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Home Federal Bancorp, Inc.
Form 10-Q
August 08, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

☒ 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

Commission File Number: 001-33795

HOME FEDERAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

500 12th Avenue South, Nampa, Idaho

(Address of principal executive offices)

Registrant's telephone number, including area code:

68-0666697

(I.R.S. Employer

Identification No.)

83651

(Zip Code)

(208) 466-4634

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 ☒ 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 ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$0.01 par value per share, 14,490,376 shares outstanding as of July 31, 2013.

HOME FEDERAL BANCORP, INC.
FORM 10-Q
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Item 1. Financial Statements

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS (In thousands, except share data) (unaudited)	June 30, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	\$76,116	\$115,529
Investments available-for-sale, at fair value	440,886	420,505
FHLB stock, at cost	17,086	17,401
Loans receivable, net of allowance for loan losses of \$11,099 and \$12,528	388,847	409,846
Accrued interest receivable	2,870	2,776
Property and equipment, net	27,112	29,057
Bank owned life insurance ("BOLI")	16,172	15,938
Real estate owned and other repossessed assets ("REO")	8,822	10,386
FDIC indemnification receivable, net	7,359	10,846
Core deposit intangible	2,281	2,523
Deferred tax assets, net	16,618	9,022
Other assets	3,579	4,791
TOTAL ASSETS	\$1,007,748	\$1,048,620
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposit accounts:		
Noninterest-bearing demand	\$154,023	\$142,207
Interest-bearing demand	246,284	248,836
Money market	151,925	167,202
Savings	85,801	83,401
Certificates	186,035	209,242
Total deposit accounts	824,068	850,888
Advances by borrowers for taxes and insurance	734	490
Accrued interest payable	136	167
Deferred compensation	6,332	6,149
Repurchase agreements	612	4,775
Other liabilities	5,513	6,366
Total liabilities	837,395	868,835
STOCKHOLDERS' EQUITY		
Serial preferred stock, \$0.01 par value; 10,000,000 authorized; issued and outstanding: none	—	—
Common stock, \$0.01 par value; 90,000,000 authorized; issued and outstanding: Jun. 30, 2013 - 17,514,997 issued; 14,490,376 outstanding Dec. 31, 2012 - 17,512,997 issued; 14,453,399 outstanding	145	145
Additional paid-in capital	132,622	131,934
Retained earnings	45,719	46,337
Unearned shares issued to employee stock ownership plan ("ESOP")	(6,444)	) (6,823
Accumulated other comprehensive income (loss)	(1,689)	) 8,192
Total stockholders' equity	170,353	179,785

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,007,748	\$1,048,620
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See accompanying notes.

HOME FEDERAL BANCORP, INC. AND
SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest income:				
Loans	\$8,751	\$9,033	\$16,989	\$20,250
Investments	2,605	2,209	5,180	4,413
Other interest income	62	71	116	141
Total interest income	11,418	11,313	22,285	24,804
Interest expense:				
Deposits	750	991	1,546	2,093
Repurchase agreements	3	16	19	37
Total interest expense	753	1,007	1,565	2,130
Net interest income	10,665	10,306	20,720	22,674
Provision for loan losses	(356)	) (434)	) (583)	) (1,217)
Net interest income after provision for loan losses	11,021	10,740	21,303	23,891
Noninterest income:				
Service charges and fees	2,131	2,274	4,114	4,381
Gain on sale of investments (\$231 and \$485 of gains during the three and six months ended June 30, 2013, respectively, are comprised of accumulated other comprehensive income reclassifications)	231	603	485	1,138
Increase in cash surrender value of BOLI	118	122	234	242
FDIC indemnification provision	(6)	) (411)	) (47)	) (1,230)
Impairment of FDIC indemnification asset, net	(2,322)	) (1,705)	) (4,316)	) (5,048)
Other income	80	253	260	546
Total noninterest income	232	1,136	730	29
Noninterest expense:				
Compensation and benefits	5,659	6,175	11,669	12,312
Occupancy and equipment	1,374	1,514	2,794	3,077
Data processing	935	942	1,863	1,947
Advertising	166	223	289	377
Postage and supplies	215	247	421	553
Professional services	595	630	1,119	1,269
Insurance and taxes	453	561	804	1,082
Amortization of intangibles	118	144	242	296
Provision for REO	548	291	643	398
Other expenses	334	379	650	755
Total noninterest expense	10,397	11,106	20,494	22,066
Income before income taxes	856	770	1,539	1,854
Income tax provision	281	211	503	593
Net income	\$575	\$559	\$1,036	\$1,261
Earnings per common share:				
Basic	\$0.04	\$0.04	\$0.07	\$0.09
Diluted	0.04	0.04	0.07	0.09
Weighted average number of shares outstanding:				
Basic	13,697,281	14,638,663	13,673,036	14,705,256

