PARKE BANCORP, INC.
Form 10-Q
August 14, 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 No. 000-51338

PARKE BANCORP, INC.
(Exact name of registrant as specified in its charter)

New Jersey	65-1241959
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
601 Delsea Drive, Washington Township, New Jersey	08080
(Address of principal executive offices)	(Zip Code)

856-256-2500
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

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

Large accelerated filer [ ]   Accelerated filer [ ]   Non-accelerated filer [ ]   Smaller reporting company [X]

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 August 14, 2013, there were issued and outstanding 5,982,810 shares of the registrant's common stock.

PARKE BANCORP, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2013

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Parke Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets

(unaudited)
(in thousands except share and per share data)

	June 30, 2013	December 31, 2012
Assets		
Cash and due from financial institutions	$ 3,598	$ 2,601
Federal funds sold and cash equivalents	33,491	74,265
Cash and cash equivalents	37,089	76,866
Investment securities available for sale, at fair value	17,531	19,340
Investment securities held to maturity (fair value of $2,139 at June 30, 2013 and $2,239 at December 31, 2012)	2,084	2,066
Total investment securities	19,615	21,406
Loans held for sale	698	495
Loans, net of unearned income	644,024	629,712
Less: Allowance for loan losses	(20,867)	(18,936)
Net loans	623,157	610,776
Accrued interest receivable	2,762	2,727
Premises and equipment, net	4,012	3,989
Other real estate owned (OREO)	23,669	26,057
Restricted stock, at cost	2,047	2,223
Bank owned life insurance (BOLI)	10,928	10,743
Deferred tax asset	4,815	4,696
Other assets	9,571	10,499
Total Assets	$ 738,363	$ 770,477
Liabilities and Equity		
Liabilities		
Deposits		
Noninterest-bearing deposits	$ 29,945	$ 30,342
Interest-bearing deposits	579,574	606,865
Total deposits	609,519	637,207
FHLBNY borrowings	20,365	20,448
Other borrowed funds	5,000	10,000
Subordinated debentures	13,403	13,403
Accrued interest payable	475	537
Other liabilities	4,734	5,339
Total liabilities	653,496	686,934
Equity		
Preferred stock, cumulative perpetual, $1,000 liquidation value; authorized 1,000,000 shares; Issued: 16,288 shares at June 30, 2013 and December 31, 2012	16,168	16,065
Common stock, $.10 par value; authorized 10,000,000 shares; Issued:	619	560

6,193,710 shares at June 30, 2013 and 5,594,793 shares at December 31, 2012				
Additional paid-in capital		52,665		48,869
Retained earnings		19,464		21,068
Accumulated other comprehensive loss		(858)		(745)
Treasury stock, 210,900 shares at June 30, 2013 and December 31, 2012, at cost		(2,180)		(2,180)
Total shareholders' equity		85,878		83,637
Noncontrolling interest in consolidated subsidiaries		(1,011)		(94)
Total equity		84,867		83,543
Total liabilities and equity	$	738,363	$	770,477

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	For the six months ended June 30,		For the three months ended June 30,	
	2013	2012	2013	2012
	(in thousands except share data)		(in thousands except share data)	
Interest income:				
Interest and fees on loans	$17,811	$18,871	$8,765	$9,358
Interest and dividends on investments	383	540	179	252
Interest on federal funds sold and cash equivalents	73	119	33	66
Total interest income	18,267	19,530	8,977	9,676
Interest expense:				
Interest on deposits	2,664	3,459	1,289	1,687
Interest on borrowings	426	475	204	233
Total interest expense	3,090	3,934	1,493	1,920
Net interest income	15,177	15,596	7,484	7,756
Provision for loan losses	(2,000)	(4,300)	(1,000)	(2,050)
Net interest income after provision for loan losses	13,177	11,296	6,484	5,706
Noninterest income:				
Gain on sale of SBA loans	1,468	1,357	969	755
Loan fees	323	159	161	105
Net income from BOLI	185	91	94	46
Service fees on deposit accounts	116	104	65	54
Loss on sale and write-down of real estate owned	(455)	(625)	(91)	(537)
Other	323	528	113	108
Total noninterest income	1,960	1,614	1,311	531
Noninterest expense:				
Compensation and benefits	3,382	2,852	1,724	1,410
Professional services	756	776	439	500
Occupancy and equipment	483	531	239	267
Data processing	243	203	132	109
FDIC insurance	544	546	296	276
OREO expense	788	687	403	318
Other operating expense	1,759	1,902	994	1,110
Total noninterest expense	7,955	7,497	4,227	3,990
Income before income tax expense	7,182	5,413	3,568	2,247
Income tax expense	2,810	1,529	1,397	257
Net income attributable to Company and noncontrolling interest	4,372	3,884	2,171	1,990
Net income attributable to noncontrolling interest	(247)	(248)	(183)	(141)
Net income attributable to Company	4,125	3,636	1,988	1,849
Preferred stock dividend and discount accretion	(510)	(504)	(256)	(253)

