed approximately $135.7 million of liabilities, including approximately $125.9 million in customer deposits, $9.6 million of other borrowed money and $402,000 in other liabilities. These balances are book balances and do not reflect the fair value adjustments which are shown on the following table. The acquisition did not include any loss sharing agreement with the FDIC.

The bid accepted by the FDIC included no deposit premium. The assets were acquired at a discount of $29.0 million from book value. The FDIC made a payment of $17.2 million to the Bank upon the final closing date balance sheet for

SCB Bank that reflected the difference between the purchase price of the assets acquired and the value of the liabilities assumed.

The Bank engaged in this transaction with the expectation that it would be immediately accretive and add a new market area with a demographic profile consistent with many of the current Indiana markets served by the Bank.

The transaction was accounted for under the acquisition method of accounting in accordance with the Business Combination topic of the FASB Accounting Standards Codification (“ASC 310-20 and 310-30”). The statement of net assets and liabilities acquired as of February 10, 2012, are presented below. The assets and liabilities of SCB were recorded at the respective acquisition date provisional fair values, and identifiable intangible assets were recorded at provisional fair value.

Assets		Liabilities	
Cash and due from banks (1)	$29,113	Deposits:	
Investment securities, available for sale	18,896	Non-interest bearing	$13,715
Federal Home Loan Bank stock	1,761	NOW accounts	14,746
Loans:		Savings and money market	25,843
Commercial	51,042	Certificate of deposit	71,605
Residential mortgage	11,181	Total Deposits	125,909
Installment	31,570		
Total Loans	93,793	Federal Home Loan Bank advances	10,286
		Other liabilities	804
Premises	1,516	Total Liabilities Assumed	$136,999
Core deposit intangible	484		
Other assets	560	Net Gain on Acquisition	$9,124
Total Assets Purchased	$146,123		

(1) Includes $17,200,000 cash received from the FDIC.

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In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was acquired loans. The Bank acquired the $113.0 million loan portfolio at a fair value discount of $19.2 million. The performing portion of the portfolio, $86.3 million, had an estimated fair value of $76.5 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20. Discounts or premiums on term loans are accounted for under an effective yield method. Prepayments on term loans are accounted for in the effective yield calculation. Discounts or premiums on lines of credit are treated in a straight line method over the term of the lines of credit.

Certain loans for which specific credit-related deterioration has occurred since origination are recorded at fair value which is derived from calculating the present value of the amounts expected to be collected. Income recognition on these loans is based on reasonable expectation about the timing and amount of cash flows to be collected. Some of the acquired loans deemed impaired and considered collateral dependent, with the timing of a sale of loan collateral indeterminate, remain on non-accrual status and have little to no accretable yield.

In accordance with ASC 310-30 (formerly Statement of Position (“SOP”) 03-3 as of February 10, 2012, loans acquired during 2012 for which it was probable at acquisition that all contractually required payments would not be collected are as follows:

Preliminary estimate of contractually required principal and interest at acquisition	$31,143
Preliminary estimate of contractual cash flows not expected to be collected (nonaccretable differences)	9,688
Preliminary estimate of expected cash flows at acquisition	21,455
Preliminary estimate of interest component of expected cash flows (accretable discount)	4,152
Preliminary estimate of fair value of acquired loans accounted for under ASC 310-30	$17,303

Pro-forma statements were determined to be impracticable due to the nature of the transaction as certain assets were not purchased.

NOTE 3

INVESTMENT SECURITIES

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of the investment securities at the dates indicated were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at September 30, 2013				
U.S. Government-sponsored agency securities	$3,791	$18	$9	$3,800

State and municipal	200,662	4,983	3,463	202,182
U.S. Government-sponsored mortgage-backed securities	397,687	6,136	5,654	398,169
Corporate obligations	6,335		5,851	484
Equity securities	1,706			1,706
Total available for sale	610,181	11,137	14,977	606,341
Held to maturity at September 30, 2013				
State and municipal	115,796	498	6	116,288
U.S. Government-sponsored mortgage-backed securities	191,998	6,600	503	198,095
Total held to maturity	307,794	7,098	509	314,383
Total Investment Securities	$917,975	$18,235	$15,486	$920,724

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2012				
U.S. Government-sponsored agency securities	$4,475	$165		$4,640
State and municipal	148,187	10,025	$18	158,194
U.S. Government-sponsored mortgage-backed securities	337,631	10,994	46	348,579
Corporate obligations	6,105		5,881	224
Equity securities	1,706			1,706
Total available for sale	498,104	21,184	5,945	513,343
Held to maturity at December 31, 2012				
State and municipal	117,227	5,489	1	122,715
U.S. Government-sponsored mortgage-backed securities	243,793	11,681	15	255,459
Total held to maturity	361,020	17,170	16	378,174
Total Investment Securities	$859,124	$38,354	$5,961	$891,517

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The amortized cost and fair value of available for sale securities and held to maturity securities at September 30, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at September 30, 2013:				
Due in one year or less	$8,404	$8,591	$1,060	$1,061
Due after one through five years	11,972	12,481	13,116	13,324
Due after five through ten years	57,708	59,110	59,473	59,634
Due after ten years	132,704	126,284	42,147	42,269
	$210,788	$206,466	$115,796	$116,288
U.S. Government-sponsored mortgage-backed securities	397,687	398,169	191,998	198,095
Equity securities	1,706	1,706		
Total Investment Securities	$610,181	$606,341	$307,794	$314,383

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was $375,411,000 at September 30, 2013, and $335,775,000 at December 31, 2012.

