EAGLE BANCORP INC
Form 10-Q
May 10, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2012

OR

o 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 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland	**52-2061461**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7815 Woodmont Avenue, Bethesda, Maryland	**20814**
(Address of principal executive offices)	(Zip Code)

(301) 986-1800

(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 o

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 o

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.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act Yes o No x

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

As of April 30, 2012, the registrant had 20,221,336 shares of Common Stock outstanding.

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EAGLE BANCORP, INC.

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Item 1 Financial Statements

EAGLE BANCORP, INC.

Consolidated Balance Sheets

March 31, 2012, December 31, 2011 and March 31, 2011

(dollars in thousands, except per share data)

	March 31, 2012 (Unaudited)	December 31, 2011 (Audited)	March 31, 2011 (Unaudited)
Assets			
Cash and due from banks	$ 5,838	$ 5,374	$ 22,768
Federal funds sold	18,990	21,785	74,209
Interest bearing deposits with banks and other short-term investments	117,326	205,252	10,188
Investment securities available for sale, at fair value	345,021	313,811	228,507
Federal Reserve and Federal Home Loan Bank stock	11,374	10,242	10,406
Loans held for sale	87,496	176,826	12,459
Loans	2,186,940	2,056,256	1,790,084
Less allowance for credit losses	(31,875)	(29,653)	(25,582)
Loans, net	2,155,065	2,026,603	1,764,502
Premises and equipment, net	12,864	12,320	10,217
Deferred income taxes	14,658	14,673	14,302
Bank owned life insurance	13,839	13,743	13,443
Intangible assets, net	4,066	4,145	4,330
Other real estate owned	3,014	3,225	3,529
Other assets	25,998	23,256	17,408
Total Assets	$ 2,815,549	$ 2,831,255	$ 2,186,268
Liabilities and Shareholders Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$ 698,636	$ 688,506	$ 402,041
Interest bearing transaction	75,751	80,105	61,219
Savings and money market	1,084,622	1,068,370	780,386
Time, $100,000 or more	293,570	332,470	370,326
Other time	215,656	222,644	212,908
Total deposits	2,368,235	2,392,095	1,826,880
Customer repurchase agreements	111,580	103,362	89,753
Long-term borrowings	49,300	49,300	49,300
Other liabilities	10,426	19,787	10,216
Total Liabilities	2,539,541	2,564,544	1,976,149
Shareholders Equity			
Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series A, $1,000 per share liquidation preference, shares issued and outstanding 23,235 at March 31, 2011, discount of $554, net			22,629
Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series B, $1,000 per share liquidation preference, shares issued and outstanding 56,600 at March 31, 2012 and December 31, 2011	56,600	56,600	

Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 20,220,166, 19,952,844 and 19,811,532, respectively	199	197	197
Warrant	946	946	946
Additional paid in capital	134,455	132,670	130,703
Retained earnings	78,911	71,423	53,349
Accumulated other comprehensive income	4,897	4,875	2,295
Total Shareholders Equity	276,008	266,711	210,119
Total Liabilities and Shareholders Equity	$ 2,815,549	$ 2,831,255	$ 2,186,268

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Operations

For the Three Month Periods Ended March 31, 2012 and 2011 (Unaudited)

(dollars in thousands, except per share data)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Interest Income		
Interest and fees on loans	$ 30,723	$ 24,615
Interest and dividends on investment securities	1,694	1,620
Interest on balances with other banks and short-term investments	137	19
Interest on federal funds sold	14	42
Total interest income	32,568	26,296
Interest Expense		
Interest on deposits	3,468	4,111
Interest on customer repurchase agreements	96	150
Interest on long-term borrowings	534	529
Total interest expense	4,098	4,790
Net Interest Income	28,470	21,506
Provision for Credit Losses	3,970	2,116
Net Interest Income After Provision For Credit Losses	24,500	19,390
Noninterest Income		
Service charges on deposits	979	749
Gain on sale of loans	4,139	1,701
Gain on sale of investment securities	153	
Increase in the cash surrender value of bank owned life insurance	97	101
Other income	644	382
Total noninterest income	6,012	2,933
Noninterest Expense		
Salaries and employee benefits	10,424	7,311
Premises and equipment expenses	2,510	1,991
Marketing and advertising	286	234
Data processing	1,256	689
Legal, accounting and professional fees	1,101	1,136
FDIC insurance	489	743
Other expenses	2,496	2,209
Total noninterest expense	18,562	14,313
Income Before Income Tax Expense	11,950	8,010
Income Tax Expense	4,317	2,874
Net Income	7,633	5,136
Preferred Stock Dividends and Discount Accretion	141	320
Net Income Available to Common Shareholders	$ 7,492	$ 4,816
Earnings Per Common Share		
Basic	$ 0.37	$ 0.24
Diluted	$ 0.36	$ 0.24

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Comprehensive Income

For the Three Month Periods Ended March 31, 2012 and 2011 (Unaudited)

(dollars in thousands)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net Income	$ 7,633	$ 5,136
Other comprehensive income, net of tax:		
Unrealized gain on securities available for sale	114	237
Less: reclassification adjustment for gains net of taxes of $61 included in net income	(92)	
Net change in unrealized gains on securities	22	237
Comprehensive Income	$ 7,655	$ 5,373

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Changes in Shareholders Equity

For the Three Month Periods Ended March 31, 2012 and 2011 (Unaudited)

(dollars in thousands, except per share data)