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Diluted	13,763,806	14,638,663	13,738,501	14,705,256
Dividends declared per share:	\$0.06	\$0.055	\$0.12	\$0.11

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF
COMPREHENSIVE INCOME (LOSS) (In thousands)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Comprehensive income (loss):				
Net income	\$575	\$559	\$1,036	\$1,261
Other comprehensive income (loss):				
Change in unrealized holding gain on securities available-for-sale, net of taxes of \$(5,372), \$1,013, \$(6,115) and \$1,406, respectively	(8,420	) 1,587	(9,585	) 2,203
Adjustment for realized gains, net of taxes of \$(90), \$(236), \$(189) and \$(445), respectively	(141	) (368	) (296	) (695
Other comprehensive income (loss)	(8,561	) 1,219	(9,881	) 1,508
Comprehensive income (loss)	\$ (7,986	) \$ 1,778	\$ (8,845	) \$ 2,769

See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS'
EQUITY

(In thousands, except share data) (unaudited)	Common Stock		Additional Paid-In Capital	Retained Earnings	Unearned Shares Issued to ESOP	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount					
Balance at December 31, 2012	14,453,399	\$ 145	\$ 131,934	\$ 46,337	\$(6,823)	\$ 8,192	\$ 179,785
Restricted stock issued, net of forfeitures	40,857	—					—
Repurchased restricted stock to pay taxes	(5,880)		(73)				(73)
ESOP shares committed to be released			100		379		479
Exercise of stock options	2,000		24				24
Share-based compensation			639				639
Dividends paid (\$0.12 per share)				(1,654)			(1,654)
Tax adjustments for equity comp. plans			(2)				(2)
Net income				1,036			1,036
Other comprehensive loss						(9,881)	(9,881)
Balance at June 30, 2013	14,490,376	\$ 145	\$ 132,622	\$ 45,719	\$(6,444)	\$ (1,689)	\$ 170,353

See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (unaudited)

Six Months Ended

June 30,

2013

2012

CASH FLOWS FROM OPERATING ACTIVITIES:

Net income	\$1,036	\$1,261	
Adjustments to reconcile net income to cash provided from operating activities:			
Depreciation and amortization	1,423	1,539	
Amortization of core deposit intangible	242	296	
Impairment of FDIC indemnification receivable	4,316	5,048	
Net amortization of premiums and discounts on investments	1,395	2,765	
Gain on sale of investments available-for-sale ("AFS")	(485)	(1,138))
Gain on sale of fixed assets and repossessed assets	(100)	(372))
ESOP shares committed to be released	479	389	
Share based compensation expense	639	473	
Provision for loan losses	(583)	(1,217))
Valuation allowance on real estate and other property owned	643	398	
Accrued deferred compensation expense, net	183	124	
Net deferred loan fees	96	(936))
Deferred income tax provision	(1,292)	(3,222))
Net increase in cash surrender value of BOLI	(234)	(242))
Change in assets and liabilities:			
Interest receivable	(94)	(110))
Other assets	866	(2,213))
Interest payable	(30)	(41))
Other liabilities	(924)	(1,809))
Net cash provided from operating activities	7,576	993	

CASH FLOWS FROM INVESTING ACTIVITIES:

Principal repayments, maturities and calls of investments AFS	54,187	47,109	
Proceeds from sales of investments AFS	19,460	56,110	
Purchase of investments AFS	(111,124)	(145,524))
Proceeds from redemption of FHLB stock	315	—	
Reimbursement (repayment) of loan losses under loss share agreement	(155)	442)
Net decrease in loans	19,994	13,287	
Proceeds from sales of fixed assets and repossessed assets	2,890	10,739	
Purchases of fixed assets	(114)	(473))
Net cash used by investing activities	(14,547)	(18,310))

CASH FLOWS FROM FINANCING ACTIVITIES:

Net decrease in deposits	(26,820)	(38,334))
Net increase in advances by borrowers for taxes and insurance	244	487	
Net decrease in investments sold under obligation to repurchase	(4,163)	(172))
Repurchased restricted stock to pay taxes	(73)	(38))
Proceeds from exercise of stock options	24	—	
Repurchases of common stock	—	(4,106))
Dividends paid	(1,654)	(1,620))
Net cash used by financing activities	(32,442)	(43,783))
NET DECREASE IN CASH AND CASH EQUIVALENTS	(39,413)	(61,100))
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	115,529	144,293	
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$76,116	\$83,193	

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(continued)

(In thousands) (unaudited)

Six Months Ended
June 30,

2013 2012

SUPPLEMENTAL DISCLOSURE OF CASH FLOW
INFORMATION:

Cash paid during the year for:

Interest	\$ 1,596	\$ 2,171
Income taxes	765	7,064

NONCASH INVESTING AND FINANCING
ACTIVITIES:

Acquisition of real estate and other assets in settlement of loans	\$ 1,562	\$ 7,917
Fair value adjustment to securities AFS, net of taxes	(9,881	) 1,508
Transfer of fixed assets into REO	609	—

See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Basis of Presentation

The consolidated financial statements presented in this report include the accounts of Home Federal Bancorp, Inc., a Maryland corporation (the “Company”), and its wholly-owned subsidiary, Home Federal Bank (the “Bank”), which is a state-chartered commercial bank headquartered in Nampa, Idaho. As used throughout this report, the term the “Company” refers to Home Federal Bancorp, Inc., and its consolidated subsidiary, unless the context otherwise requires.

The consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information and are unaudited. All significant intercompany transactions and balances have been eliminated. In the opinion of the Company's management, all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the interim periods included herein have been made. Operating results for the three and six months ended June 30, 2013, are not necessarily indicative of the results that may be expected for future periods.

On July 30, 2010, the Bank entered into a purchase and assumption agreement with the FDIC to assume all of the deposits and acquire certain assets of LibertyBank, headquartered in Eugene, Oregon (“LibertyBank Acquisition”). In August 2009, the Bank entered into a purchase and assumption agreement with the FDIC to assume all of the deposits and certain assets of Community First Bank, headquartered in Prineville, Oregon (“CFB Acquisition”). All of the loans purchased in the CFB Acquisition and the majority of loans and leases purchased in the LibertyBank Acquisition are included under the loss sharing agreements with the FDIC and are referred to as “covered loans.” Real estate owned and repossessed assets (“REO”) acquired in the CFB Acquisition and the LibertyBank Acquisition that are also included in the loss sharing agreements are referred to as “covered REO.” The covered loans and covered REO are collectively referred to as “covered assets.” Loans and foreclosed and repossessed assets not subject to loss sharing agreements with the FDIC are referred to as “noncovered loans” or “noncovered assets.”

Certain information and note disclosures normally included in the Company's annual consolidated financial statements have been condensed or omitted. Therefore, these consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (“2012 Form 10-K”), filed with the Securities and Exchange Commission (“SEC”) on March 15, 2013.

Certain reclassifications have been made to prior year's financial statements in order to conform to the current year presentation. The reclassifications had no effect on previously reported net income or equity.

Note 2 – Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about these amounts. The new guidance was effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this guidance did not have a significant

impact on the Company's Consolidated Financial Statements but the disclosures are included.

In October 2012, the FASB issued ASU 2012-06, Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. ASU 2012-06 addresses the diversity in practice about how to interpret the terms “on the same basis” and “contractual limitations” when subsequently measuring an indemnification asset. The adoption of this ASU was effective for fiscal years and interim periods beginning on or after December 15, 2012. This ASU did not have a

significant impact on the Company's Consolidated Financial Statements as the Company accounted for its indemnification asset in a manner consistent with this ASU.

In June 2013, the FASB issued ASU 2013-08, Financial Services - Investment Companies (Topic 946) - Amendments to the Scope, Measurement and Disclosure Requirements. ASU 2013-08 sets forth the characteristics of investment companies and a new approach for determining whether a company is an investment company. The fundamental characteristics of an investment company include (i) the company obtains funds from investors and provides the investors with investment management services; (ii) the company commits to its investors that its business purpose and only substantive activities are investing the funds for returns solely from capital appreciation, investment income, or both; and (iii) the company or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income. ASU 2013-08 also sets forth the scope, measurement and disclosure requirements for investment companies. ASU 2013-08 will become effective for the Company on January 1, 2014 and is not expected to have a significant impact on the Company's Consolidated Financial Statements.