The book value of securities sold under agreements to repurchase amounted to $111,138,000 at September 30, 2013, and $128,094,000 at December 31, 2012.

Gross gains and losses on the sales and redemptions of available for sale securities, and other-than-temporary impairment ("OTTI") losses recognized for the three and nine months ended September 30, 2013 and 2012 are shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Sales and Redemptions of Available for Sale Securities:				
Gross gains	$—	$843	$487	$2,134
Gross losses	—	—	—	—
Other-than-temporary impairment losses	—	—	—	$—

The following table shows the Corporation's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2013, and December 31, 2012:

Less than 12 Months	12 Months or Longer	Total

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Investment Securities at September 30, 2013						
U.S. Government-sponsored agency securities	$1,439	$9			$1,439	$9
State and municipal	76,681	3,467	$239	$2	76,920	3,469
U.S. Government-sponsored mortgage-backed securities	204,743	6,157			204,743	6,157
Corporate obligations			453	5,851	453	5,851
Total Temporarily Impaired Investment Securities	$282,863	$9,633	$692	$5,853	$283,555	$15,486

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Investment Securities at December 31, 2012						
State and municipal	$4,524	$19			$4,524	$19
U.S. Government-sponsored mortgage-backed securities	12,320	61			12,320	61
Corporate obligations			$194	$5,881	194	5,881
Total Temporarily Impaired Investment Securities	$16,844	$80	$194	$5,881	$17,038	$5,961

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Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost as indicated in the table below.

	September 30, 2013	December 31, 2012
Investments reported at less than historical cost:		
Historical cost	$299,041	$22,999
Fair value	$283,555	$17,038
Percent of the Corporation's available for sale and held to maturity portfolio	31.0 %	1.9 %

The Corporation’s management has evaluated all securities with unrealized losses for other-than-temporary impairment ("OTTI") as of September 30, 2013. The evaluations are based on the nature of the securities, the extent and duration of the loss and the intent and ability of the Corporation to hold these securities either to maturity or through the expected recovery period.

The current unrealized losses are primarily concentrated within trust preferred securities held by the Corporation. Such investments have an amortized cost of $6.3 million and a fair value of $453,000, which is less than 1 percent of the Corporation’s entire investment portfolio. On all but one small pool investment, the Corporation utilized Moody’s to determine their fair value.

In determining the fair value of the trust preferred securities, the Corporation utilizes a third party for portfolio accounting services, including market value input. The Corporation has obtained an understanding of what inputs are being used by the vendor in pricing the portfolio and how the vendor was classifying these securities based upon these inputs. From these discussions, the Corporation’s management is comfortable that the classifications are proper. The Corporation has gained trust in the data for two reasons: (a) independent spot testing of the data is conducted by the Corporation through obtaining market quotes from various brokers on a periodic basis and (b) actual gains or loss resulting from the sale of certain securities has proven the data to be accurate over time.

Discount rates used in the OTTI cash flow analysis on these variable rate securities were those margins in effect at the inception of the security added to the appropriate three-month LIBOR spot rate obtained from the forward LIBOR curve used to project future principal and interest payments. These spreads ranged from .85 percent to 1.57 percent spread over LIBOR.

Management believes the declines in fair value for these securities are temporary. Should any additional 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 net income in the period the OTTI is identified.

U.S. Government-Sponsored Mortgage-Backed Securities

The unrealized losses on the Corporation’s investment in U.S. Government-sponsored mortgage-backed securities were a result of changes in interest rates. The Corporation expects to recover the amortized cost basis over the term of the securities as the decline in market value is attributable to changes in interest rates and not credit quality. The

Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at September 30, 2013.

State and Municipal

The unrealized losses on the Corporation's investments in securities of state and political subdivisions were caused by changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at September 30, 2013.

Corporate Obligations

The Corporation's unrealized losses on Corporate Obligations were due to the decline in value related to the pooled trust preferred securities, and is attributable to temporary illiquidity and the financial crisis affecting these markets, coupled with the potential credit loss resulting from the adverse change in expected cash flows. Due to the illiquidity in the market, it is unlikely that the Corporation would be able to recover its investment in these securities if the Corporation sold the securities at this time. Management has analyzed the cash flow characteristics of the securities and this analysis included utilizing the most recent trustee reports and any other relevant market information, including announcements of deferrals or defaults of trust preferred securities. The Corporation compared expected discounted cash flows, based on performance indicators of the underlying assets in the security, to the carrying value of the investment to determine if OTTI existed. The Corporation does not intend to sell the investment, and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the remainder of the investment securities, which are classified as Level 3 inputs in the fair value hierarchy, to be other-than-temporarily impaired at September 30, 2013.

