CITY HOLDING CO
Form 10-Q
August 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended June 30, 2014
OR
[ ] TRANSITION REPORT PURSANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Transition Period From ____________To_____________.

Commission File number 0-11733
CITY HOLDING COMPANY
(Exact name of registrant as specified in its charter)

West Virginia	55-0619957
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

25 Gatewater Road	
Charleston, West Virginia	25313
(Address of principal executive offices)	(Zip Code)

(304) 769-1100
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [X]
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 Exchange Act).
Yes [ ] No [X]

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.
Common stock, $2.50 Par Value – 15,501,470 shares as of August 6, 2014.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management’s Discussion and Analysis of Financial Condition and Result of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company’s actual results differing from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to: (1) the Company may incur additional loan loss provision due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company could have adverse legal actions of a material nature; (4) the Company may face competitive loss of customers; (5) the Company may be unable to manage its expense levels; (6) the Company may have difficulty retaining key employees; (7) changes in the interest rate environment may have results on the Company’s operations materially different from those anticipated by the Company’s market risk management functions; (8) changes in general economic conditions and increased competition could adversely affect the Company’s operating results; (9) changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company’s operating results; (10) the Company may experience difficulties growing loan and deposit balances; (11) the current economic environment poses significant challenges for us and could adversely affect the Company's financial condition and results of operations; (12) deterioration in the financial condition of the U.S. banking system may impact the valuations of investments the Company has made in securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; and (13) the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the regulations promulgated and to be promulgated thereunder, which may subject the Company and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses. Forward-looking statements made herein reflect management’s expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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Part I - Financial Information

Item 1 - Financial Statements

Consolidated Balance Sheets
City Holding Company and Subsidiaries
(in thousands)

Assets	June 30, 2014 (Unaudited)	December 31, 2013
Cash and due from banks	$93,962	$75,999
Interest-bearing deposits in depository institutions	16,778	9,877
Cash and Cash Equivalents	110,740	85,876
Investment securities available for sale, at fair value	258,761	352,660
Investment securities held-to-maturity, at amortized cost (approximate fair value at June 30, 2014 and December 31, 2013, - $98,461 and $5,335, respectively)	96,039	4,117
Other securities	14,234	13,343
Total Investment Securities	369,034	370,120
Gross loans	2,577,777	2,606,197
Allowance for loan losses	(20,536)	(20,575)
Net Loans	2,557,241	2,585,622
Bank owned life insurance	93,567	92,047
Premises and equipment, net	80,171	82,548
Accrued interest receivable	7,727	6,866
Net deferred tax asset	37,793	42,165
Goodwill and other intangible assets	74,670	75,142
Other assets	33,771	27,852
Total Assets	$3,364,714	$3,368,238
Liabilities		
Deposits:		
Noninterest-bearing	$500,391	$493,228
Interest-bearing:		
Demand deposits	609,584	601,527
Savings deposits	635,293	612,772
Time deposits	1,040,979	1,077,606
Total Deposits	2,786,247	2,785,133
Short-term borrowings:		
Customer repurchase agreements	133,142	137,798
Long-term debt	16,495	16,495
Other liabilities	31,599	41,189
Total Liabilities	2,967,483	2,980,615
Shareholders’ Equity		
	—	—

Preferred stock, par value $25 per share: 500,000 shares authorized; none issued		
Common stock, par value $2.50 per share: 50,000,000 shares authorized; 18,499,282 shares issued at June 30, 2014 and December 31, 2013, less 2,892,542 and 2,748,922 shares in treasury, respectively	46,249	46,249

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Capital surplus	106,830	107,596
Retained earnings	348,018	333,970
Cost of common stock in treasury	(101,357)	(95,202)
Accumulated other comprehensive income (loss):		
Unrealized gain (loss) on securities available-for-sale	371	(2,110)
Underfunded pension liability	(2,880)	(2,880)
Total Accumulated Other Comprehensive Loss	(2,509)	(4,990)
Total Shareholders’ Equity	397,231	387,623
Total Liabilities and Shareholders’ Equity	$3,364,714	$3,368,238

See notes to consolidated financial statements.