Net income available to common shareholders	$3,615	$3,132	$1,732	$1,596
Earnings per common share:				
Basic	$0.61	$0.53	$0.29	$0.27
Diluted	$0.61	$0.53	$0.29	$0.27
Weighted average shares outstanding:				
Basic	5,944,915	5,916,502	5,962,623	5,917,118
Diluted	5,944,915	5,916,502	5,963,644	5,917,118

See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the six months ended June 30,		For the three months ended June 30,	
	2013	2012	2013	2012
	(in thousands)		(in thousands)	
Net income attributable to Company	$4,125	$3,636	$1,988	$1,849
Unrealized (losses) gains on securities:				
Non-credit related unrealized gains on securities with OTTI	15	32	3	44
Unrealized (losses) gains on securities without OTTI	(304)	50	(243)	32
Tax Impact	116	(33)	96	(30)
Less reclassification adjustment for gain on sales of securities realized in net income	—	—	—	—
Less reclassification adjustment for credit related OTTI realized in net income	—	—	—	—
Total unrealized (losses) gains on securities	(173)	49	(144)	46
Gross pension liability adjustments	100	12	47	10
Tax Impact	(40)	(5)	(19)	(3)
Total pension liability adjustment	60	7	28	7
Total other comprehensive (loss) income	(113)	56	(116)	53
Total comprehensive income	$4,012	$3,692	$1,872	$1,902

See accompanying notes to consolidated financial statements

Parke Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF EQUITY
(unaudited)

	Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity	Non-Controlling Interest	Total Equity
	(in thousands except share data)									
Balance, December 31, 2012	$16,065	5,594,793	$560	$48,869	$21,068	$(745)	$(2,180)	$83,637	$(94)	$83,543
Capital withdrawals by noncontrolling interest									(1,164)	(1,164)
Stock options exercised		57,591	6	284				290		290
Redemption of Warrant				(930)	(720)			(1,650)		(1,650)
10% common stock dividend		541,612	53	4,442	(4,497)			(2)		(2)
Net income					4,125			4,125	247	4,372
Changes in other comprehensive income						(113)		(113)		(113)
Dividend on preferred stock (5% annually)					(409)			(409)		(409)
Accretion of discount on preferred stock	103				(103)			—		—
Balance, June 30, 2013	$16,168	6,193,996	$619	$52,665	$19,464	$(858)	$(2,180)	$85,878	$(1,011)	$84,867

See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the six months ended June 30,	
	2013	2012
	(Amounts in thousands)	
Cash Flows from Operating Activities		
Net income	$4,372	$3,884
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	169	183
Provision for loan losses	2,000	4,300
Bank owned life insurance	(185)	(91)
Supplemental executive retirement plan expense	17	68
Gain on sale of SBA loans	(1,468)	(1,357)
SBA loans originated for sale	(11,831)	(12,784)
Proceeds from sale of SBA loans originated for sale	13,096	14,366
Loss on sale & write down of other real estate owned	455	625
Net accretion of purchase premiums and discounts on securities	21	(11)
Deferred income tax benefit	(119)	602
Changes in operating assets and liabilities:		
Decrease (increase) in accrued interest receivable and other assets	893	(2,031)
(Decrease) increase in accrued interest payable and other accrued liabilities	(605)	1,144
Net cash provided by operating activities	6,815	8,898
Cash Flows from Investing Activities		
Purchases of investment securities available for sale	(2,022)	(4,148)
Redemptions of restricted stock	176	1,338
Proceeds from sale and call of securities available for sale	1,000	—
Proceeds from maturities and principal payments on mortgage backed securities	2,501	3,189
Proceeds from sale of other real estate owned	3,157	1,246
Advances on other real estate owned	(64)	(207)
Net (increase) decrease in loans	(15,541)	5,961
Purchases of bank premises and equipment	(93)	(191)
Net cash (used in) provided by investing activities	(10,886)	7,188
Cash Flows from Financing Activities		
Payment of dividend on preferred stock	(409)	(407)
Cash payment of fractional shares on 10% stock dividend	(2)	(1)
Minority interest capital withdrawal, net	(1,164)	(759)
Proceeds from exercise of stock options	290	35
Redemption payment for TARP Warrant	(1,650)	—
Net decrease in FHLBNY and short term borrowings	(83)	(30,078)
Net decrease in other borrowed funds	(5,000)	—
Net (decrease) increase in noninterest-bearing deposits	(397)	1,733
Net (decrease) increase in interest-bearing deposits	(27,291)	22,142
Net cash used in financing activities	(35,706)	(7,335)
(Decrease) increase in cash and cash equivalents	(39,777)	8,751
Cash and Cash Equivalents, January 1,	76,866	110,228

Cash and Cash Equivalents, June 30,	$37,089	$118,979
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		
Interest on deposits and borrowed funds	$3,152	$3,937
Income taxes	$2,708	$2,365
Supplemental Schedule of Noncash Activities:		
Real estate acquired in settlement of loans	$1,160	$8,981

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

Parke Bancorp, Inc. ("Parke Bancorp" or the "Company") is a bank holding company incorporated under the laws of the State of New Jersey in January 2005 for the sole purpose of becoming the holding company of Parke Bank (the "Bank").