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Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses and other market factors. The following table provides information about debt securities for which only a credit loss was recognized in income and other losses were recorded in other comprehensive income.

	Accumulated Credit Losses in 2013	Accumulated Credit Losses in 2012
Credit losses on debt securities held:		
Balance, January 1	$11,355	$11,355
Additions related to other-than-temporary losses not previously recognized		
Balance, September 30	$11,355	$11,355

NOTE 4

LOANS AND ALLOWANCE

The Corporation’s primary lending focus is small business and middle market commercial, residential real estate, auto and small consumer lending, which results in portfolio diversification. The following tables show the composition in the loan portfolio, loan grades and the allowance for loan losses excluding loans held for sale. Residential real estate loans held for sale as of September 30, 2013, and December 31, 2012, were $5,312,000 and $22,300,000, respectively.

The following table shows the composition of the Corporation’s loan portfolio by loan class for the periods indicated:

	September 30, 2013	December 31, 2012
Commercial and industrial loans	$652,356	$622,579
Agricultural production financing and other loans to farmers	98,489	112,527
Real estate loans:		
Construction	149,875	98,639
Commercial and farmland	1,264,180	1,266,682
Residential	452,277	473,537
Home Equity	206,816	203,406
Individuals' loans for household and other personal expenditures	70,380	75,748
Lease financing receivables, net of unearned income	1,815	2,590
Other loans	29,269	46,501
Loans	2,925,457	2,902,209
Allowance for loan losses	(66,224)	(69,366)
Net Loans	$2,859,233	$2,832,843

The Corporation maintains an allowance for loan losses to cover probable credit losses identified in the loan portfolio. The allowance is increased by the provision for loan losses and decreased by charge offs less recoveries. The provision for loan losses is a charge against earnings. All charge offs are approved by the Bank's senior loan officers or loan committees, depending on the amount of the charge off. The Bank charges off a loan when a determination is made that all or a portion of the loan is not collectible.

The amount provided for loan losses in a given period may be greater than or less than the net loan losses experienced during the period, and is based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision amount in a given period is based on management's ongoing review and evaluation of the loan portfolio, including an internally administered loan "watch" list and an independent loan review process. The allowance evaluation takes into consideration identified credit problems, the possibility of losses inherent in the loan portfolio that are not specifically identified and management's judgment as to the impact of current economic conditions on the portfolio.

Management believes that the allowance for loan losses is adequate to cover probable losses inherent in the loan portfolio as of September 30, 2013. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation's financial results. It requires management to make difficult, subjective and complex judgments, to estimate the effect of uncertain matters. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examinations, and will increase or decrease as deemed necessary to ensure the allowance remains adequate and directionally consistent. In addition, the allowance as a percentage of charge offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

The historical loss allocation for loans not deemed impaired according to ASC 310 is the product of the volume of loans within the non-impaired criticized and non-criticized risk grade classifications, each segmented by call code, and the historical loss factor for each respective classification and call code segment. The historical loss factors are based upon actual loss experience within each risk and call code classification. The historical look back period for non-criticized loans looks to the most recent rolling-four-quarter average and aligns with the look back period for non-impaired criticized loans. Each of the rolling four quarter periods used to obtain the average, include all charge offs for the previous twelve-month period, therefore the historical look back period includes seven quarters. The resulting allocation is reflective of current conditions. Criticized loans are grouped based on the risk grade assigned to the loan. Loans with a special mention grade are assigned a loss factor, and loans with a classified grade but not impaired are assigned a separate loss factor. The loss factor computation for this allocation includes a segmented historical loss migration analysis of criticized risk grades to charge off.

In addition to the specific reserves and historical loss components of the allowance, consideration is given to various environmental factors to help ensure that losses inherent in the portfolio are reflected in the allowance for loan losses. The environmental component adjusts the historical loss allocations for commercial and consumer loans to reflect relevant current conditions that, in management's opinion, have an impact on loss recognition. Environmental factors that management reviews in the analysis include: national and local economic trends and conditions; trends in growth in the loan portfolio and growth in higher risk areas; levels of, and trends in, delinquencies and non-accruals; experience and depth of lending management and staff; adequacy of, and adherence to, lending policies and procedures including those for underwriting; industry concentrations of credit; and adequacy of risk identification systems and controls through the internal loan review and internal audit processes.