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Consolidated Statements of Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands, except earnings per share data)

	Three months ended June 30,		Six months ended June 30,	
Interest Income	2014	2013	2014	2013
Interest and fees on loans	$28,621	$31,771	$58,355	$61,709
Interest and dividends on investment securities:				
Taxable	2,930	2,632	5,933	5,382
Tax-exempt	277	312	558	636
Interest on federal funds sold	—	9	—	22
Total Interest Income	31,828	34,724	64,846	67,749
Interest Expense				
Interest on deposits	2,737	3,195	5,490	6,422
Interest on short-term borrowings	85	79	160	149
Interest on long-term debt	151	153	301	309
Total Interest Expense	2,973	3,427	5,951	6,880
Net Interest Income	28,855	31,297	58,895	60,869
Provision for loan losses	435	2,011	1,798	3,749
Net Interest Income After Provision for Loan Losses	28,420	29,286	57,097	57,120
Non-interest Income				
Gains on sale of investment securities	818	9	901	93
Service charges	6,739	6,897	12,899	13,432
Bankcard revenue	3,838	3,450	7,523	6,649
Insurance commissions	1,319	1,358	3,344	3,198
Trust and investment management fee income	1,111	964	2,148	1,954
Bank owned life insurance	765	799	1,521	1,611
Other income	549	775	1,108	1,641
Total Non-interest Income	15,139	14,252	29,444	28,578
Non-interest Expense				
Salaries and employee benefits	12,977	12,640	26,116	25,589
Occupancy and equipment	2,395	2,500	5,010	4,971
Depreciation	1,533	1,453	3,011	2,852
FDIC insurance expense	357	341	767	853
Advertising	925	819	1,749	1,554
Bankcard expenses	833	766	1,639	1,493
Postage, delivery, and statement mailings	530	552	1,105	1,158
Office supplies	420	463	830	904
Legal and professional fees	612	535	1,021	971
Telecommunications	506	465	844	910
Repossessed asset losses (gains), net of expenses	142	(23)	521	(178)
Merger related costs	—	65	—	5,604
Other expenses	3,075	3,383	5,068	6,682
Total Non-interest Expense	24,305	23,959	47,681	53,363
Income Before Income Taxes	19,254	19,579	38,860	32,335
Income tax expense	6,497	6,573	12,300	11,342

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Net Income Available to Common Shareholders	$12,757	$13,006	$26,560	$20,993
Total comprehensive income	$14,462	$8,798	$29,041	$16,875
Average common shares outstanding	15,556	15,582	15,583	15,521
Effect of dilutive securities:				
Employee stock awards and warrant outstanding	150	170	155	166
Shares for diluted earnings per share	15,706	15,752	15,738	15,687
Basic earnings per common share	$0.81	$0.83	$1.69	$1.34
Diluted earnings per common share	$0.80	$0.82	$1.67	$1.33
Dividends declared per common share	$0.40	$0.37	$0.80	$0.74

See notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	$12,757	$13,006	$26,560	$20,993
Unrealized gains (losses) on available-for-sale securities arising during the period	3,521	(6,661)	4,834	(6,434)
Reclassification adjustment for gains	(818)	(9)	(901)	(93)
Other comprehensive income (loss) before income taxes	2,703	(6,670)	3,933	(6,527)
Tax effect	(998)	2,462	(1,452)	2,409
Other comprehensive income (loss), net of tax	1,705	(4,208)	2,481	(4,118)
Comprehensive income, net of tax	$14,462	$8,798	$29,041	$16,875

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
City Holding Company and Subsidiaries
Six Months Ended June 30, 2014 and 2013
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2012	$46,249	$103,524	$309,270	$(124,347)	(1,422)	$333,274
Net income			20,993			20,993
Other comprehensive loss					(4,118)	(4,118)
Acquisition of Community Financial Corporation		4,236		24,272		28,508
Cash dividends declared ($0.74 per share)			(11,866)			(11,866)
Stock-based compensation expense, net		(512)		1,215		703
Exercise of 62,685 stock options		(13)		1,410		1,397
Balance at June 30, 2013	$46,249	$107,235	$318,397	$(97,450)	$ (5,540)	$368,891

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2013	46,249	$107,596	$333,970	(95,202)	$ (4,990)	$387,623
Net income			26,560			26,560
Other comprehensive income					2,481	2,481
Cash dividends declared ($0.80 per share)			(12,512)			(12,512)
Stock-based compensation expense, net		(494)		1,383		889
Exercise of 19,000 stock options		(272)		825		553
Purchase of 194,651 treasury shares				(8,363)		(8,363)
Balance at June 30, 2014	46,249	$106,830	$348,018	(101,357)	$ (2,509)	$397,231