	Preferred Stock	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balance, January 1, 2012	$ 56,600	$ 197	$ 946	$ 132,670	$ 71,423	$ 4,875	$ 266,711
Net Income					7,633		7,633
Net change in other comprehensive income						22	22
Stock-based compensation				1,187	(1)		1,186
Common stock issued 284,748 shares under purchase and equity compensation plans		2		579	(1)		580
Tax benefits related to non-qualified stock compensation				19	(2)		17
Preferred stock:							
Preferred stock dividends					(141)		(141)
Discount accretion							
Balance, March 31, 2012	**$ 56,600**	**$ 199**	**$ 946**	**$ 134,455**	**$ 78,911**	**$ 4,897**	**$ 276,008**
Balance, January 1, 2011	$ 22,582	$ 197	$ 946	$ 130,382	$ 48,551	$ 2,058	$ 204,716
Net Income					5,136		5,136
Net change in other comprehensive income						237	237
Stock-based compensation				186			186
Common stock issued 27,692 shares under purchase and equity compensation plans				88			88
Tax benefits related to non-qualified stock compensation				47			47
Preferred stock:							
Preferred stock dividends					(291)		(291)
Discount accretion	47				(47)		
Balance, March 31, 2011	**$ 22,629**	**$ 197**	**$ 946**	**$ 130,703**	**$ 53,349**	**$ 2,295**	**$ 210,119**

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows

For the Three Month Periods Ended March 31, 2012 and 2011 (Unaudited)

(dollars in thousands)

	2012	2011
Cash Flows From Operating Activities:		
Net Income	$ 7,633	$ 5,136
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	3,970	2,116
Depreciation and amortization	761	575
Gains on sale of loans	(4,139)	(1,701)
Origination of loans held for sale	(278,308)	(81,049)
Proceeds from sale of loans held for sale	371,777	150,862
Net increase in cash surrender value of BOLI	(97)	(101)
(Increase) decrease in deferred income taxes	(15)	169
Net loss on sale of other real estate owned	61	39
Net gain on sale of investment securities	(153)	
Stock-based compensation expense	1,186	186
Excess tax benefit from stock-based compensation	(17)	(47)
Increase in other assets	(2,743)	(2,877)
Decrease in other liabilities	(9,362)	(756)
Net cash provided by operating activities	90,554	72,552
Cash Flows From Investing Activities:		
(Decrease) increase in interest bearing deposits with other banks and short term investments	(131)	1,464
Purchases of available for sale investment securities	(56,763)	(8,325)
Proceeds from maturities of available for sale securities	11,808	7,866
Proceeds from sale/call of available for sale securities	13,920	
Purchases of federal reserve and federal home loan bank stock	(1,133)	(878)
Proceeds from redemption of federal reserve and federal home loan bank stock		
Net increase in loans	(132,432)	(117,971)
Proceeds from sale of other real estate owned	338	5,073
Bank premises and equipment acquired	(1,232)	(1,361)
Net cash used in investing activities	(165,625)	(114,132)
Cash Flows From Financing Activities:		
(Decrease) increase in deposits	(23,860)	100,082
Increase (decrease) in customer repurchase agreements	8,218	(7,831)
Payment of dividends on preferred stock	(141)	(291)
Proceeds from exercise of stock options	580	88
Excess tax benefit from stock-based compensation	17	47
Net cash (used in) provided by financing activities	(15,186)	92,095
Net (Decrease) Increase In Cash and Cash Equivalents	(90,257)	50,515
Cash and Cash Equivalents at Beginning of Period	232,411	46,462
Cash and Cash Equivalents at End of Period	$ 142,154	$ 96,977
Supplemental Cash Flows Information:		
Interest paid	$ 4,622	$ 5,303
Income taxes paid	$ 5,950	$ 1,730
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$ 365	$ 1,645

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March31, 2012 and 2011 (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the Company), EagleBank (the Bank), Eagle Commercial Ventures, LLC (ECV), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The consolidated financial statements of the Company included herein are unaudited. The consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2011 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company s Accounting Policies as disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland; Washington, DC; and Arlington and Fairfax Counties in Virginia. The primary financial services offered by the Bank include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration (SBA), is typically sold to third party investors in a transaction apart from the loan s origination. The Bank offers its products and services through sixteen branch offices and various electronic capabilities, including remote deposit services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, provides subordinated financing for the acquisition, development and construction of real estate projects, where the primary financing is provided by the Bank or others. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending Revenue Recognition below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

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Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of Small Business Administration loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations.

The Company s current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of March 31, 2012 and December 31, 2011. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Other assets in the Statement of Financial Condition. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in other noninterest income in the Consolidated Statement of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 to 60 days. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at a premium at the time the borrower commits to an interest rate with the intent that the buyer has assumed the interest rate risk on the loan. As a result, the Company is not exposed to losses on loans sold nor will it realize gains, related to rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

Investment Securities

The Company has no securities classified as trading, nor are any investment securities classified as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company s asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income, a separate component of shareholders equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the Consolidated Statements of Operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayment assumptions and call optionality. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management s intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for, other-than-temporary, declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security.

The entire amount of an impairment loss is recognized in earnings only when (1) the Company intends to sell the debt security, or (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in shareholders equity as comprehensive income, net of deferred taxes.

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Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company s policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company s portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of minimal delay in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

Higher Risk Lending Revenue Recognition

The Company has occasionally made higher risk acquisition, development, and construction (ADC) loans that entail higher risks than ADC loans made following normal underwriting practices (higher risk loan transactions). These higher risk loan transactions are currently made through the Company s subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standards Executive Committee (AcSEC) guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on certain of these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC s guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Such additional interest is included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2012 and 2011 (although normal interest income was recorded). ECV had four higher risk lending transactions outstanding at March 31, 2012 and three such transactions outstanding at December 31, 2011, amounting to $4.0 million and $2.3 million, respectively.