The risk characteristics of the Corporation’s material portfolio segments are as follows:

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral and risk grade criteria. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Residential and Consumer

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Corporation generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income and credit rating of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

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The following tables summarize changes in the allowance for loan losses by loan segment for the three and nine months ended September 30, 2013, and September 30, 2012:

	Three Months Ended September 30, 2013					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, July 1	$26,563	$23,605	$2,885	$15,113	$36	$68,202
Provision for losses	(346)	1,560	(31)	333	17	1,533
Recoveries on loans	1,494	258	110	311	3	2,176
Loans charged off	(1,680)	(2,795)	(161)	(1,051)		(5,687)
Balances, September 30, 2013	$26,031	$22,628	$2,803	$14,706	$56	$66,224

	Nine Months Ended September 30, 2013					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	$25,913	$26,703	$2,593	$14,157		$69,366
Provision for losses	1,929	132	267	3,236	$68	5,632
Recoveries on loans	4,050	3,023	426	946	3	8,448
Loans charged off	(5,861)	(7,230)	(483)	(3,633)	(15)	(17,222)
Balances, September 30, 2013	$26,031	$22,628	$2,803	$14,706	$56	$66,224

	Three Months Ended September 30, 2012					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, July 1	$17,791	$35,133	$2,431	$14,788		$70,143
Provision for losses	5,431	(879)	147	(90)		4,609
Recoveries on loans	526	1,598	219	174		2,517
Loans charged off	(1,424)	(4,439)	(168)	(1,745)		(7,776)
Balances, September 30, 2012	$22,324	$31,413	$2,629	$13,127		$69,493

	Nine Months Ended September 30, 2012					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	$17,731	$37,919	$2,902	$12,343	$3	$70,898
Provision for losses	10,333	149	(14)	3,565	(4)	14,029
Recoveries on loans	1,193	3,462	595	968	1	6,219

Loans charged off	(6,933)	(10,117)	(854)	(3,749)		(21,653)
Balances, September 30, 2012	$22,324	$31,413	$2,629	$13,127		$69,493

The following tables show the Corporation's allowance for credit losses and loan portfolio by loan segment as of the periods indicated:

	September 30, 2013					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	$285	$757		$6		$1,048
Collectively evaluated for impairment	25,630	21,560	$2,803	14,700	$56	64,749
Loans Acquired with Deteriorated Credit Quality	116	311				427
Total Allowance for Loan Losses	$26,031	$22,628	$2,803	$14,706	$56	$66,224
Loan Balances:						
Individually evaluated for impairment	$7,946	$33,912		$2,839		$44,697
Collectively evaluated for impairment	771,299	1,370,737	$70,380	655,842	$1,815	2,870,073
Loans Acquired with Deteriorated Credit Quality	869	9,406		412		10,687
Loans	$780,114	$1,414,055	$70,380	$659,093	$1,815	$2,925,457

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	December 31, 2012					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	$1,628	$2,565		$50		$4,243
Collectively evaluated for impairment	24,285	24,138	$2,593	14,107		65,123
Total Allowance for Loan Losses	$25,913	$26,703	$2,593	$14,157		$69,366
Loan Balances:						
Individually evaluated for impairment	$14,190	$45,394		$8,515		$68,099
Collectively evaluated for impairment	765,707	1,309,912	$75,748	667,401	$2,590	2,821,358
Loans Acquired with Deteriorated Credit Quality	1,710	10,015		1,027		12,752
Loans	$781,607	$1,365,321	$75,748	$676,943	$2,590	$2,902,209

Loans are reclassified to a non-accruing status when, in management's judgment, the collateral value and financial condition of the borrower do not justify accruing interest. Interest previously recorded, but not deemed collectible, is reversed and charged against current income. Payments subsequently received on non-accrual loans are applied to principal. A loan is returned to accrual status when principal and interest are no longer past due and collectability is probable, typically after a minimum of six consecutive months of performance. Payments received on impaired accruing or delinquent loans are applied to interest income as accrued.

The following table summarizes the Corporation's non-accrual loans by loan class as of the periods indicated:

	September 30, 2013	December 31, 2012
Commercial and industrial loans	$6,467	$12,195
Agriculture Production financing and other loans to farmers	31	
Real Estate Loans:		
Construction	2,643	4,814
Commercial and farmland	16,187	22,612
Residential	8,375	11,476
Home Equity	1,093	1,997
Individuals' loans for household and other personal expenditures	32	
Lease financing receivables, net of unearned income		301
Other Loans	164	4
Total	$34,992	$53,399

Commercial impaired loans include all non-accrual loans, loans accounted for under ASC 310-30 and renegotiated loans, as well as substandard, doubtful and loss grade loans that were still accruing but deemed impaired according to guidance set forth in ASC 310. Also included in impaired loans are accruing loans that are contractually past due 90 days or more. A loan is deemed impaired when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected.

Allowable methods for determining the amount of impairment include estimating fair value 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. The fair value of real estate is generally based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically ascertained by assessing, either singularly or some combination of, asset appraisals, accounts receivable aging reports, inventory listings and or customer financial statements. Both appraised values and values based on borrower's financial information are discounted as considered appropriate based on age and quality of the information and current market conditions.