The Bank is a commercial bank which commenced operations on January 28, 1999. The Bank is chartered by the New Jersey Department of Banking and insured by the Federal Deposit Insurance Corporation ("FDIC"). Parke Bancorp and the Bank maintain their principal offices at 601 Delsea Drive, Washington Township, New Jersey. The Bank also conducts business through branches in Galloway Township, Northfield and Washington Township, New Jersey and Philadelphia, Pennsylvania.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Bank is subject to the regulations of certain state and federal agencies, and accordingly, the Bank is periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank's business is particularly susceptible to future state and federal legislation and regulations.

The FDIC and the New Jersey Department of Banking and Insurance Consent Orders: On April 9, 2012, the Bank entered into Consent Orders with the FDIC and the New Jersey Department of Banking and Insurance (the "Department"). Under the Consent Orders, the terms of which are substantially identical, the Bank is required, among other things, subject to review and approval by the FDIC and the Department: (i) to adopt and implement a plan to reduce the Bank's position in delinquent or classified assets; (ii) to adopt and implement a program providing for a periodic independent review of the Bank's loan portfolio and the identification of problem credits; (iii) to review and revise the Bank's loan policies and procedures to address identified lending deficiencies; and (iv) to adopt and implement a plan to reduce and manage each of the concentrations of credit identified by the FDIC and the Department.

The Consent Orders also require the Bank to obtain the prior approval of the FDIC and the New Jersey Department before declaring or paying any dividend or appointing or changing the title or responsibilities of any director or senior executive officer. Additional regulatory provisions require FDIC prior approval before the Bank enters into any employment agreement or other agreement or plan providing for the payment of a "golden parachute payment" or the making of any golden parachute payment. The Bank believes it is in substantial compliance with the terms of the Consent Order.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation: The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and predominant practices within the banking industry.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary the Bank. Also included are the accounts of 44 Business Capital Partners LLC, a joint venture formed in 2009 to originate and service SBA loans. The Bank has a 51% ownership interest in the

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joint venture. Parke Capital Trust I, Parke Capital Trust II and Parke Capital Trust III are wholly-owned subsidiaries but are not consolidated because they do not meet the requirements for consolidation under applicable accounting guidance. All significant inter-company balances and transactions have been eliminated.

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the six months and three months ended June 30, 2013 and 2012 are unaudited. The balance sheet as of December 31, 2012, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the six months ended June 30, 2013 are not necessarily indicative of the results for the full year.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the allowance for loan losses, other than temporary impairment losses on investment securities, the valuation of deferred income taxes, servicing assets and carrying value of OREO.

Recently Issued Accounting Pronouncements:

In December 2011, the FASB issued ASU 2011-11, "Balance Sheet, Disclosure about Offsetting Assets and Liabilities (Topic 210)". The objective of this update is to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. This includes the effect or potential effect of rights of setoff associated with an entity's recognized assets and recognized liabilities within the scope of this Update. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they offset in accordance with either Section 210-20-45 or Section 815-10-45. These amendments are effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. Adoption of this update did not have a material impact on the Company's financial position or results of operations.

In January 2013, the FASB issued ASU 2013-01, "Balance Sheet, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities (Topic 210)". The amendments in this update clarify that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. An entity is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. Adoption of this update did not have a material impact on the Company's financial position or results of operations.

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (Topic 220)". The amendments in this

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update aim to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account instead of directly to income or expense in the same reporting period. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted the amendments of ASU 2011-12 effective January 1, 2013 and has applied the amendments retrospectively. Adoption of this update did not have a material impact on the Company's financial position or results of operations.

NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of June 30, 2013 and December 31, 2012:

As of June 30, 2013	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
	(Amounts in thousands)				
Available for sale:					
U.S. Government sponsored entities	$7	$—	$—	$—	$7
Corporate debt obligations	500	7	—	—	507
Residential mortgage-backed securities	12,054	323	129	—	12,248
Collateralized mortgage obligations	701	37	—	—	738
Collateralized debt obligations	5,556	—	1,041	484	4,031
Total available for sale	$18,818	$367	$1,170	$484	$17,531
Held to maturity:					
States and political subdivisions	$2,084	$55	$—	$—	$2,139

As of December 31, 2012	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
	(Amounts in thousands)				
Available for sale:					
U.S. Government sponsored entities	$7	$—	$—	$—	$7
Corporate debt obligations	1,500	24	—	—	1,524
Residential mortgage-backed securities	12,359	540	—	—	12,899
Collateralized mortgage obligations	916	58	—	—	974
Collateralized debt obligations	5,556	—	1,121	499	3,936
Total available for sale	$20,338	$622	$1,121	$499	$19,340
Held to maturity:					
States and political subdivisions	$2,066	$173	$—	$—	$2,239

The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of June 30, 2013 are as follows:

	Amortized Cost	Fair Value
	(Amounts in thousands)	
Available for sale:		
Due within one year	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	6,063	4,545
Residential mortgage-backed securities and collateralized mortgage obligations	12,755	12,986
Total available for sale	$18,818	$17,531
Held to maturity:		
Due within one year	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	2,084	2,139
Total held to maturity	$2,084	$2,139

Expected maturities will differ from contractual maturities for mortgage related securities because the issuers of certain debt securities do have the right to call or prepay their obligations without any penalty.