Allowance for Credit Losses

The allowance for credit losses represents an amount which, in management s judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management s judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

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The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification (ASC) Topic 450, *Contingencies,* or ASC Topic 310, *Receivables.* Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board Committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management s evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management s judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank s loan portfolio and allowance for credit losses. Such review may result in recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from five to seven years for furniture, fixtures and equipment, to three to five years for computer software and hardware, and to ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the Consolidated Statements of Operations.

Other Real Estate Owned (OREO)

Assets acquired through loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by recent appraisals. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in economic conditions or review by regulatory examiners.

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Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company s testing of potential goodwill impairment (which is performed annually) at December 31, 2011, resulted in no impairment being recorded.

Customer Repurchase Agreements

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company s Consolidated Statement of Condition, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, *Income Taxes*. Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made for either uncertain tax positions nor accompanying potential tax penalties and interest for underpayments of income taxes in the Company s tax reserves. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at either March 31, 2012 or December 31, 2011.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

Earnings per Common Share

Basic net income per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents.

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Stock-Based Compensation

In accordance with ASC Topic 718, *Compensation,* the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value (computed at the date of option grant) of any outstanding fixed stock option grants and restricted stock awards which vest subsequent to December 31, 2005. Compensation expense on variable stock option grants (i.e. performance based grants) is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 6 for a description of stock-based compensation awards, activity and expense.

New Authoritative Accounting Guidance

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities.* ASU 2011-11 amends Topic 210, Balance Sheet, to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a significant impact on the Company s consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12 *Comprehensive Income (Topic 220) - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.* ASU 2011-12 defers changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to redeliberate whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by ASU No. 2011-12. ASU 2011-12 is effective for annual and interim periods beginning after December 15, 2011 and did not have a significant impact on the Company s consolidated financial statements.

2. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2012, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

3. Investment Securities Available for Sale

Amortized cost and estimated fair value of securities available for sale are summarized as follows:

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[redacted]				
U. S. Government agency securities	$ 92,413	$ 1,370	$ 73	$ 93,710
Residential mortgage backed securities	178,688	3,326	249	181,765
Municipal bonds	65,354	4,172	298	69,228
Other equity investments	404		86	318
	$ 336,859	$ 8,868	$ 706	$ 345,021

[redacted]				
U. S. Government agency securities	$ 102,283	$ 1,547	$ 77	$ 103,753
Residential mortgage backed securities	145,451	2,767	240	147,978
Municipal bonds	57,548	4,227	2	61,773
Other equity investments	404		97	307
	$ 305,686	$ 8,541	$ 416	$ 313,811

Gross unrealized losses and fair value by length of time that the individual available for sale securities have been in a continuous unrealized loss position are as follows:

[redacted]						
U. S. Government agency securities	$ 20,638	$ 73	$	$	$ 20,638	$ 73
Residential mortgage backed securities	34,006	249			34,006	249
Municipal bonds	11,251	298			11,251	298
Other equity investments			92	86	92	86
	$ 65,895	$ 620	$ 92	$ 86	$ 65,987	$ 706

	Less than 12 Months		12 Months or Greater		Total	
December 31, 2011 (dollars in thousands)	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U. S. Government agency securities	$ 25,313	$ 77	$	$	$ 25,313	$ 77
Residential mortgage backed securities	35,017	240			35,017	240
Municipal bonds	510	2			510	2
Other equity investments			81	97	81	97
	$ 60,840	$ 319	$ 81	$ 97	$ 60,921	$ 416

The unrealized losses that exist are generally the result of changes in market interest rates and interest spread relationships since original purchases. The weighted average duration of debt securities, which comprise 99.9% of total investment securities, is relatively short at 3.7 years. The gross unrealized loss on other equity investments represents common stock of one local banking company owned by the Company, and traded on a

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broker bulletin board exchange. The estimated fair value is determined by broker quoted prices. The unrealized loss is deemed a result of generally weak valuations for many smaller community bank stocks. The individual banking company is profitable, has good financial trends and has a satisfactory capital position. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions. The Company does not believe that the investment securities that were in an unrealized loss position as of March 31, 2012 represent an other-than-temporary impairment for the reasons noted. The Company does not intend to sell the investments and it is more likely than not that the Company will not have to sell the securities before recovery of its amortized cost basis, which may be maturity. In addition, at March 31, 2012, the Company held $11.4 million in equity securities in a combination of Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) stocks which are required to be held for regulatory purposes and are not marketable.

The amortized cost and estimated fair value of investments available for sale by contractual maturity are shown in the table below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2012		December 31, 2011	
(dollars in thousands)	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**
U. S. Government agency securities maturing:				
One year or less	$ 5,015	$ 5,046	$ 15,783	$ 15,906
After one year through five years	84,531	85,565	83,638	84,740
After five years through ten years	2,867	3,099	2,862	3,107
Residential mortgage backed securities	178,688	181,765	145,451	147,978
Municipal bonds maturing:				
After one year through five years	10,071	10,474	10,089	10,539
Five years through ten years	53,444	56,980	47,459	51,234
After ten years	1,839	1,774		
Other equity investments	404	318	404	307
	$ 336,859	$ 345,021	$ 305,686	$ 313,811

The carrying value of securities pledged as collateral for certain government deposits, securities sold under agreements to repurchase, and certain lines of credit with correspondent banks at March 31, 2012 was $275.5 million. As of March 31, 2012 and December 31, 2011, there were no holdings of securities of any one issuer, other than the U.S. Government and U.S. Government agency securities that exceeded ten percent of shareholders equity.

The following table provides information, on an amortized cost basis, regarding the contractual maturity and weighted-average yield of the investment portfolio at March 31, 2012. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Yields on tax exempt securities have not been calculated on a tax equivalent basis.