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The following tables show the composition of the Corporation's commercial impaired loans by loan class for the periods indicated:

	September 30, 2013		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	$21,683	$7,758	
Agriculture production financing and other loans to farmers	33	31	
Real Estate Loans:			
Construction	6,161	3,789	
Commercial and farmland	46,834	33,085	
Residential	4,671	2,569	
Home equity	3,386	199	
Other loans	457	172	
Total	$83,225	$47,603	
Impaired loans with related allowance:			
Commercial and industrial loans	$1,119	$853	$401
Real Estate Loans:			
Construction			
Commercial and farmland	6,520	5,700	1,068
Residential	74	71	6
Other loans			
Total	$7,713	$6,624	$1,475
Total Impaired Loans	$90,938	$54,227	$1,475

	December 31, 2012		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	$28,532	$11,730	
Real Estate Loans:			
Construction	9,787	5,164	
Commercial and farmland	58,173	43,204	
Residential	8,820	6,215	
Home equity	4,199	1,006	
Other loans	83	14	
Total	$109,594	$67,333	
Impaired loans with related allowance:			

Commercial and industrial loans	$4,415	$4,155	$1,628
Real Estate Loans:			
Construction	1,202	1,058	105
Commercial and farmland	5,579	5,182	2,460
Residential	1,722	1,451	50
Total	$12,918	$11,846	$4,243
Total Impaired Loans	$122,512	$79,179	$4,243

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	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial	$8,352	$110	$9,553	$184
Agriculture production financing and other loans to farmers	32		33	
Real Estate Loans:				
Construction	4,115	29	4,262	85
Commercial and farmland	34,298	620	35,198	1,642
Residential	2,687	82	3,028	114
Home equity	217		236	
Other loans	174		184	1
Total	$49,875	$841	$52,494	$2,026
Impaired loans with related allowance:				
Commercial and industrial	$865		$889	$7
Real Estate Loans:				
Construction				
Commercial and farmland	5,742	$5	5,844	5
Residential	74		78	
Other loans				
Total	$6,681	$5	$6,811	$12
Total Impaired Loans	$56,556	$846	$59,305	$2,038

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	$9,994	$26	$11,615	$68
Agriculture production financing and other loans to farmers	300		300	
Real Estate Loans:				
Construction	6,658	17	7,665	47
Commercial and farmland	31,081	250	33,459	706

Residential	6,936	20	7,342	54
Home equity	713	3	727	10
Other loans	17		18	1
Total	$55,699	$316	$61,126	$886
Impaired loans with related allowance:				
Commercial and industrial loans	$5,244	$11	$5,307	$32
Real Estate Loans:				
Construction	510		541	
Commercial and farmland	12,326	32	12,371	95
Residential	1,485	19	1,485	56
Total	$19,565	$62	$19,704	$183
Total Impaired Loans	$75,264	$378	$80,830	$1,069

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As part of the ongoing monitoring of the credit quality of the Corporation's loan portfolio, management tracks certain credit quality indicators including trends related to: (i) the level of criticized commercial loans, (ii) net charge offs, (iii) non-performing loans and (iv) the general national and local economic conditions.

The Corporation utilizes a risk grading of pass, special mention, substandard, doubtful and loss to assess the overall credit quality of large commercial loans. All large commercial credit grades are reviewed at a minimum of once a year for pass grade loans. Loans with grades below pass are reviewed more frequently depending on the grade. A description of the general characteristics of these grades is as follows:

- Pass - Loans that are considered to be of acceptable credit quality.
- Special Mention - Loans which possess some credit deficiency or potential weakness, which deserves close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Corporation's credit position at some future date. Special mention assets are not adversely classified and do not expose the Corporation to sufficient risk to warrant adverse classification. The key distinctions of this category's classification are that it is indicative of an unwarranted level of risk; and weaknesses are considered “potential”, not “defined”, impairments to the primary source of repayment. Examples include businesses that may be suffering from inadequate management, loss of key personnel or significant customer or litigation.
- Substandard - A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Other characteristics may include:
  - the likelihood that a loan will be paid from the primary source of repayment is uncertain or financial deterioration is underway and very close attention is warranted to ensure that the loan is collected without loss,
  - the primary source of repayment is gone, and the Corporation is forced to rely on a secondary source of repayment, such as collateral liquidation or guarantees,
  - loans have a distinct possibility that the Corporation will sustain some loss if deficiencies are not corrected,
  - unusual courses of action are needed to maintain a high probability of repayment,
  - the borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments,
  - the Corporation is forced into a subordinated or unsecured position due to flaws in documentation,
  - loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms,
  - the Corporation is seriously contemplating foreclosure or legal action due to the apparent deterioration of the loan, and
  - there is significant deterioration in market conditions to which the borrower is highly vulnerable.

- Doubtful - Loans that have all of the weaknesses of those classified as Substandard. However, based on currently existing facts, conditions and values, these weaknesses make full collection of principal highly questionable and improbable. Other credit characteristics may include the primary source of repayment is gone or there is considerable doubt as to the quality of the secondary sources of repayment. The possibility of loss is high, but because of certain important pending factors that may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

- Loss – Loans that are considered uncollectible and of such little value that continuing to carry them as an asset is not warranted. Loans will be classified as Loss when it is neither practical not desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

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The following tables summarize the credit quality of the Corporation’s loan portfolio, by loan class as of the periods indicated. Consumer non-performing loans include accruing consumer loans 90 plus days delinquent and consumer non-accrual loans. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified date.