As of June 30, 2013 and December 31, 2012, approximately $12.4 million and $10.3 million, respectively, of investment securities were pledged as collateral for borrowed funds. In addition, securities with a carrying value of $6.7 million and $4.2 million, respectively, were pledged to secure public deposits at June 30, 2013 and December 31, 2012.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired (“OTTI”), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2013 and December 31, 2012:

As of June 30, 2013	Less than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Amounts in thousands)					
Available for sale:						
Residential mortgage backed securities and collateralized mortgage obligations	5,992	129	—	—	5,992	129
Collateralized debt obligations	—	—	3,709	1,041	3,709	1,041
Total available for sale	$5,992	$129	$3,709	$1,041	$9,701	$1,170
Held to maturity:						
States and political subdivisions	$—	$—	$—	$—	$—	$—

As of December 31, 2012	Less than 12 Months		12 Months or Greater		Total	
Desriptin of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Amoutns in thousands)					
Available for sale:						
Collateralized debt obligations	—	—	3,629	1,121	3,629	1,121
Total available for sale	$—	$—	$3,629	$1,121	$3,629	$1,121
Held to maturity:						
States and political subdivisions	$—	$—	$—	$—	$—	$—

Residential Mortgage-Backed Securities and Collateralized Mortgage Obligations: The unrealized losses on the Company's investment in mortgage-backed securities relates to four securities. The losses were caused by movement in interest rates. The securities were issued by FNMA, a government sponsored entity. It is expected that the U.S. government will guarantee all contractual cash flows. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider the investment in these securities to be other-than-temporarily impaired at June 30, 2013.

Collateralized Debt Obligations: The Company's unrealized loss on investments in collateralized debt obligations ("CDOs") relates to three securities issued by financial institutions, totaling $3.7 million. CDOs are pooled securities primarily secured by trust preferred securities ("TruPS"), subordinated debt and surplus notes issued by small and mid-sized banks and insurance companies. These securities are generally floating rate instruments with 30-year maturities, and are callable at par by the issuer after five years. The current economic downturn has had a significant adverse impact on the financial services industry; consequently, TruPS CDOs do not have an active trading market. With the assistance of competent third-party valuation specialists, the Company utilized the following methodology to determine the fair value:

Cash flows were developed based on the estimated speeds at which the trust preferred securities are expected to prepay (a range of 1% to 2%), the estimated rates at which the trust preferred securities are expected to defer payments, the estimated rates at which the trust preferred securities are expected to default (a range of 0.57% to 0.66%), and the severity of the losses on securities which default (95%). Trust preferred securities generally allow for prepayment by the issuer without a prepayment penalty any time after five years. Due to the lack of new trust preferred issuances and the relatively poor conditions of the financial institution industry, a relatively modest rate of prepayment was assumed going forward. Estimates for conditional default rates ("CDR") are based on the payment characteristics of the trust preferred securities themselves (e.g. current, deferred, or defaulted) as well as the financial condition of the trust preferred issuers in the pool. Estimates for the near-term rates of deferral and CDR are based on key financial ratios relating to the financial institutions' capitalization, asset quality, profitability and liquidity. Finally, we consider whether or not the financial institution has received TARP funding, and if it has, the amount. Longer-term rates of deferral and defaults are based on historical averages. The fair value of each bond was assessed by discounting its projected cash flows by a discount rate. The discount rates were based on the yields of publicly traded TruPS and preferred stock issued by comparably rated banks (3 month LIBOR plus a spread of 400 to 959 basis points). The fair value for previous reporting periods was based on indicative market bids and resulted in much lower values due to the inactive trading market.

The underlying issuers have been analyzed, and projections have been made regarding the future performance, considering factors including defaults and interest deferrals. The analysis indicates that the

Company should expect to receive all contractual cash flows. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, it does not consider these investments to be other than temporarily impaired at June 30, 2013.

Other Than Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an OTTI exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity.

The following table presents a roll-forward of the credit loss component of the amortized cost of debt securities that we have written down for OTTI and the credit component of the loss that is recognized in earnings. OTTI recognized in earnings for credit-impaired debt securities is presented as additions in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairments). The credit loss component is reduced if we sell, intend to sell or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive cash flows in excess of what we expected to receive over the remaining life of the credit-impaired debt security, the security matures or is fully written down. Changes in the credit loss component of credit-impaired debt securities were as follows for the periods ended June 30, 2013 and 2012.