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[redacted]

U. S. Government agency securities	$ 5,015	1.30%	$ 84,531	1.29%	$ 2,867	2.98%	$		$ 92,413	1.34%
Residential mortgage backed securities	2,212	4.60%	134,575	2.47%	41,901	2.93%			178,688	2.60%
Muncipal bonds			10,071	3.32%	53,444	3.48%	1,839	2.37%	65,354	3.42%
Other equity investments									404	0.00%
	$ 7,227	2.31%	$ 229,177	2.07%	$ 98,212	3.23%	$ 1,839	2.37%	$ 336,859	2.41%

4. Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily in the Washington, DC metropolitan area and surrounding communities. A substantial portion of the Bank s loan portfolio consists of loans to businesses secured by real estate and other business assets.

Loans, net of unamortized net deferred fees, at March 31, 2012, December 31, 2011, and March 31, 2011 are summarized by type as follows:

	March 31, 2012		December 31, 2011		March 31, 2011	
(dollars in thousands)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Commercial	$ 492,824	23%	$ 478,886	23%	$ 443,251	25%
Investment - commercial real estate (1)	829,984	38%	756,645	37%	671,803	38%
Owner occupied - commercial real estate	275,723	13%	250,174	12%	226,322	13%
Real estate mortgage - residential	43,057	2%	39,552	2%	19,665	1%
Construction - commercial and residential (1)	417,346	19%	395,267	19%	317,353	18%
Construction - C&I (owner occupied) (1)	27,412	1%	34,402	2%	17,308	1%
Home equity	95,437	4%	97,103	5%	88,602	5%
Other consumer	5,157		4,227		5,780	
Total loans	2,186,940	100%	2,056,256	100%	1,790,084	100%
Less: Allowance for Credit Losses	(31,875)		(29,653)		(25,582)	
Net loans	$ 2,155,065		$ 2,026,603		$ 1,764,502	

(1) Includes loans for land acquisition and development.

Unamortized net deferred fees amounted to $6.3 million and $5.2 million at March 31, 2012 and December 31, 2011, respectively.

As of March 31, 2012 and December 31, 2011, the Bank serviced $29.8 million and $27.3 million, respectively, of SBA loans participations which are not reflected as loan balances on the Consolidated Balance Sheets.

Loan Origination / Risk Management

The Company s goal is to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include; carefully enforcing loan policies and procedures, evaluating each borrower s business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for loan repayment,

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and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.

The composition of the Company s loan portfolio is heavily weighted toward commercial real estate, both owner occupied and investment real estate. At March 31, 2012, commercial real estate, and real estate construction loans combined represented approximately 71% of the loan portfolio. Owner occupied commercial real estate and owner occupied commercial real estate construction represent 14% of the loan portfolio. When owner occupied commercial real estate and commercial construction loans are excluded, the percentage of commercial real estate and construction loans to total loans decreases to 57%. These loans are underwritten to mitigate lending risks typical of this type of loan such as declines in real estate values, changes in borrower cash flow and general economic conditions. The Bank typically requires a maximum loan to value of 80% or less and minimum cash flow debt service coverage of 1.15 to 1.0. Personal guarantees are generally required, but may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

The Company is also an active traditional commercial lender providing loans for a variety of purposes, including cash flow, equipment and account receivable financing. This loan category represents approximately 23% of the loan portfolio at March 31, 2012 and is generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited. SBA loans represent 2% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the uninsured portion of the credit. The Company generally sells the insured portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans are subject to a maximum loan size established by the SBA.

Approximately 4% of the loan portfolio at March 31, 2012 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

The remaining 2% of the loan portfolio consists of longer-term residential mortgage loans. These are typically loans underwritten to the same underwriting standards as residential loans held for sale but for shorter terms, generally less than 10 years.

Loans are secured primarily by duly recorded first deeds of trust. In some cases, the Bank may accept a recorded second trust position. In general, borrowers will have a proven ability to build, lease, manage and/or sell a commercial or residential project and demonstrate satisfactory financial condition. Additionally, an equity contribution toward the project is customarily required.

Construction loans require that the financial condition and experience of the general contractor and major subcontractors be satisfactory to the Bank. Guaranteed, fixed price contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for larger scale projects.

Loans intended for residential land acquisition, lot development and construction are made on the premise that the land: 1) is or will be developed for building sites for residential structures, and; 2) will ultimately be utilized for construction or improvement of residential zoned real properties, including the creation of housing. Residential development and construction loans will finance projects such as single family subdivisions, planned unit developments, townhouses, and condominiums. Residential land acquisition, development and construction loans generally are underwritten with a maximum term of 36 months, including extensions approved at origination.

Commercial land acquisition and construction loans are secured by real property where loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner user commercial properties. Borrowers are generally required to put equity into each project at levels determined by the appropriate Loan Committee. Commercial land acquisition and construction loans generally are underwritten with a maximum term of 24 months.

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All construction draw requests must be presented in writing on American Institute of Architects documents and certified by the contractor, the borrower and the borrower s architect. Each draw request shall also include the borrower s soft cost breakdown certified by the borrower or its Chief Financial Officer. Prior to an advance, the Bank or its contractor inspects the project to determine that the work has been completed, to justify the draw requisition.

Commercial permanent loans are secured by improved real property which is generating income in the normal course of operation. Debt service coverage, assuming stabilized occupancy, must be satisfactory to support a permanent loan. The debt service coverage ratio is ordinarily at least 1.15 to 1. As part of the underwriting process, debt service coverage ratios are stress tested assuming a 200 basis point increase in interest rates from their current levels.

Commercial permanent loans generally are underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

Personal guarantees are generally received from the principals, and only in instances where the loan-to-value is sufficiently low and the debt service is sufficiently high is consideration given to either limiting or not requiring personal recourse.