	September 30, 2013							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	$603,166	$ 18,481	$ 29,155	$ 1,554				$652,356
Agriculture production financing and other loans to farmers	98,458		31					98,489
Real Estate Loans:								
Construction	142,169	2,752	4,491				$ 463	149,875
Commercial and farmland	1,163,570	41,954	58,309	112			235	1,264,180
Residential	139,481	1,504	10,803	140		$293,329	7,020	452,277
Home equity	6,633	105	1,126			197,776	1,176	206,816
Individuals' loans for household and other personal expenditures						70,285	95	70,380
Lease financing receivables, net of unearned income	1,688		127					1,815
Other loans	29,063	2	204					29,269
Loans	$2,184,228	$ 64,798	$ 104,246	$ 1,806		$561,390	$ 8,989	$2,925,457

	December 31, 2012							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	$559,852	$ 23,678	$ 34,460	$ 4,589				$622,579
Agriculture production financing and other loans to farmers	112,209	224	94					112,527
Real Estate Loans:								
Construction	85,728	1,384	11,356				$ 171	98,639
Commercial and farmland	1,148,561	38,199	79,078	553			291	1,266,682

Residential	145,402	5,437	13,880	922		$ 301,614	6,282	473,537
Home equity	9,092	893	1,657			189,721	2,043	203,406
Individuals' loans for household and other personal expenditures						75,748		75,748
Lease financing receivables, net of unearned income						2,289	301	2,590
Other loans	46,473		28					46,501
Loans	$2,107,317	$ 69,815	$ 140,553	$ 6,064		$ 569,372	$ 9,088	$2,902,209

The following table shows a past due aging of the Corporation’s loan portfolio, by loan class as of September 30, 2013, and December 31, 2012:

	September 30, 2013						
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total
Commercial and industrial loans	$645,044	$845			$ 6,467	$ 7,312	$652,356
Agriculture production financing and other loans to farmers	98,458				31	31	98,489
Real Estate Loans:							
Construction	147,157			$75	2,643	2,718	149,875
Commercial and farmland	1,246,319	843	$831		16,187	17,861	1,264,180
Residential	439,860	2,627	998	417	8,375	12,417	452,277
Home equity	204,028	1,153	260	282	1,093	2,788	206,816
Individuals' loans for household and other personal expenditures	69,819	378	88	63	32	561	70,380
Lease financing receivables, net of unearned income	1,815						1,815
Other loans	29,105				164	164	29,269
Loans	$2,881,605	$5,846	$2,177	$837	$ 34,992	$ 43,852	$2,925,457

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	December 31, 2012						
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total
Commercial and industrial loans	$607,442	$2,628	$144	$170	$ 12,195	$ 15,137	$622,579
Agriculture production financing and other loans to farmers	112,527						112,527
Real Estate Loans:							
Construction	93,426	399			4,814	5,213	98,639
Commercial and farmland	1,238,907	3,276	1,822	65	22,612	27,775	1,266,682
Residential	453,743	5,734	1,338	1,246	11,476	19,794	473,537
Home equity	199,063	1,467	323	556	1,997	4,343	203,406
Individuals' loans for household and other personal expenditures	74,919	799	30			829	75,748
Lease financing receivables, net of unearned income	2,289				301	301	2,590
Other loans	46,497				4	4	46,501
Loans	$2,828,813	$14,303	$3,657	$2,037	$ 53,399	$ 73,396	$2,902,209

See the information regarding the analysis of loan loss experience in the "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of Management’s Discussion and Analysis of Financial Condition and Results of Operations included as ITEM 2 of this Form 10-Q.

On occasion, borrowers experience declines in income and cash flow. As a result, these borrowers seek to reduce contractual cash outlays including debt payments. Concurrently, in an effort to preserve and protect earning assets, specifically troubled loans, the Corporation works to maintain its relationship with certain customers who are experiencing financial difficulty by contractually modifying the borrower's debt agreement with the Corporation. In certain loan restructuring situations, the Corporation may grant a concession to a debtor experiencing financial difficulty, resulting in a trouble debt restructuring. A concession is deemed to be granted when, as a result of the restructuring, the Corporation does not expect to collect all amounts due, including interest accrued at the original contract rate. If the payment of principal at original maturity is primarily dependent on the value of collateral, the current value of the collateral is considered in determining whether the principal will be paid.
The following tables summarize troubled debt restructurings that occurred during the periods indicated:

	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Commercial and industrial loans	$162	$ 183	1	$294	$ 315	5
Real Estate Loans:						

Commercial and farmland	1,464	1,469	6	6,449	5,450	10
Residential	190	191	2	658	649	8
Individuals' loans for household and other personal expenditures				44	45	2
Total	$1,816	$ 1,843	9	$7,445	$ 6,459	25

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Commercial and industrial loans	$875	$ 1,048	3	$1,155	$ 1,327	6
Real Estate Loans:						
Construction	303	303	1	794	653	2
Commercial and farmland	875	875	2	2,967	2,828	7
Residential	239	241	4	2,196	2,063	19
Individuals' loans for household and other personal expenditures	90	117	4	90	117	4
Total	$2,382	$ 2,584	14	$7,202	$ 6,988	38

Commercial and Farmland real estate loans account for 67 percent and 40 percent of the troubled debt restructured loans made in the three and nine months ended September 30, 2013, respectively. Five and twelve troubled debt restructured loans made during the three and nine months ended September 30, 2013, respectively, are in accrual status.