In July 2013, the FASB issued ASU 2013-10, Derivatives and Hedging (Topic 815) - Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. ASU 2013-10 permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to interest rates on direct U.S. Treasury obligations and the London Interbank Offered Rate ("LIBOR"). ASU 2013-10 is effective prospectively for qualifying new or re-designated hedging relationships entered into on or after July 17, 2013 and is not expected to have a significant impact on the Company's Consolidated Financial Statements.

Note 3 – Earnings Per Share ("EPS")

Basic earnings per common share is computed by dividing net income allocated to common stock by the weighted average number of common shares outstanding during the period which excludes the participating securities (securities that may participate in undistributed earnings with common stock). Diluted earnings per common share includes the dilutive effect of additional potential common shares from stock compensation awards, but excludes awards considered participating securities. ESOP shares are not considered outstanding for earnings per share purposes until they are committed to be released.

The following table presents the computation of basic and diluted earnings per share for the periods indicated (in thousands, except share and per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	\$575	\$559	\$1,036	\$1,261
Allocated to participating securities	(4	) (4	) (8	) (11
Net income allocated to common stock	\$571	\$555	\$1,028	\$1,250
Weighted average common shares outstanding, gross	14,473,548	15,531,981	14,460,002	15,588,611
Less: Average unearned ESOP shares	(671,370	) (749,210	) (681,100	) (758,941
Less: Average participating securities	(104,897	) (144,108	) (105,866	) (124,414
Weighted average common shares outstanding, net	13,697,281	14,638,663	13,673,036	14,705,256
Net effect of dilutive stock options	66,525	—	65,465	—
Weighted average shares and common stock equivalents	13,763,806	14,638,663	13,738,501	14,705,256
Income per common share:				
Basic	\$0.04	\$0.04	\$0.07	\$0.09

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Diluted	0.04	0.04	0.07	0.09
Options excluded from the calculation due to their anti-dilutive effect on EPS	966,854	986,590	967,914	986,590

Note 4 – Investments

The Company's investment policies are designed to provide and maintain adequate liquidity and to generate favorable rates of return without incurring undue interest rate or credit risk, and generally limit investments to mortgage-backed securities, securities issued by U.S. Government-sponsored enterprises ("GSE"), municipal bonds, certificates of deposit and marketable corporate debt obligations. Investments available-for-sale consisted of the following at June 30, 2013 and December 31, 2012 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total	
June 30, 2013						
Obligations of U.S. GSE	\$62,067	\$519	\$(909)	) \$61,677	14.0	%
Obligations of states and political subdivisions	42,124	753	(1,090)	) 41,787	9.5	
U.S. Treasury bonds	9,602	—	(752)	) 8,850	2.0	
Mortgage-backed securities, GSE-issued	329,602	5,433	(6,714)	) 328,321	74.4	
Mortgage-backed securities, private label	258	—	(7)	) 251	0.1	
Total	\$443,653	\$6,705	\$(9,472)	) \$440,886	100.0	%
December 31, 2012						
Obligations of U.S. GSE	\$56,179	\$1,481	\$—	) \$57,660	13.7	%
Obligations of states and political subdivisions	38,932	2,009	(51)	) 40,890	9.7	
Mortgage-backed securities, GSE-issued	311,690	10,116	(134)	) 321,672	76.5	
Mortgage-backed securities, private label	287	—	(4)	) 283	0.1	
Total	\$407,088	\$13,606	\$(189)	) \$420,505	100.0	%

For the six months ended June 30, 2013 and 2012, proceeds from sales of investments available-for-sale amounted to \$19.5 million and \$56.1 million, respectively. Gross realized gains for the six months ended June 30, 2013 and 2012 were \$518,000 and \$1.1 million respectively, against gross realized losses of \$33,000 and \$0, respectively. All gains and losses were included in noninterest income on the Consolidated Statements of Operations.