	For the Six Months Ended June 30,	
	2013	2012
	(Amounts in thousands)	
Beginning balance	$ 1,219	$ 1,950
Initial credit impairment	—	—
Subsequent credit impairments	—	—
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	—	—
Reductions for securities deemed worthless	(54)	(399)
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$ 1,165	$ 1,551

	For the Three Months Ended June 30,	
	2013	2012
	(Amounts in thousands)	
Beginning balance	$ 1,165	$ 1,551
Initial credit impairment	—	—
Subsequent credit impairments	—	—
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	—	—
Reductions for securities deemed worthless	—	—
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$ 1,165	$ 1,551

There were no investment gains and losses recognized in income during the six month periods ended June 30, 2013 and 2012.

NOTE 4. LOANS

The portfolio of loans outstanding consists of:

	June 30, 2013		December 31, 2012	
	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans
	(Amounts in thousands)			
Commercial and Industrial	$ 24,828	3.9%	$ 21,925	3.5%
Real Estate Construction:				
Residential	7,726	1.2	7,331	1.2
Commercial	47,476	7.4	41,875	6.6
Real Estate Mortgage:				
Commercial – Owner Occupied	156,992	24.4	157,616	25.0
Commercial – Non-owner Occupied	222,696	34.6	221,731	35.2
Residential – 1 to 4 Family	146,706	22.8	140,164	22.3
Residential – Multifamily	20,064	3.1	21,181	3.4
Consumer	17,536	2.6	17,889	2.8
Total Loans	$644,024	100.0%	$629,712	100.0%

Loan Origination/Risk Management: In the normal course of business the Company is exposed to a variety of operational, reputational, legal, regulatory and credit risks that could adversely affect our financial performance. Most of our asset risk is primarily tied to credit (lending) risk. The Company has lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Board of Directors reviews and approves these policies, guidelines and procedures. When we originate a loan we make certain subjective judgments about the borrower's ability to meet the loan's terms and conditions. We also make objective and subjective value assessments on the assets we finance. The borrower's ability to repay can be adversely affected by economic changes. Likewise, changes in market conditions and other external factors can affect asset valuations. The Company actively monitors the quality of its loan portfolio. A reporting system supplements the credit review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit risk, loan delinquencies, troubled debt restructures, nonperforming and potential problem loans. Diversification in the loan portfolio is another means of managing risk associated with fluctuations in economic conditions.

With respect to construction loans to developers and builders that are secured by non-owner occupied properties, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analyses of the developers and property owners. Construction loans are generally underwritten based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate

repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. Commercial real estate loans may be riskier than loans for one-to-four family residences and are typically larger in dollar size. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is generally largely dependent on the successful operation and management 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. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location within our market area. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. The Company also monitors economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Consumer loans may carry a higher degree of repayment risk than residential mortgage loans. Repayment is typically dependent upon the borrower's financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. To monitor and manage consumer loan risk, policies and procedures have been developed and modified as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Historically the Company's losses on consumer loans have been negligible.

The Company maintains an outsourced independent loan review program that reviews and validates the credit risk assessment program on a periodic basis. Results of these external independent reviews are presented to management. The external independent loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit risk management personnel.

Nonaccrual and Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when a loan is 90 days past due, unless the loan is well secured and in the process of collection, as required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An age analysis of past due loans by class at June 30, 2013 and December 31, 2012 follows:

June 30, 2013	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(Amounts in thousands)					
Commercial and Industrial	$—	$—	$130	$130	$24,698	$24,828
Real Estate Construction:						
Residential	—	—	845	845	6,881	7,726
Commercial	—	—	12,961	12,961	34,515	47,476
Real Estate Mortgage:						
Commercial – Owner Occupied	—	—	1,058	1,058	155,934	156,992
Commercial – Non-owner Occupied	—	—	19,118	19,118	203,578	222,696
Residential – 1 to 4 Family	5,565	—	9,421	14,986	131,720	146,706
Residential – Multifamily	—	—	1,467	1,467	18,597	20,064
Consumer	58	—	252	310	17,226	17,536
Total Loans	$5,623	$—	$45,252	$50,875	$593,149	$644,024

December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(Amounts in thousands)					
Commercial and Industrial	$—	$—	$248	$248	$21,677	$21,925
Real Estate Construction:						
Residential	—	—	799	799	6,532	7,331
Commercial	—	—	12,958	12,958	28,917	41,875
Real Estate Mortgage:						
Commercial – Owner Occupied	—	—	1,218	1,218	156,398	157,616
Commercial – Non-owner Occupied	6,439	—	19,228	25,667	196,064	221,731
Residential – 1 to 4 Family	1,703	169	10,072	11,944	128,220	140,164
Residential – Multifamily	—	—	2,838	2,838	18,343	21,181
Consumer	71	49	188	308	17,581	17,889
Total Loans	$8,213	$218	$47,549	$55,980	$573,732	$629,712

Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

All impaired loans have are assessed for recoverability based on an independent third-party full appraisal to determine the net realizable value ("NRV") based on the fair value of the underlying collateral, less cost to sell and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are generally updated every 12 months or sooner if we have identified possible further deterioration in value. Prior to receiving the updated appraisal, we will establish a specific reserve for any estimated deterioration, based upon our assessment of market conditions, adjusted for estimated costs to sell and other identified costs. If the NRV is greater than the loan amount, then no impairment loss exists. If the NRV is less than the loan amount, the shortfall is recognized by a specific reserve. If the borrower fails to pledge additional collateral in the ninety day period, a charge-off equal to the difference between the loan carrying value and NRV will occur. In certain circumstances, however, a direct charge-off may be taken at the time that the NRV calculation reveals a shortfall. All impaired loans are evaluated based on the criteria stated above on a quarterly basis and any change in the reserve requirements are recorded in the period identified. All partially charged-off loans remain on nonaccrual status until they are brought current as to both principal and interest and have at least nine months of payment history and future collectability of principal and interest is assured.