The Company s loan portfolio includes loans made for real estate Acquisition, Development and Construction (ADC) purposes, including both investment and owner occupied projects. ADC loans amounted to $444.8 million at March 31, 2012. The majority of the ADC portfolio, both speculative and non speculative, includes loan funded interest reserves. ADC loans containing loan funded interest reserves represent approximately 30% of the outstanding ADC loan portfolio at March 31, 2012. The decision to establish a loan-funded interest reserve is made upon origination of the ADC loan and is based upon a number of factors considered during underwriting of the credit including: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) the level of collateral protection. When appropriate, an interest reserve provides an effective means of addressing the cash flow characteristics of a properly underwritten ADC loan. The Company does not significantly utilize interest reserves in other loan products. The Company recognizes that one of the risks inherent in the use of interest reserves is the potential masking of underlying problems with the project and/or the borrower s ability to repay the loan. In order to mitigate this inherent risk, the Company employs a series of reporting and monitoring mechanisms on all ADC loans, whether or not an interest reserve is provided, including: (i) construction and development timelines which are monitored on an ongoing basis which track the progress of a given project to the timeline projected at origination; (ii) a construction loan administration department independent of lending function; (iii) third party independent construction loan inspection reports; (iv) monthly interest reserve monitoring reports detailing the balance of the interest reserves approved at origination and the days of interest carry represented by the reserve balances as compared to the then current anticipated time to completion and/or sale of speculative projects; and (v) quarterly commercial real estate construction meetings among senior Company management which includes monitoring of current and projected real estate market conditions. If a project has not performed as expected, it is not the customary practice of the Company to increase loan funded interest reserves.

From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, ECV, which under its operating documents conducts lending only to real estate projects. Such loans, which are made to finance projects (which may also be financed at the Bank level), may have higher risk characteristics than loans made by the Bank, such as lower priority interests and/or higher loan to value ratios. The Company seeks an overall financial return on these transactions commensurate with the risks and structure of each individual loan. Certain transactions bear current interest at a rate with a significant premium to normal market rates. Other loan transactions carry a standard rate of current interest, but also earn additional interest based on a percentage of the profits of the underlying project.

The following table details activity in the allowance for credit losses by portfolio segment for the three months ended March 31, 2012 and 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

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(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
March 31, 2012								
Allowance for credit losses:								
Balance at beginning of period	$ 9,609	$ 7,304	$ 1,898	$ 399	$ 8,546	$ 1,528	$ 369	$ 29,653
Loans charged-off	(773)	(291)		(300)	(240)	(244)	(5)	(1,853)
Recoveries of loans previously charged-off	7	2			94	1	1	105
Net loan charged-off	(766)	(289)		(300)	(146)	(243)	(4)	(1,748)
Provision for credit losses	(306)	1,130	248	(99)	3,260	44	(307)	3,970
Ending balance	$ 8,537	$ 8,145	$ 2,146	$	$ 11,660	$ 1,329	$ 58	$ 31,875
For the Period Ended March 31, 2012								
Allowance for credit losses:								
Individually evaluated for impairment	$ 1,874	$ 829	$ 201	$	$ 2,899	$ 138	$ 4	$ 5,945
Collectively evaluated for impairment	6,663	7,316	1,945		8,761	1,191	54	25,930
Ending balance	$ 8,537	$ 8,145	$ 2,146	$	$ 11,660	$ 1,329	$ 58	$ 31,875
March 31, 2011								
Allowance for credit losses:								
Balance at beginning of period	$ 8,630	$ 6,668	$ 2,064	$ 115	$ 5,745	$ 1,441	$ 91	$ 24,754
Loans charged-off	(686)	(32)			(741)			(1,459)
Recoveries of loans previously charged-off	3				167	1		171
Net loan charged-off	(683)	(32)			(574)	1		(1,288)
Provision for credit losses	606	21	125	46	1,307	10	1	2,116
Ending balance	$ 8,553	$ 6,657	$ 2,189	$ 161	$ 6,478	$ 1,452	$ 92	$ 25,582
For the Period Ended March 31, 2011								
Allowance for credit losses:								
Individually evaluated for impairment	$ 2,404	$ 613	$ 165	$	$ 1,045	$ 135	$	$ 4,362
Collectively evaluated for impairment	6,149	6,044	2,024	161	5,433	1,317	92	21,220
Ending balance	$ 8,553	$ 6,657	$ 2,189	$ 161	$ 6,478	$ 1,452	$ 92	$ 25,582

The Company s recorded investments in loans as of March 31, 2012, December 31, 2011 and March 31, 2011 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company s impairment methodology was as follows:

(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
March 31, 2012								
Recorded investment in loans:								
Individually evaluated for impairment	$ 9,395	$ 9,880	$ 2,895	$	$ 24,358	$ 512	$ 8	$ 47,048
Collectively evaluated for impairment	483,429	820,104	272,828	43,057	420,400	94,925	5,149	2,139,892
Ending balance	$ 492,824	$ 829,984	$ 275,723	$ 43,057	$ 444,758	$ 95,437	$ 5,157	$ 2,186,940
December 31, 2011								
Recorded investment in loans:								
Individually evaluated for impairment	$ 11,741	$ 9,304	$ 5,280	$ 751	$ 26,855	$ 363	$ 1,345	$ 55,639
	467,145	747,341	244,894	38,801	402,814	96,740	2,882	2,000,617

Collectively evaluated for impairment								
Ending balance	$ 478,886	$ 756,645	$ 250,174	$ 39,552	$ 429,669	$ 97,103	$ 4,227	$ 2,056,256
March 31, 2011								
Recorded investment in loans:								
Individually evaluated for impairment	$ 21,153	$ 9,193	$ 3,966	$	$ 21,582	$ 284	$	$ 56,178
Collectively evaluated for impairment	422,098	662,666	222,355	19,661	313,079	88,267	5,780	1,733,906
Ending balance	$ 443,251	$ 671,859	$ 226,321	$ 19,661	$ 334,661	$ 88,551	$ 5,780	$ 1,790,084

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At March 31, 2012, the nonperforming loans acquired from Fidelity & Trust Financial Corporation (Fidelity) have a carrying value of $2.1 million and an unpaid principal balance of $11.8 million and were evaluated separately in accordance with ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. The various impaired loans were recorded at estimated fair value with any excess being charged-off or treated as a non-accretable discount. Subsequent downward adjustments to the valuation of impaired loans acquired will result in additional loan loss provisions and related allowance for credit losses. Subsequent upward adjustments to the valuation of impaired loans acquired will result in accretable discount.

Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company s primary credit quality indicators are to use an internal credit risk rating system that categorizes loans into pass, watch, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company s credit quality indicators:

Pass: Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.

Watch: Loan paying as agreed with generally acceptable asset quality; however Borrower s performance has not met expectations. Balance sheet and/or income statement has shown deterioration to the point that the company could not sustain any further setbacks. Credit is expected to be strengthened through improved company performance and/or additional collateral within a reasonable period of time.

Special Mention: Loans in the classes that comprise the commercial portfolio segment that have potential weaknesses that deserve management s close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan. The special mention credit quality indicator is not used for classes of loans that comprise the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans that are considered special mention.

Classified: Classified (a) Substandard - Loans inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Classified (b) Doubtful - Loans that have all the weaknesses inherent in a loan classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

The Company s credit quality indicators are periodically updated on a case-by-case basis. The following table presents by class and by credit quality indicator, the recorded investment in the Company s loans and leases as of March 31, 2012, December 31, 2011 and March 31, 2011.

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(dollars in thousands)	Pass	Watch and Special Mention	Substandard	Doubtful	Total Loans
March 31, 2012					
Commercial	$ 454,373	$ 29,019	$ 9,395	$ 37	$ 492,824
Investment - commercial real estate	815,951	4,902	9,131		829,984
Owner occupied - commercial real estate	254,405	18,423	2,895		275,723
Real estate mortgage residential	42,308		749		43,057
Construction - commercial and residential	387,770	32,631	24,357		444,758
Home equity	94,925		512		95,437
Other consumer	5,149		8		5,157
Total	$ 2,054,881	$ 84,975	$ 47,047	$ 37	$ 2,186,940
December 31, 2011					
Commercial	$ 438,943	$ 28,202	$ 11,704	$ 37	$ 478,886
Investment - commercial real estate	739,668	7,673	9,304		756,645
Owner occupied - commercial real estate	235,988	8,906	5,280		250,174
Real estate mortgage residential	38,801		751		39,552
Construction - commercial and residential	394,135	8,679	26,855		429,669
Home equity	96,740		363		97,103
Other consumer	2,882		1,345		4,227
Total	$ 1,947,157	$ 53,460	$ 55,602	$ 37	$ 2,056,256
March 31, 2011					
Commercial	$ 398,494	$ 23,604	$ 20,268	$ 885	$ 443,251
Investment - commercial real estate	651,086	11,580	9,193		671,859
Owner occupied - commercial real estate	214,503	7,852	3,966		226,321
Real estate mortgage residential	19,661				19,661
Construction - commercial and residential	299,929	13,150	21,582		334,661
Home equity	88,267		284		88,551
Other consumer	5,780				5,780
Total	$ 1,677,720	$ 56,186	$ 55,293	$ 885	$ 1,790,084

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 nonaccrual status when, in management s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual 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. The level of nonperforming loans at March 31, 2012 as compared to December 31, 2011 was impacted significantly by the addition of one commercial construction real estate loan in the amount of $8.4 million placed on nonaccrual in the first quarter of 2012.

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The following presents by class of loan, information related to nonaccrual loans as of the periods ended March 31, 2012, December 31, 2011 and March 31, 2011.

(dollars in thousands)	March 31, 2012	December 31, 2011	March 31, 2011
Commercial	$ 3,565	$ 5,718	$ 5,732
Investment - commercial real estate	7,013	7,662	4,024
Owner occupied - commercial real estate	277	282	295
Real estate mortgage - residential	731	1,041	1,310
Construction - commercial and residential	24,591	17,459	21,520
Home equity	530	624	296
Other consumer	8	8	
Total nonperforming loans (1)(2)	$ 36,715	$ 32,794	$ 33,177

(1) Excludes performing TDRs totaling $11.4 million at March 31, 2012, $13.9 million at December 31, 2011 and $3.1 million at March 31, 2011.

(2) Gross interest income that would have been recorded in 2012 if nonaccrual loans shown above had been current and in accordance with their original terms was $648 thousand, no interest was recorded on these loans for the three months ended March 31, 2012. See Note 1 to the Consolidated Financial Statements for a description of the Company s policy for placing loans on nonaccrual status.

The following table presents by class, an aging analysis and the recorded investments in loans past due as of March 31, 2012.

(dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Recorded Investment in Loans
March 31, 2012						
Commercial	$ 3,998	$ 2,404	$ 3,565	$ 9,967	$ 482,857	$ 492,824
Investment - commercial real estate	675	4,509	7,013	12,197	817,787	829,984
Owner occupied - commercial real estate	5,377	350	277	6,004	269,719	275,723
Real estate mortgage residential		258	731	989	42,068	43,057
Construction - commercial and residential	619	5,106	24,591	30,316	414,442	444,758
Home equity	33		530	563	94,874	95,437
Other consumer	2	35	8	45	5,112	5,157
Total	$ 10,704	$ 12,662	$ 36,715	$ 60,081	$ 2,126,859	$ 2,186,940

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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The following table presents by class, information related to impaired loans for the periods ended March 31, 2012, December 31, 2011 and March 31, 2011.