The fair value of investments with unrealized losses, the amount of unrealized losses and the length of time these unrealized losses existed as of June 30, 2013 and December 31, 2012, were as follows (in thousands):

	Less Than 12 Months		12 Months or Longer		Total	Unrealized
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Losses
June 30, 2013						
Obligations of U.S. GSE	\$25,662	\$(909)	) \$—	\$—	\$25,662	\$(909)
Obligations of states and political subdivisions	24,556	(1,090)	) —	—	24,556	(1,090)
U.S. Treasury bonds	8,850	(752)	) —	—	8,850	(752)
Mortgage-backed securities, GSE-issued	155,545	(6,712)	) 113	(2)	155,658	(6,714)
Mortgage-backed securities, private label	—	—	251	(7)	251	(7)
Total	\$214,613	\$(9,463)	) \$364	\$(9)	) \$214,977	\$(9,472)
December 31, 2012						
	\$6,117	\$(51)	) \$—	\$—	\$6,117	\$(51)

Obligations of states and political
subdivisions

Mortgage-backed securities, GSE-issued	20,461	(131	) 114	(3	) 20,575	(134)
Mortgage-backed securities, private label	—	—	283	(4) 283	(4)
Total	\$26,578	\$(182) \$397	\$(7) \$26,975	\$(189)

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Management has evaluated these investments and has determined that the decline in value is not other than temporary and not related to the underlying credit quality of the issuers or an industry specific event. The declines in value are on investments that have contractual maturity dates and future principal payments that will be sufficient to recover the current amortized cost of the investments. The Company does not have the intent to sell these investments and it is likely that it will not be required to sell these investments before their anticipated recovery.

The contractual maturities of investments available-for-sale at the dates indicated are shown below (in thousands). Expected maturities may differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties.

	June 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	\$11,042	\$11,078	\$14,136	\$14,206
Due after one year through five years	6,300	6,495	7,051	7,280
Due after five years through ten years	24,068	24,197	20,719	21,908
Due after ten years	72,383	70,544	53,205	55,156
Mortgage-backed securities	329,860	328,572	311,977	321,955
Total	\$443,653	\$440,886	\$407,088	\$420,505

As of June 30, 2013, and December 31, 2012, the Bank pledged investments for the following obligations (in thousands):

	June 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
FHLB borrowings	\$18,902	\$20,241	\$23,482	\$25,397
Federal Reserve Bank	904	935	1,166	1,222
Repurchase agreements	5,868	6,059	4,607	4,855
Deposits of municipalities and public units	8,376	8,894	9,871	10,573
Total	\$34,050	\$36,129	\$39,126	\$42,047

Note 5 – Loans and Leases Receivable and the Allowance for Loan Losses

Loans and leases receivable are summarized as follows at June 30, 2013, and December 31, 2012 (dollars in thousands):

	June 30, 2013		December 31, 2012	
	Amount	Percent of Gross	Amount	Percent of Gross
Real estate:				
One-to-four family residential	\$76,567	19.1 %	\$87,833	20.8 %
Multifamily residential	33,250	8.3	34,377	8.1
Commercial	177,041	44.3	185,132	43.8
Total real estate	286,858	71.7	307,342	72.7
Real estate construction:				
One-to-four family residential	21,780	5.4	13,016	3.1
Multifamily residential	2,726	0.7	520	0.1
Commercial and land development	21,739	5.4	25,391	6.0
Total real estate construction	46,245	11.5	38,927	9.2
Consumer:				
Home equity	38,678	9.7	41,793	9.9
Automobile	780	0.2	966	0.2
Other consumer	3,527	0.9	4,012	1.1
Total consumer	42,985	10.8	46,771	11.2
Commercial business	23,869	6.0	29,249	6.9
Gross loans	399,957	100.0 %	422,289	100.0 %
Deferred loan (fees) costs, net	(11)		85	
Allowance for loan losses	(11,099)		(12,528)	
Loans receivable, net	\$388,847		\$409,846	

The following tables present loans at their recorded investment. Recorded investment includes the unpaid principal balance, net of purchase adjustments, plus accrued interest less charge offs and net deferred loan fees. Accrued interest on loans was \$1.1 million at both June 30, 2013, and December 31, 2012.