Impaired loans at June 30, 2013 and December 31, 2012 are set forth in the following tables.

June 30, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$ 75	$ 142	$ —
Real Estate Construction:			
Residential	187	661	—
Commercial	12,895	12,895	—
Real Estate Mortgage:			
Commercial – Owner Occupied	718	718	—
Commercial – Non-owner Occupied	12,144	15,110	—
Residential – 1 to 4 Family	8,412	8,839	—
Residential – Multifamily	1,467	1,659	—
Consumer	252	252	—
	36,150	40,276	—
With an allowance recorded:			
Commercial and Industrial	555	555	64
Real Estate Construction:			
Residential	658	1,399	93
Commercial	1,947	2,005	90
Real Estate Mortgage:			
Commercial – Owner Occupied	5,846	5,875	205
Commercial – Non-owner Occupied	36,766	36,815	2,480
Residential – 1 to 4 Family	3,450	3,671	343
Residential – Multifamily	373	373	6
Consumer	—	—	—
	49,595	50,693	3,281
Total:			
Commercial and Industrial	630	697	64
Real Estate Construction:			
Residential	845	2,060	93
Commercial	14,842	14,900	90
Real Estate Mortgage:			
Commercial – Owner Occupied	6,564	6,593	205
Commercial – Non-owner Occupied	48,910	51,925	2,480
Residential – 1 to 4 Family	11,862	12,510	343
Residential – Multifamily	1,840	2,032	6
Consumer	252	252	—
	$ 85,745	$ 90,969	$ 3,281

December 31, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$ 248	$ 315	$ —
Real Estate Construction:			
Residential	800	2,126	—
Commercial	12,891	12,891	—
Real Estate Mortgage:			
Commercial – Owner Occupied	876	1,031	—
Commercial – Non-owner Occupied	19,228	22,027	—
Residential – 1 to 4 Family	8,945	9,372	—
Residential – Multifamily	2,838	2,838	—
Consumer	188	188	—
	46,014	50,788	—
With an allowance recorded:			
Commercial and Industrial	500	500	10
Real Estate Construction:			
Residential	187	661	24
Commercial	1,988	2,045	96
Real Estate Mortgage:			
Commercial – Owner Occupied	5,718	5,748	216
Commercial – Non-owner Occupied	29,187	29,187	1,053
Residential – 1 to 4 Family	3,605	4,290	301
Residential – Multifamily	377	377	6
Consumer	—	—	—
	41,562	42,808	1,706
Total:			
Commercial and Industrial	748	815	10
Real Estate Construction:			
Residential	987	2,787	24
Commercial	14,879	14,936	96
Real Estate Mortgage:			
Commercial – Owner Occupied	6,594	6,779	216
Commercial – Non-owner Occupied	48,415	51,214	1,053
Residential – 1 to 4 Family	12,550	13,662	301
Residential – Multifamily	3,215	3,215	6
Consumer	188	188	—
	$ 87,576	$ 93,596	$ 1,706

The following tables present by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the six months and three months ended June 30, 2013 and 2012:

	Six Months Ended June 30,			
	2013		2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Amounts in thousands)			
Commercial and Industrial	$688	$ 13	$856	$ 11
Real Estate Construction:				
Residential	736	—	3,658	45
Commercial	14,864	51	8,130	3
Real Estate Mortgage:				
Commercial – Owner Occupied	6,550	131	8,547	136
Commercial – Non-owner Occupied	49,258	874	51,825	1,007
Residential – 1 to 4 Family	11,890	136	11,273	180
Residential – Multifamily	2,631	60	3,614	54
Consumer	252	3	210	2
Total	$86,869	$ 1,268	$88,113	$ 1,438

	Three Months Ended June 30,			
	2013		2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Amounts in thousands)			
Commercial and Industrial	$631	$ 4	$730	$ 11
Real Estate Construction:				
Residential	769	—	5,180	27
Commercial	14,856	26	12,296	—
Real Estate Mortgage:				
Commercial – Owner Occupied	6,564	69	8,087	103
Commercial – Non-owner Occupied	49,113	484	48,630	565
Residential – 1 to 4 Family	11,877	69	11,307	121
Residential – Multifamily	2,215	49	3,631	1
Consumer	252	1	190	1
Total	$86,277	$ 702	$90,051	$ 829