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Six months ended June 30,	
	2014	2013
Net income	$26,560	$20,993
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion and amortization	(2,599)	(3,694)
Provision for loan losses	1,798	3,749
Depreciation of premises and equipment	3,011	2,852
Deferred income tax expense	2,615	3,268
Net periodic employee benefit cost	286	378
Realized investment securities gains	(901)	(93)
Stock-compensation expense	889	703
Increase in value of bank-owned life insurance	(1,520)	(1,608)
Loans originated for sale	(2,454)	(15,656)
Proceeds from the sale of loans originated for sale	3,129	19,576
Gain on sale of loans	(84)	(427)
Change in accrued interest receivable	(861)	(189)
Change in other assets	(5,986)	15,945
Change in other liabilities	(9,919)	(11,469)
Net Cash Provided by Operating Activities	13,964	34,328
Proceeds from sales of securities available-for-sale	1,660	18,438
Proceeds from maturities and calls of securities available-for-sale	26,237	60,543
Proceeds from maturities and calls of securities held-to-maturity	1,254	9,188
Purchases of securities available-for-sale	(13,530)	(22,335)
Purchases of securities held-to-maturity	(10,226)	—
Net decrease (increase) in loans	29,225	(11,732)
Purchases of premises and equipment	(664)	(3,276)
Acquisition of Community Financial Corporation, net of cash acquired of $8,888	—	(21,852)
Net Cash Provided by Investing Activities	33,956	28,974
Net increase in noninterest-bearing deposits	7,163	37,908
Net (decrease) increase in interest-bearing deposits	(5,638)	6,291
Net (decrease) increase in short-term borrowings	(4,656)	9,697
Purchases of treasury stock	(8,363)	—
Proceeds from exercise of stock options, net of tax benefit	553	1,397
Dividends paid	(12,115)	(11,255)
Net Cash (Used in) Provided by Financing Activities	(23,056)	44,038
Increase in Cash and Cash Equivalents	24,864	107,340
Cash and cash equivalents at beginning of period	85,876	84,994
Cash and Cash Equivalents at End of Period	$110,740	$192,334

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)
June 30, 2014

Note A –Background and Basis of Presentation

City Holding Company is a financial holding company headquartered in Charleston, West Virginia and conducts its principal activities through its wholly-owned subsidiary, City National Bank of West Virginia ("City National"). City National operates a network of 82 branch offices primarily along the I-64 corridor from Grayson, Kentucky through Lexington, Virginia; and along the I-81 corridor through the Shenandoah Valley from Staunton, Virginia to Martinsburg, West Virginia. City's branch network includes 57 offices in West Virginia, 14 offices in Virginia, 8 offices in Kentucky and 3 offices in Ohio. City National provides credit, deposit, investment advisory and insurance products and services to a broad geographical area that includes many rural and small community markets in addition to larger cities such as Charleston (WV), Huntington (WV), Winchester (VA), Staunton (VA), Virginia Beach (VA), Ashland (KY) and Martinsburg (WV). In addition to its branch network, the bank's delivery channels include ATMs, mobile banking, on-line banking, debit cards, cash management tools and telephone banking systems.

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of the City Holding Company and its wholly-owned subsidiaries (collectively, “the Company”). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for six months ended June 30, 2014 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2014. The Company’s accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management’s estimates.

The consolidated balance sheet as of December 31, 2013 has been derived from audited financial statements included in the Company’s 2013 Annual Report to Shareholders. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2013 Annual Report of the Company.

Certain amounts in the financial statements have been reclassified. Such reclassifications had no impact on shareholders’ equity or net income for any period.

Note B - Recent Accounting Pronouncements

In January 2014, the FASB issued ASU No. 2014-01, "Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects." This ASU permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment. The ASU also requires reporting entities to disclose information that enable users of its financial statements to understand the nature of its investments in qualified affordable housing projects, and the effect of the measurement of its investments in qualified affordable housing projects and the related tax credits on its financial position and results of operations. This ASU will become effective for the Company on January 1, 2015. The adoption of ASU 2014-01 is not expected to have a material impact on the Company's financial statements.

In January 2014, the FASB issued ASU No. 2014-04, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." This ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through similar legal agreement. Additionally, the amendments require interim and annual disclosures of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local

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requirements of the applicable jurisdiction. This ASU will become effective for the Company on January 1, 2015. The adoption of ASU 2014-04 is not expected to have a material impact on the Company's financial statements.