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The following tables show the recorded investment of troubled debt restructurings, by modification type, that occurred during the periods indicated:

	Three Months Ended September 30, 2013			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	$175			$175
Real Estate Loans:				
Commercial and farmland	1,399			1,399
Residential	158	$34		192
Total	$1,732	$34		$1,766

	Nine Months Ended September 30, 2013			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	$228		$63	$291
Real Estate Loans:				
Commercial and farmland	1,399		1,950	3,349
Residential	158	$94	353	605
Individuals' loans for household and other personal expenditures			26	26
Total	$1,785	$94	$2,392	$4,271

	Three Months Ended September 30, 2012			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans			$1,048	$1,048
Real Estate Loans:				
Construction			299	299
Commercial and farmland		$680	195	875
Residential			167	167
Individuals loans for household and other personal expenditures		7	109	116
Total		$687	$1,818	$2,505

	Nine Months Ended September 30, 2012			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	$230		$1,072	$1,302
Real Estate Loans:				

Construction			639	639
Commercial and farmland	1,693	$680	385	2,758
Residential	528	252	1,100	1,880
Individuals' loans for household and other personal expenditures		7	109	116
Total	$2,451	$939	$3,305	$6,695

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The following tables summarize troubled debt restructures that occurred during the twelve months ended September 30, 2013, and September 30, 2012, that subsequently defaulted during the period indicated and remained in default at period end. For purposes of this schedule, a loan is considered in default if it is 30 or more days past due.

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Commercial and Industrial loans	1	$18	1	$18
Real Estate Loans:				
Commercial and farmland			1	223
Residential	2	166	2	166
Total	3	$184	4	$407

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Commercial and Industrial loans	3	$1,415	3	$1,415
Real Estate Loans:				
Commercial and farmland	1	23	1	23
Residential	7	371	11	2,494
Total	11	$1,809	15	$3,932

For potential consumer loan restructures, impairment evaluation occurs prior to modification. Any subsequent impairment is typically addressed through the charge off process, or may be addressed through a specific reserve. Consumer troubled debt restructurings are generally included in the general historical allowance for loan loss at the post modification balance. Consumer non-accrual and delinquent troubled debt restructurings are also considered in the calculation of the non-accrual and delinquency trend environmental allowance allocation. Commercial troubled debt restructured loans risk graded special mention, substandard, doubtful and loss are individually evaluated for impairment under ASC 310. Any resulting specific reserves are included in the allowance for loan losses. Commercial 30 - 89 day delinquent troubled debt restructurings are included in the calculation of the delinquency trend environmental allowance allocation. All commercial non-impaired loans, including non-accrual and 90+ day delinquents, are included in the ASC 450 loss migration analysis.

NOTE 5

ACCOUNTING FOR CERTAIN LOANS ACQUIRED IN A PURCHASE

The Bank acquired loans in a purchase during the year ended December 31, 2012. The following table includes the carrying amount of these loans, which are included in the balance sheet amounts of loans receivable at September 30, 2013 and December 31, 2012.

	September 30, 2013	December 31, 2012
Commercial and industrial loans	$6,265	$8,542
Agricultural production financing and other loans to farmers	1,382	1,127
Real estate loans:		
Construction	8	58
Commercial and farmland	18,553	24,259
Residential	9,614	12,118
Home Equity	16,529	18,805
Individuals' loans for household and other personal expenditures	336	691
Other Loans	164	
Total	$52,851	$65,600

Accretable yield, or income expected to be collected, is as follows:

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
Beginning balance	$3,959	$5,142
Accretion	(413)	(1,596)
Ending balance, September 30, 2013	$3,546	$3,546

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(table dollar amounts in thousands, except share data)

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Beginning balance	$9,048	$9,774
Accretion	(2,612)	(3,338)
Ending balance, September 30, 2012	$6,436	$6,436

At acquisition, certain purchased loans evidenced deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Certain loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan to value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition, which incorporated the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

NOTE 6

DERIVATIVE FINANCIAL INSTRUMENTS

Risk Management Objective of Using Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Corporation enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash payments principally related to certain variable-rate liabilities. The Corporation also has derivatives that are a result of a service the Corporation provides to certain qualifying customers, and, therefore, are not used to manage interest rate risk in the Corporation's assets or liabilities. The Corporation manages a matched book with respect to its derivative instruments offered as a part of this service to its customers in order to minimize its net risk exposure resulting from such transactions.