Delinquent and nonaccrual loans. The following tables present the recorded investment in nonperforming loans and an aging of performing loans by class as of June 30, 2013 and December 31, 2012 (in thousands):

June 30, 2013							
Nonperforming Loans							
	Nonaccrual	Past Due 90 or More Days, Still Accruing	Total	Loans Delinquent 30-59 Days	Loans Delinquent 60-89 Days	Loans Not Past Due	Total Loans
Noncovered loans							
Real estate:							
One-to-four family residential	\$2,915	\$—	\$2,915	\$ —	\$ 105	\$66,501	\$69,521
Multifamily residential	795	—	795	—	—	30,468	31,263
Commercial real estate	119	—	119	—	—	130,925	131,044
Total real estate	3,829	—	3,829	—	105	227,894	231,828
Real estate construction:							
One-to-four family residential	631	—	631	—	—	21,031	21,662
Multifamily residential	—	—	—	—	—	2,715	2,715
Commercial real estate	192	—	192	—	—	17,491	17,683
Total real estate construction	823	—	823	—	—	41,237	42,060
Consumer:							
Home equity	527	—	527	103	—	29,440	30,070
Automobile	6	—	6	—	—	646	652
Other consumer	—	—	—	—	—	2,938	2,938
Total consumer	533	—	533	103	—	33,024	33,660
Commercial business	248	—	248	—	—	15,757	16,005
Total noncovered loans	5,433	—	5,433	103	105	317,912	323,553
Covered loans							
Real estate:							
One-to-four family residential	252	—	252	—	—	6,851	7,103
Multifamily residential	—	—	—	—	—	2,881	2,881
Commercial real estate	3,517	—	3,517	—	—	42,537	46,054
Total real estate	3,769	—	3,769	—	—	52,269	56,038
Commercial real estate construction	228	—	228	—	—	3,759	3,987
Consumer:							
Home equity	35	—	35	—	—	8,797	8,832
Automobile	—	—	—	—	—	130	130
Other consumer	—	—	—	—	—	627	627
Total consumer	35	—	35	—	—	9,554	9,589
Commercial business	—	—	—	—	—	7,866	7,866
Total covered loans	4,032	—	4,032	—	—	73,448	77,480
Total gross loans	\$9,465	\$—	\$9,465	\$ 103	\$ 105	\$391,360	\$401,033

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December 31, 2012							
Nonperforming Loans							
	Nonaccrual	Past Due 90 or More Days, Still Accruing	Total	Loans Delinquent 30-59 Days	Loans Delinquent 60-89 Days	Loans Not Past Due	Total Loans
Noncovered loans							
Real estate:							
One-to-four family residential	\$3,240	\$—	\$3,240	\$ 498	\$ 217	\$75,741	\$79,696
Multifamily residential	825	—	825	—	—	30,228	31,053
Commercial real estate	3,727	—	3,727	—	—	132,825	136,552
Total real estate	7,792	—	7,792	498	217	238,794	247,301
Real estate construction:							
One-to-four family residential	593	—	593	—	—	12,423	13,016
Multifamily residential	—	—	—	—	—	520	520
Commercial real estate	218	—	218	—	—	19,756	19,974
Total real estate construction	811	—	811	—	—	32,699	33,510
Consumer:							
Home equity	643	—	643	31	7	30,979	31,660
Automobile	—	—	—	—	3	752	755
Other consumer	—	—	—	13	—	3,257	3,270
Total consumer	643	—	643	44	10	34,988	35,685
Commercial business	351	—	351	—	—	17,183	17,534
Total noncovered loans	9,597	—	9,597	542	227	323,664	334,030
Covered loans							
Real estate:							
One-to-four family residential	338	—	338	—	—	7,835	8,173
Multifamily residential	—	—	—	—	—	3,325	3,325
Commercial real estate	4,108	—	4,108	—	—	44,471	48,579
Total real estate	4,446	—	4,446	—	—	55,631	60,077
Commercial real estate construction	248	—	248	—	—	5,169	5,417
Consumer:							
Home equity	85	—	85	30	—	10,164	10,279
Automobile	—	—	—	—	—	210	210
Other consumer	10	—	10	5	5	742	762
Total consumer	95	—	95	35	5	11,116	11,251
Commercial business	—	—	—	—	—	12,699	12,699
Total covered loans	4,789	—	4,789	35	5	84,615	89,444
Total gross loans	\$14,386	\$—	\$14,386	\$ 577	\$ 232	\$408,279	\$423,474

Loan classification. The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a monthly basis. The Company uses the following definitions for risk classification ratings:

Watch. A loan is categorized as watch if it possesses some reason for additional management oversight, such as correctable documentation deficiencies, recent financial setbacks, deteriorating financial position, industry concerns, and failure to perform on other borrowing obligations. Loans with this classification are to be monitored in an effort to correct deficiencies and upgrade the credit if warranted. At the time of this classification, they are not believed to expose the Company to significant risk.