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2012							
Commercial	$ 8,382	$ 5,226	$ 1,891	$ 7,117	$ 1,265	$ 9,539	$ 43
Investment - commercial real estate	9,155	6,277	2,157	8,434	821	10,330	39
Owner occupied - commercial	277		207	207	70	280	
Real estate mortgage residential	731	731		731		886	
Construction - commercial and residential	29,013	20,299	5,914	26,213	2,800	26,372	42
Home equity	530	307	85	392	138	577	
Other consumer	8		4	4	4	8	
Total	$ 48,096	$ 32,840	$ 10,158	$ 42,998	$ 5,098	$ 47,992	$ 124
December 31, 2011							
Commercial	$ 10,695	$ 2,723	$ 5,923	$ 8,646	$ 2,049	$ 7,955	$ 161
Investment - commercial real estate	11,205	8,222	2,373	10,595	692	8,298	159
Owner occupied - commercial	282		192	192	90	488	6
Real estate mortgage residential	1,041	8	733	741	300	1,112	24
Construction - commercial and residential	22,812	17,407	5,086	22,493	237	22,254	14
Home equity	624	353	89	442	182	557	19
Other consumer	8		4	4	4	6	
Total	$ 46,667	$ 28,713	$ 14,400	$ 43,113	$ 3,554	$ 40,670	$ 383
March 31, 2011							
Commercial	$ 5,732	$ 1,998	$ 2,000	$ 3,998	$ 1,734	$ 5,434	$
Investment - commercial real estate	7,292	4,386	2,163	6,549	743	7,237	
Owner occupied - commercial	295		230	230	65	148	
Real estate mortgage residential	1,310	1,310		1,310		1,035	
Construction - commercial and residential	21,395	6,595	13,805	20,400	995	18,225	
Home equity	296	12	149	161	135	297	
Other consumer							
Total	$ 36,320	$ 14,301	$ 18,347	$ 32,648	$ 3,672	$ 32,376	$

Modifications

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying a loan, however, forgiveness of principal is rarely granted. Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Construction loans modified in a TDR may also involve extending the interest-only payment period.

Loans modified in a TDR are typically already on non-accrual status and partial charge-offs have in some cases already been taken against the outstanding loan balance. As a result, loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance associated with the loan. An allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

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The following table presents the TDR loan modifications by portfolio segment outstanding as of March 31, 2012 and December 31, 2011:

(dollars in thousands)	Number of Contracts	TDRs Performing to Modified Terms	TDRs Not Performing to Modified Terms	Total TDRs
March 31, 2012				
Commercial	2	$ 4,817	$	$ 4,817
Investment - commercial real estate	2	2,142	217	2,359
Construction - commercial and residential	2	4,422	1,000	5,422
Total	6	$ 11,381	$ 1,217	$ 12,598
December 31, 2011				
Commercial	2	$ 4,977	$	$ 4,977
Investment - commercial real estate	2	3,543		3,543
Construction - commercial and residential	2	5,353		5,353
Total	6	$ 13,873	$	$ 13,873

During the first three months of 2012, two TDRs totaling approximately $1.2 million defaulted on their modified terms. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. The two nonperforming TDRs were reclassified to nonperforming loans as of March 31, 2012. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were no loans modified in a TDR during the three months ended March 31, 2012 and March 31, 2011.

5. Net Income per Common Share

The calculation of net income per common share for three months ended March 31, 2012 and 2011 was as follows.

(dollars and shares in thousands, except per share data)	Three Months Ended March 31, 2012	2011
Basic:		
Net income available to common shareholders	$ 7,492	$ 4,816
Average common shares outstanding	20,111	19,717
Basic net income per common share	$ 0.37	$ 0.24
Diluted:		
Net income available to common shareholders	$ 7,492	$ 4,816
Average common shares outstanding	20,111	19,717
Adjustment for common share equivalents	513	498
Average common shares outstanding-diluted	20,624	20,215
Diluted net income per common share	$ 0.36	$ 0.24
Anti-dilutive shares	116,683	218,647

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6. Stock-Based Compensation

The Company maintains the 1998 Stock Option Plan (1998 Plan), the 2006 Stock Plan (2006 Plan) and the 2011 Employee Stock Purchase Plan (2011 ESPP). In connection with the acquisition of Fidelity and its subsidiary Fidelity & Trust Bank (F&T Bank), the Company assumed the Fidelity 2004 Long Term Incentive Plan and 2005 Long Term Incentive Plan (the Fidelity Plans). No additional options may be granted under the 1998 Plan or the Fidelity Plans.

The 2006 Plan provides for the issuance of awards of incentive options, nonqualifying options, restricted stock and stock appreciation rights to selected key employees and members of the Board. As amended, 1,215,000 shares of common stock are subject to issuance pursuant to awards under the 2006 Plan. Option awards are made with an exercise price equal to the average of the high and low price of the Company s shares at the date of grant.

For awards that are service based, compensation expense is being recognized over the service (vesting) period based on fair value, which for stock option grants is computed using the Black Scholes model, and for restricted stock awards is based on the average of the high and low stock price of the Company s shares at the date of grant. For awards that are performance based, compensation expense is recorded based on the probability of achievement of the goals underlying the grant. No performance based awards are outstanding at March 31, 2012.

Approved by shareholders in May 2011, the 2011 ESPP reserved 500,000 shares of common stock for issuance to employees. Whole shares are sold to participants in the plan at 85% of the lower of the stock price at the beginning or end of each quarterly offering period. The 2011 ESPP covers all eligible employees who have completed at least one year of continuous employment, work at least 20 hours per week and at least five months a year. Participants may contribute a minimum of $10 per pay period to a maximum of $6,250 per offering period or $25,000 annually not to exceed more than 10% of compensation per pay period. At March 31, 2012, the 2011 ESPP had 479,544 shares remaining for issuance.