Cash Flow Hedges of Interest Rate Risk

The Corporation's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish these objectives, the Corporation primarily uses interest rate swaps and interest rate caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the payment of fixed amounts to a counterparty in exchange for the Corporation receiving variable payments over the life of the agreements without exchange of the underlying notional amount. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. As of September 30, 2013 and 2012, the Corporation had five interest rate swaps with a notional amount of $56.0 million and one interest rate cap with a notional amount of $13.0 million that were designated as cash flow hedges.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2013, $26.0 million of the interest rate swaps and the $13.0 million interest rate cap were used to hedge the variable cash outflows (LIBOR-based) associated with existing trust preferred securities when the outflows converted from a fixed rate to variable rate in September of 2012. In addition, the remaining $30.0 million of interest rate swaps were used to hedge the variable cash outflows (LIBOR-based) associated with three Federal Home Loan Bank advances. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the nine months ended September 30, 2013, and 2012, the Corporation did not recognize any ineffectiveness.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Corporation's variable-rate liabilities. During the next twelve months, the Corporation expects to reclassify $1,355,000 from accumulated other comprehensive income to interest expense.

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Non-designated Hedges

The Corporation does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain customers. The Corporation executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Corporation executes with a third party, such that the Corporation minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of September 30, 2013, the notional amount of customer-facing swaps was approximately $146,980,000. This amount is offset with third party counterparties, as described above.

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Corporation's derivative financial instruments, as well as their classification on the Balance Sheet, as of September 30, 2013, and December 31, 2012.

	Asset Derivatives				Liability Derivatives			
	September 30, 2013		December 31, 2012		September 30, 2013		December 31, 2012	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:								
Interest rate contracts	Other Assets	$421	Other Assets	$197	Other Liabilities	$1,441	Other Liabilities	$3,332
Derivatives not designated as hedging instruments:								
Interest rate contracts	Other Assets	$3,054	Other Assets	$6,103	Other Liabilities	$3,136	Other Liabilities	$6,434

Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Corporation's derivative financial instruments on the Income Statement for three and nine months ended September 30, 2013, and 2012.

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative
		Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013

Interest rate contracts	Other income	$(16)	$249

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative
		Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Interest rate contracts	Other income	$(70)	$(125)

The amount of gain (loss) recognized in other comprehensive income is included in the table below for the periods indicated.

Derivatives in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivative (Effective Portion)			
	Three Months ended		Nine Months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Interest Rate Products	$(248)	$(376)	$1,550	$(1,529)

The amount of gain (loss) reclassified from other comprehensive income into income is included in the table below for the periods indicated.

Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Other Comprehensive Income into Income (Effective Portion)			
	Three Months ended		Nine Months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Interest Expense	$(207)		$(587)	

The Corporation’s exposure to credit risk occurs because of nonperformance by its counterparties. The counterparties approved by the Corporation are usually financial institutions, which are well capitalized and have credit ratings through Moody’s and/or Standard & Poor’s, at or above investment grade. The Corporation’s control of such risk is through quarterly financial reviews, comparing mark-to-mark values with policy limitations, credit ratings and collateral pledging.

Credit-risk-related Contingent Features

The Corporation also has agreements with certain of its derivative counterparties that contain a provision where if the Corporation fails to maintain its status as a well or adequate capitalized institution, then the Corporation could be required to terminate or fully collateralize all outstanding derivative contracts.

The Corporation has agreements with certain of its derivative counterparties that contain a provision where if the Corporation defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, the Corporation could also be declared in default on its derivative obligations.

As of September 30, 2013, the termination value of derivatives in a net liability position related to these agreements was $4,365,000. As of September 30, 2013, the Corporation had minimum collateral posting thresholds with certain of its derivative counterparties and had posted collateral of $4,271,000. If the Corporation had breached any of these provisions at September 30, 2013, it could have been required to settle its obligations under the agreements at their termination value.

NOTE 7

DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

The Corporation used fair value measurements to record fair value adjustments, to certain assets, and liabilities and to determine fair value disclosures. The accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820 applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances.

As defined in ASC 820, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants. It represents an exit price at the measurement date. Market participants are buyers and sellers, who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset or liability being measured. Current market conditions, including imbalances between supply and demand, are considered in determining fair value. The Corporation values its assets and liabilities in the principal market where it sells the particular asset or transfers the liability with the greatest volume and level of activity. In the absence of a principal market, the valuation is based on the most advantageous market for the asset or liability (i.e., the market where the asset could be sold or the liability transferred at a price that maximizes the amount to be received for the asset or minimizes the amount to be paid to transfer the liability).

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability. Inputs can be observable or unobservable. Observable inputs are those assumptions which market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Corporation. Unobservable inputs are assumptions based on the Corporation's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date. All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy which gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs for which there is little or no market activity (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation considers an input to be significant if it drives 10 percent or more of the total fair value of a particular asset or liability.

(table dollar amounts in thousands, except share data)

Recurring Measurements

The following table presents the fair value measurements of assets and liabilities recognized in the Consolidated Condensed Balance Sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2013, and December 31, 2012.

		Fair Value Measurements Using:		
September 30, 2013	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:				
U.S. Government-sponsored agency securities	$3,800		$3,800	
State and municipal	202,182		181,672	$20,510
U.S. Government-sponsored mortgage-backed securities	398,169		398,169	
Corporate obligations	484			484
Equity securities	1,706		1,702	4
Interest rate swap asset	3,054		3,054	
Interest rate cap	421		421	
Interest rate swap liability	4,577		4,577	