Special Mention. Performing loans that have developed minor credit weaknesses since origination are categorized as special mention. Evidence of credit weakness include the primary source of repayment has deteriorated and no longer meets debt service requirements as defined in Company policy, the borrower may have a short track record and little depth of management, inadequate current financial information, marginal capitalization, and susceptibility to negative industry trends. The primary source of repayment remains viable but there is increasing reliance on collateral or guarantor support.

Substandard. A loan is considered substandard if it is inadequately protected by the current net worth, liquidity and paying capacity of the borrower or collateral pledged. Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

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

Loss. This classification of loans includes loans that are considered uncollectible and of such little value that their continuance as an active asset is not warranted. This does not mean the loan has no salvage value, however, is neither desirable nor practical to defer writing off this asset at this time. Once a determination has been made that a loss exists, the loss amount will be charged-off. As a result, generally, the Company will not report loan balances as “Loss.”

Pass. Loans not meeting the criteria above are considered to be pass rated loans. The pass classification also includes homogeneous loans (such as one-to-four family residential and consumer loans) unless the borrower experiences a delinquency or requests a modification, at which point the loan is graded as specified above.

As of June 30, 2013, and December 31, 2012, and based on the most recent analysis performed, the risk category of loans by class of loans was as follows (in thousands):

	June 30, 2013					
	Pass	Watch	Special Mention	Substandard	Doubtful	Total Loans
Noncovered loans						
Real estate:						
One-to-four family residential	\$65,259	\$482	\$—	\$3,780	\$—	\$69,521
Multifamily residential	30,312	20	46	885	—	31,263
Commercial real estate	99,478	10,217	6,001	15,348	—	131,044
Total real estate	195,049	10,719	6,047	20,013	—	231,828
Real estate construction:						
One-to-four family residential	18,418	2,613	—	631	—	21,662
Multifamily residential	2,715	—	—	—	—	2,715
Commercial real estate	17,175	316	—	192	—	17,683
Total real estate construction	38,308	2,929	—	823	—	42,060
Consumer:						
Home equity	29,433	110	—	527	—	30,070
Automobile	647	—	—	5	—	652
Other consumer	2,859	52	18	9	—	2,938
Total consumer	32,939	162	18	541	—	33,660
Commercial business	15,070	491	141	303	—	16,005
Total noncovered loans	281,366	14,301	6,206	21,680	—	323,553
Covered loans						
Real estate:						
One-to-four family residential	3,294	150	—	3,659	—	7,103
Multifamily residential	2,211	192	—	478	—	2,881
Commercial real estate	27,567	1,890	2,203	14,394	—	46,054
Total real estate	33,072	2,232	2,203	18,531	—	56,038
Commercial real estate construction	485	3,274	—	228	—	3,987
Consumer:						
Home equity	8,694	—	103	35	—	8,832
Automobile	130	—	—	—	—	130

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Other consumer	601	11	—	15	—	627
Total consumer	9,425	11	103	50	—	9,589
Commercial business	4,941	1,138	958	829	—	7,866
Total covered loans	47,923	6,655	3,264	19,638	—	77,480
Total gross loans	\$329,289	\$20,956	\$9,470	\$41,318	\$—	\$401,033

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	December 31, 2012					Total
	Pass	Watch	Special Mention	Substandard	Doubtful	Loans
Noncovered loans						
Real estate:						
One-to-four family residential	\$74,974	\$603	\$—	\$4,119	\$—	\$79,696
Multifamily residential	30,073	—	39	941	—	31,053
Commercial real estate	91,684	11,477	11,456	21,935	—	136,552
Total real estate	196,731	12,080	11,495	26,995	—	247,301
Real estate construction:						
One-to-four family residential	11,771	594	—	651	—	13,016
Multifamily residential	520	—	—	—	—	520
Commercial real estate	19,365	391	—	218	—	19,974
Total real estate construction	31,656	985	—	869	—	33,510
Consumer:						
Home equity	30,901	116	—	643	—	31,660
Automobile	755	—	—	—	—	755
Other consumer	3,159	26	21	64	—	3,270
Total consumer	34,815	142	21	707	—	35,685
Commercial business	16,249	675	175	435	—	17,534
Total noncovered loans	279,451	13,882	11,691	29,006	—	334,030
Covered loans						
Real estate:						
One-to-four family residential	3,494	151	—	4,528	—	8,173
Multifamily residential	2,617	205	—	503	—	3,325
Commercial real estate	22,272	10,302	1,813	14,192	—	48,579
Total real estate	28,383	10,658	1,813	19,223	—	60,077
Real estate construction:	849	3,939	—	629	—	5,417
Consumer:						
Home equity	10,024	109	—	146	—	10,279
Automobile	210	—	—	—	—	210
Other consumer	725	12	—	25	—	762
Total consumer	10,959	121	—	171	—	11,251
Commercial business	8,361	742	1,175	2,421	—	12,699
Total covered loans	48,552	15,460	2,988	22,444	—	89,444
Total gross loans	\$328,003	\$29,342	\$14,679	\$51,450	\$—	\$423,474