In February 2012, the Company awarded 243,767 shares of restricted stock to senior officers, directors and employees. The shares vest in five substantially equal installments beginning on the date of grant.

Below is a summary of changes in shares under option plans pursuant to our equity compensation plans for the three months ended March 31, 2012 and 2011. The information excludes restricted stock units and awards.

	Three Months Ended March 31,			
	2012		2011	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Beginning Balance	831,393	$ 11.19	995,005	$ 10.54
Issued			1,500	13.81
Exercised	(31,465)	13.72	(17,814)	5.24
Forfeited				
Expired	(26,380)	15.36	(7,426)	12.90
Ending Balance	773,548	$ 10.94	971,265	$ 10.62

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The following summarizes information about stock options outstanding at March 31, 2012. The information excludes restricted stock units and awards.

Outstanding:

Range of Exercise Prices	Stock Options Outstanding		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life
$6.05 - $8.10	292,523	$	6.52	5.93
$8.11 - $11.07	219,521		10.14	2.18
$11.08 - $15.43	148,321		11.91	2.71
$15.44 - $26.86	113,183		22.66	3.67
	773,548	$	10.94	3.92

Exercisable:

Range of Exercise Prices	Stock Options Exercisable		Weighted-Average Exercise Price
$6.05 - $8.10	157,651	$	6.68
$8.11 - $11.07	216,271		10.14
$11.08 - $15.43	116,021		11.88
$15.44 - $26.86	110,504		22.79
	600,447	$	11.90

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions as shown in the table below used for grants during the years ended December 31, 2011 and 2010. There were no stock options granted during the three months ended March 31, 2012.

	Year Ended December 31,			
		2011		2010
Expected Volatility		33.61% - 36.64%		44.44%
Weighted-Average Volatility		35.60%		44.44%
Expected Dividends		0.0%		0.0%
Expected Term (In years)		6.0 - 7.5		8.5
Risk-Free Rate		1.82%		1.01%
Weighted-Average Fair Value (Grant date)	$	5.07	$	6.23

The expected lives are based on the simplified method allowed by ASC Topic 718 *Compensation,* whereby the expected term is equal to the midpoint between the vesting period and the contractual term of the award.

The total intrinsic value of outstanding stock options and outstanding exercisable stock options was $5.3 million at March 31, 2012. The total intrinsic value of stock options exercised during the three months ended March 31, 2012 and 2011 was $68 thousand and $157 thousand, respectively. The total fair value of stock options vested was $122 thousand and $129 thousand for the three months ended March 31, 2012 and 2011, respectively.

Included in salaries and employee benefits the Company recognized $1.2 million and $186 thousand in stock-based compensation expense for the three months ended March 31, 2012 and 2011, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Unrecognized stock-based compensation expense related to stock options totaled $329 thousand at March 31, 2012. At such date, the weighted-average period over which this unrecognized expense is expected to be recognized was 3.19 years.

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The Company has unvested restricted stock award grants of 330,572 shares under the 2006 Plan at March 31, 2012. Unrecognized stock based compensation expense related to restricted stock awards totaled $4.3 million at March 31, 2012. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 3.11 years. The following table summarizes the unvested restricted stock awards at March 31, 2012 and 2011.

	Three Months Ended March 31,			
	2012		2011	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Unvested at Beginning	202,555	$ 11.67	114,463	$ 9.20
Issued	243,767	16.83	96,162	13.91
Forfeited	(8,073)	10.35		
Vested	(107,677)	13.20	(12,830)	9.35
Unvested at End	330,572	$ 15.01	197,795	$ 11.48

7. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Quoted prices in active exchange markets for identical assets or liabilities; also includes certain U.S. Treasury and other U.S. government and agency securities actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data; also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. government and agency securities, corporate debt securities, derivative instruments, and residential mortgage loans held for sale.

Level 3 Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data. This category generally includes certain private equity investments, retained interests from securitizations, and certain collateralized debt obligations.

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Assets and Liabilities Recorded as Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011.

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
March 31, 2012				
Investment securities available for sale:				
U. S. Government agency securities	$	$ 93,710	$	$ 93,710
Residential mortgage backed securities		181,765		181,765
Municipal bonds		69,228		69,228
Other equity investments	92		226	318
Residential mortgage loans held for sale		87,496		87,496
Total assets measured at fair value on a recurring basis as of March 31, 2012	$ 92	$ 432,199	$ 226	$ 432,517

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
December 31, 2011				
Investment securities available for sale:				
U. S. Government agency securities	$	$ 103,753	$	$ 103,753
Residential mortgage backed securities		147,978		147,978
Municipal bonds		61,773		61,773
Other equity investments	81		226	307
Residential mortgage loans held for sale		176,826		176,826
Total assets measured at fair value on a recurring basis as of December 31, 2011	$ 81	$ 490,330	$ 226	$ 490,637

Investment Securities Available-for-sale

Investment securities available-for-sale is recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 investment securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include US government agency debt securities, mortgage backed securities issued by government sponsored entities and municipal bonds. Securities classified as Level 3 include securities in less liquid markets.

The Company s residential loans held for sale are reported on an aggregate basis at the lower of cost or fair value.

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The following is a reconciliation of activity for assets measured at fair value based on significant unobservable (non-market) information.

	Other Equity Investments	
(dollars in thousands)	March 31, 2012	December 31, 2011
Balance, beginning of period	$ 226	$ 267
Total realized and unrealized gains and losses:		
Included in other comprehensive income		
Purchases		
Principal redemption		