Troubled debt restructurings: Periodically management evaluates our loans in order to determine the appropriate risk rating, interest accrual status and potential classification as a TDR, some of which are performing and accruing interest. A TDR is a loan on which we have granted a concession due to a borrower's financial difficulty. These are concessions that would not otherwise be considered. The terms of these modified loans may include extension of maturity, renewals, changes in interest rate, additional collateral requirements or infusion of additional capital into the project by the borrower to reduce debt or to support future debt service. On construction and land development loans we may modify the loan as a result of delays or other project issues such as slower than anticipated sell-outs, insufficient leasing activity and/or a decline in the value of the underlying collateral securing the loan. Management believes that working with a borrower to restructure a loan provides us with a better likelihood of collecting our loan. It is our policy not to renegotiate the terms of a commercial loan simply because of a delinquency status. However, we will use our Troubled Debt Restructuring Program to work with delinquent borrowers when the delinquency is temporary. We consider all loans modified in a troubled debt restructuring to be impaired.

At the time a loan is modified in a TDR, we consider the following factors to determine whether the loan should accrue interest:

- Whether there is a period of current payment history under the current terms, typically 6 months;
- Whether the loan is current at the time of restructuring; and
- Whether we expect the loan to continue to perform under the restructured terms with a debt coverage ratio that complies with the Bank's credit underwriting policy of 1.25 times debt service.

We also review the financial performance of the borrower over the past year to be reasonably assured of repayment and performance according to the modified terms. This review consists of an analysis of the borrower's historical results; the borrower's projected results over the next four quarters; current financial information of the borrower and any guarantors. The projected repayment source needs to be reliable, verifiable, quantifiable and sustainable. In addition, all TDRs are reviewed quarterly to determine the amount of any impairment.

At the time of restructuring, the amount of the loan principal for which we are not reasonably assured of repayment is charged-off, but not forgiven.

A borrower with a restructured loan must make a minimum of six consecutive monthly payments at the restructured level and be current as to both interest and principal to be on accrual status.

Performing TDRs (not reported as non-accrual loans) totaled $39.5 million and $40.0 million with related allowances of $1.4 million and $1.4 million as of June 30, 2013 and December 31, 2012, respectively. Non-performing TDRs totaled $23.6 million and $27.1 million with related allowances of $0 and $8,000 as of June 30, 2013 and December 31, 2012, respectively. All TDRs are classified as impaired loans and are included in the impaired loan disclosures above.

The following tables detail loans modified during the six months and three months ended June 30, 2013 and 2012, including the number of modifications, the recorded investment both pre- and post-modification and the nature of the modifications made.

	Six Months Ended June 30,					
	2013			2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in Thousands)					
Troubled Debt Restructurings						
Commercial and Industrial	—	$ —	$ —	2	$ 575	$ 575
Construction:						
Residential	—	—	—	—	—	—
Commercial	—	—	—	1	408	408
Real Estate Mortgage:						
Commercial – Owner Occupied	—	—	—	1	3,148	3,148
Commercial – Non-owner Occupied	—	—	—	2	2,897	2,897
Residential – 1-4 Family	—	—	—	2	3,961	3,961
Residential – Multifamily	—	—	—	1	373	373
Consumer	—	—	—	—	—	—
Total	—	$ —	$ —	9	$ 11,362	$ 11,362

	Three Months Ended June 30,					
	2013			2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in Thousands)					
Troubled Debt Restructurings						
Commercial and Industrial	—	$ —	$ —	2	$ 575	$ 575
Construction:						
Residential	—	—	—	—	—	—
Commercial	—	—	—	1	408	408
Real Estate Mortgage:						
Commercial – Owner Occupied	—	—	—	1	3,148	3,148
Commercial – Non-owner Occupied	—	—	—	2	2,897	2,897
Residential – 1-4 Family	—	—	—	2	3,961	3,961
Residential – Multifamily	—	—	—	1	373	373
Consumer	—	—	—	—	—	—

Total	—	$ —	$ —	9	$ 11,362	$ 11,362

	Six Months Ended June 30,							
	2013				2012			
	Extension	Period of Interest Only	Interest Rate Reduction	Total	Extension	Period of Interest Only	Interest Rate Reduction	Total
	(Dollars in Thousands)							
Troubled Debt Restructurings								
Commercial and Industrial	$ —	$ —	$ —	$ —	$ 500	$ —	$ 75	$ 575
Construction:								
Residential	—	—	—	—	—	—	—	—
Commercial	—	—	—	—	—	—	408	408
Real Estate Mortgage:								
Commercial – Owner Occupied	—	—	—	—	3,148	—	—	3,148
Commercial – Non-owner Occupied	—	—	—	—	—	—	2,897	2,897
Residential – 1-4 Family	—	—	—	—	919	—	3,042	3,961
Residential – Multifamily	—	—	—	—	—	373	—	373
Consumer	—	—	—	—	—	—	—	—
Total	$ —	$ —	$ —	$ —	$ 4,567	$ 373	$ 6,422	$ 11,362