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity" This ASU changes the requirements for reporting discontinued operations. A disposal of a component or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity’s operations when certain criteria are met. Additional disclosures are also required for disposals that meet the criteria to be reported in discontinued operations. This ASU will become effective for the Company on January 1, 2015. The adoption of ASU 2014-08 is not expected to have a material impact on the Company's financial statements.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-09, "Revenue from Contracts with Customers (Topic 606)". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The core principle will be achieved using a five step process. This ASU will become effective for the Company on January 1, 2016. The adoption of ASU 2014-09 is not expected to have a material impact on the Company's financial statements.

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures". The amendments in this update require two accounting changes. First, the amendments in this update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counter-party, which will result in secured borrowing accounting for the repurchase agreement. This update also requires certain disclosures for these types of transactions. This ASU will become effective for the Company on January 1, 2015. The adoption of ASU 2014-11 is not expected to have a material impact on the Company's financial statements.

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-12, "Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period". The amendments in this update require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Performance targets should not be reflected in estimating the grant date fair value of the award, but compensation cost should be recognized in the period for which the requisite service has already been rendered. This ASU will become effective for the Company on January 1, 2016, with early adoption permitted. The adoption of ASU 2014-12 is not expected to have a material impact on the Company's financial statements.

Note C –Investments

The amortized cost and estimated fair values of the Company's securities are shown in the following table (in thousands):

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	June 30, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:								
U.S. Treasuries and U.S. government agencies	$2,049	$ 29	$—	$2,078	$2,317	$ 48	$—	$2,365
Obligations of states and political subdivisions	39,276	883	19	40,140	41,027	627	106	41,548
Mortgage-backed securities:								
U.S. government agencies	192,241	3,361	3,072	192,530	282,653	2,765	7,310	278,108
Private label	1,946	15	—	1,961	2,184	16	3	2,197
Trust preferred securities	10,445	277	1,698	9,024	12,943	2,113	1,900	13,156
Corporate securities	7,797	230	357	7,670	9,788	183	843	9,128
Total Debt Securities	253,754	4,795	5,146	253,403	350,912	5,752	10,162	346,502
Marketable equity securities	2,537	1,309	—	3,846	3,334	1,339	—	4,673
Investment funds	1,525	—	13	1,512	1,525	—	40	1,485
Total Securities Available-for-Sale	$257,816	$ 6,104	$ 5,159	$258,761	$355,771	$ 7,091	$ 10,202	$352,660

	June 30, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities held-to-maturity								
Mortgage-backed securities								
US government agencies	$91,916	$ 1,841	$—	$93,757	$—	$—	$—	$—
Trust preferred securities	4,123	581	—	4,704	4,117	1,218	—	5,335
Total Securities Held-to-Maturity	$96,039	$ 2,422	$—	$98,461	$4,117	$ 1,218	$—	$5,335
Other investment securities:								
Non-marketable equity securities	$14,234	$—	$—	$14,234	$13,343	$—	$—	$13,343
Total Other Investment Securities	$14,234	$—	$—	$14,234	$13,343	$—	$—	$13,343

Securities with limited marketability, such as stock in the Federal Reserve Bank or the Federal Home Loan Bank, are carried at cost and are reported as non-marketable equity securities in the table above.

Certain investment securities owned by the Company were in an unrealized loss position (i.e., amortized cost basis exceeded the estimated fair value of the securities). The following table shows the gross unrealized losses and fair value of the Company’s investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

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	June 30, 2014					
	Less Than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	$1,549	$1	$468	$18	$2,017	$19
Mortgage-backed securities:						
U.S. Government agencies	12,610	302	94,963	2,770	107,573	3,072
Trust preferred securities	477	201	4,809	1,497	5,286	1,698
Corporate securities	—	—	4,377	357	4,377	357
Investment funds	—	—	1,488	13	1,488	13
Total	$14,636	$504	$106,105	$4,655	$120,741	$5,159

	December 31, 2013					
	Less Than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	$5,600	$87	$243	$19	$5,843	$106
Mortgage-backed securities:						
U.S. Government agencies	195,661	7,113	5,040	197	200,701	7,310
Private label	1,491	3	—	—	1,491	3
Trust preferred securities	—	—	4,400	1,900	4,400	1,900
Corporate securities	5,881	843	—	—	5,881	843
Investment funds	$1,460	$40	$—	$—	1,460	40
Total	$210,093	$8,086	$9,683	$2,116	$219,776	$10,202

Marketable equity securities consist of investments made by the Company in equity positions of various regional community bank holding companies, with ownership positions ranging from nominal to a 4% ownership position in First National Corporation (FXNC).