Impaired loans. A loan is considered impaired when, based upon currently known information, it is deemed probable that the Company will be unable to collect all amounts due as scheduled according to the original terms of the agreement with the borrower. Additionally, all troubled debt restructurings (“TDRs”) are considered impaired.

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The following table presents loans deemed impaired by class of loans as of and during the three and six months ended June 30, 2013 (in thousands):

	June 30, 2013			Average Recorded Investment	
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Noncovered loans					
With no related allowance recorded:					
Real estate:					
One-to-four family residential	\$3,771	\$3,221	\$—	\$3,360	\$3,446
Commercial real estate	3,994	3,912	—	6,459	6,745
Total real estate	7,765	7,133	—	9,819	10,191
Real estate construction:					
One-to-four family residential	317	312	—	281	273
Commercial real estate	191	192	—	195	179
Total real estate construction	508	504	—	476	452
Home equity	491	324	—	370	391
Commercial business	257	257	—	302	321
Total noncovered loans with no related allowance	9,021	8,218	—	10,967	11,355
With an allowance recorded:					
Real estate:					
One-to-four family residential	1,022	1,019	(270)	1,030	1,039
Multifamily residential	795	795	(66)	803	810
Commercial real estate	89	89	(3)	215	259
Total real estate	1,906	1,903	(339)	2,048	2,108
Real estate construction:					
One-to-four family residential	319	319	(70)	351	364
Commercial real estate	—	—	—	—	24
Total real estate construction	319	319	(70)	351	388
Home equity	221	221	(118)	221	222
Total noncovered loans with an allowance recorded	2,446	2,443	(527)	2,620	2,718
Covered loans					
With no related allowance recorded:					
Real estate:					
One-to-four family residential	—	—	—	—	42
Commercial real estate	2,936	2,186	—	2,530	2,536
Total real estate	2,936	2,186	—	2,530	2,578
Commercial real estate construction	498	228	—	231	236
Home equity	541	35	—	85	85
Commercial business and leases	—	—	—	—	3
Total covered loans with no related allowance	3,975	2,449	—	2,846	2,902
Total impaired loans	\$15,442	\$13,110	\$(527)	\$16,433	\$16,975

At June 30, 2013, the unpaid principal balance for purposes of this table includes \$2.3 million that was partially charged-off but not forgiven.

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The following table presents loans deemed impaired by class of loans as of December 31, 2012, and during the three and six months ended June 30, 2012 (in thousands):

	December 31, 2012			Average Recorded Investment	
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Noncovered loans					
With no related allowance recorded:					
Real estate:					
One-to-four family residential	\$4,259	\$3,620	\$—	\$3,814	\$4,094
Commercial real estate	7,403	7,316	—	4,869	4,051
Total real estate	11,662	10,936	—	8,683	8,145
Real estate construction:					
One-to-four family residential construction	317	259	—	162	365
Commercial real estate	146	146	—	151	101
Total real estate construction	463	405	—	313	466
Consumer:					
Home equity	758	434	—	742	699
Automobile	—	—	—	29	30
Other consumer	—	—	—	10	10
Total consumer	758	434	—	781	739
Commercial business	360	361	—	368	388
Total noncovered loans with no related allowance	13,243	12,136	—	10,145	9,738
With an allowance recorded:					
Real estate:					
One-to-four family residential	1,057	1,057	(309)	1,559	1,558
Multifamily residential	825	825	(114)	427	285
Commercial real estate	347	347	(41)	5,498	5,683
Total real estate	2,229	2,229	(464)	7,484	7,526
Real estate construction:					
One-to-four family residential construction	392	392	(145)	355	382
Commercial real estate	72	72	(12)	337	370
Total real estate construction	464				