	Three Months Ended June 30,							
	2013				2012			
	Extension	Period of Interest Only	Interest Rate Reduction	Total	Extension	Period of Interest Only	Interest Rate Reduction	Total
	(Dollars in Thousands)							
Troubled Debt Restructurings								
Commercial and Industrial	$ —	$ —	$ —	$ —	$ 500	$ —	$ 75	$ 575
Construction:								
Residential	—	—	—	—	—	—	—	—
Commercial	—	—	—	—	—	—	408	408
Real Estate Mortgage:								
Commercial – Owner Occupied	—	—	—	—	3,148	—	—	3,148
Commercial – Non-owner Occupied	—	—	—	—	—	—	2,897	2,897
Residential – 1-4 Family	—	—	—	—	919	—	3,042	3,961
	—	—	—	—	—	373	—	373

Residential – Multifamily								
Consumer	—	—	—	—	—	—	—	—
Total	$ —	$ —	$ —	$ —	$ 4,567	$ 373	$ 6,422	$ 11,362

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The following tables show loans that were modified and deemed TDRs that subsequently defaulted during the six months and three months ended June 30, 2013 and 2012.

	Six Months Ended June 30,			
	2013		2012	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Amounts in thousands)			
Commercial and Industrial	—	$ —	1	$ 75
Real Estate Construction:				
Residential	1	187	—	—
Commercial	—	—	2	920
Real Estate Mortgage:				
Commercial – Owner Occupied	—	—	—	—
Commercial – Non-owner Occupied	—	—	1	1,217
Residential – 1-4 Family	—	—	1	209
Residential – Multifamily	—	—	1	1,971
Consumer	—	—	—	—
Total	1	$ 187	6	$ 4,392

	Three Months Ended June 30,			
	2013		2012	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Amounts in thousands)			
Commercial and Industrial	—	$ —	1	$ 75
Real Estate Construction:				
Residential	—	—	—	—
Commercial	—	—	2	920
Real Estate Mortgage:				
Commercial – Owner Occupied	—	—	—	—
Commercial – Non-owner Occupied	—	—	—	—
Residential – 1-4 Family	—	—	—	—
Residential – Multifamily	—	—	—	—
Consumer	—	—	—	—
Total	—	$ —	3	$ 995

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall allowance for loan losses estimate. The level of any re-defaults will likely be affected by future economic conditions. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is repaid in full, foreclosed, sold or it meets the criteria to be removed from TDR status.

Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grades of loans, the level of classified loans, net charge-offs, nonperforming loans (see details above) and the general economic conditions in the region.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 7. Grades 1 through 4 are considered “Pass”. A description of the general characteristics of the seven risk grades is as follows:

1. Good: Borrower exhibits the strongest overall financial condition and represents the most creditworthy profile.
2. Satisfactory (A): Borrower reflects a well-balanced financial condition, demonstrates a high level of creditworthiness and typically will have a strong banking relationship with the Bank.
3. Satisfactory (B): Borrower exhibits a balanced financial condition and does not expose the Bank to more than a normal or average overall amount of risk. Loans are considered fully collectable.
4. Watch List: Borrower reflects a fair financial condition, but there exists an overall greater than average risk. Risk is deemed acceptable by virtue of increased monitoring and control over borrowings. Probability of timely repayment is present.
5. Other Assets Especially Mentioned (OAEM): Financial condition is such that assets in this category have a potential weakness or pose unwarranted financial risk to the Bank even though the asset value is not currently impaired. The asset does not currently warrant adverse classification but if not corrected could weaken and could create future increased risk exposure. Includes loans which require an increased degree of monitoring or servicing as a result of internal or external changes.
6. Substandard: This classification represents more severe cases of #5 (OAEM) characteristics that require increased monitoring. Assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral. Asset has a well-defined weakness or weaknesses that impairs the ability to repay debt and jeopardizes the timely liquidation or realization of the collateral at the asset’s net book value.
7. Doubtful: Assets which have all the weaknesses inherent in those assets classified #6 (Substandard) but the risks are more severe relative to financial deterioration in capital and/or asset value; accounting/evaluation techniques may be questionable and the overall possibility for collection in full is highly improbable. Borrowers in this category require constant monitoring, are considered work-out loans and present the potential for future loss to the Bank.

An analysis of the credit risk profile by internally assigned grades as of June 30, 2013 and December 31, 2012 is as follows:

At June 30, 2013	Pass	OAEM	Substandard	Doubtful	Total
	(Amounts in thousands)				
Commercial and Industrial	$21,985	$1,941	$902	$—	$24,828
Real Estate Construction:					
Residential	6,881	—	845	—	7,726
Commercial	26,142	—	21,334	—	47,476
Real Estate Mortgage:					
Commercial – Owner Occupied	149,932	1,375	5,685	—	156,992
Commercial – Non-owner Occupied	176,086	11,925	34,685	—	222,696
Residential – 1 to 4 Family	133,577	2,240	10,889	—	146,706
Residential – Multifamily	17,144	1,080	1,840	—	20,064
Consumer	17,284	—	252	—	17,536
Total	$549,031	$18,561	$76,432	$—	