During the six months ended June 30, 2014 and 2013, the Company had no credit-related net investment impairment losses. Also, for the year ended December 31, 2013, the Company had no credit-related net investment impairment losses.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary would be reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition, capital strength, and near-term (12 months) prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; (iii) the historical volatility in the market value of the investment and/or the liquidity or illiquidity of the investment; (iv) adverse conditions specifically related to the security, an industry, or a geographic area; or (v) the intent to sell the investment security and if it's more likely than not that the Company will not have to sell the security before recovery of its cost basis. In addition, management also employs a continuous monitoring process in regards to its marketable equity securities, specifically its portfolio of regional community bank holding company stocks. Although the regional community bank holding company stocks that are owned by the Company are publicly traded, the trading activity for these stocks is minimal, with trading volumes of less than 0.2%

of each respective company being traded on a daily basis. As part of management's review process for these securities, management reviews the financial condition of each respective regional community bank for any indications of financial weakness.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Company will receive full value for the securities. Furthermore, as of June 30, 2014, management does not intend to sell an impaired security and it is not more than likely that it will be required to sell the security before the recovery of its amortized cost basis. The unrealized losses on debt securities are primarily the result of interest rate changes, credit spread widening on agency-issued mortgage related securities, general financial market uncertainty and market volatility. These conditions will not prohibit the Company from receiving its contractual principal and interest payments on its debt securities. The fair value is expected to recover as the securities approach their maturity date or repricing date. As of June 30, 2014, management believes the unrealized losses detailed in the table above are temporary and no impairment loss has been recognized in the Company's consolidated income statement. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period of the other-than-temporary impairment is identified, while any noncredit loss will be recognized in other comprehensive income.

At June 30, 2014, the book value of the Company's five pooled trust preferred securities totaled $3.0 million with an estimated fair value of $1.8 million. All of these securities are mezzanine tranches. Pooled trust preferred securities represent beneficial interests in securitized financial assets that the Company analyzes within the scope of ASC 320, "Investments-Debt and Equity Securities" and are evaluated quarterly for other-than-temporary-impairment ("OTTI"). Management performs an analysis of OTTI utilizing its internal methodology as described below to estimate expected cash flows to be received in the future. The Company reviews each of its pooled trust preferred securities to determine if an OTTI charge would be recognized in current earnings in accordance with ASC 320, "Investments-Debt and Equity Securities". There is a risk that collateral deterioration could cause the Company to recognize additional OTTI charges in earnings in the future.

When evaluating pooled trust preferred securities for OTTI, the Company determines a credit related portion and a noncredit related portion. The credit related portion is recognized in earnings and represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. The noncredit related portion is recognized in other comprehensive income, and represents the difference between the book value and the fair value of the security less the amount of the credit related impairment. The determination of whether it is probable that an adverse change in estimated cash flows has occurred is evaluated by comparing estimated cash flows to those previously projected as further described below. The Company considers this process to be its primary evidence when determining whether credit related OTTI exists. The results of these analyses are significantly affected by other variables such as the estimate of future cash flows, credit worthiness of the underlying issuers and determination of the likelihood of defaults of the underlying collateral.

The Company utilizes a third party model to compute the present value of expected cash flows which considers the structure and term of each of the five respective pooled trust preferred securities and the financial condition of the underlying issuers. Specifically, the third party model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. For issuing banks that have defaulted, management generally assumes no recovery. For issuing banks that have deferred its interest payments, management excludes the collateral balance associated with these banks and assumes no recoveries of such collateral balance in the future. The exclusion of such issuing banks in a current deferral position is based on such bank experiencing a certain level of financial difficulty that raises doubt about its ability to satisfy its contractual debt obligation, and accordingly, the Company excludes the associated collateral balance from its estimate of expected cash flows. Other assumptions used in the estimate of expected cash flows include expected future default rates and prepayments. Specifically, the model assumes annual prepayments of 1.0% with 100% at maturity and assumes 150 basis points of additional annual defaults from banks that are currently not in default or deferral. In addition, the model assumes no recoveries except for one trust preferred security which assumes that one of the banks currently deferring will cure such positions. Management compares the present value of expected cash flows to those previously projected to determine if an adverse change in cash flows has occurred. If an adverse change in cash flows has occurred, management determines the credit loss to be recognized in the current period and the portion related to noncredit factors to be recognized in other comprehensive income.

The following table presents a progression of the credit loss component of OTTI on debt and equity securities recognized in earnings during the six months ended June 30, 2014 and for the year ended December 31, 2013 (in thousands). The credit loss component represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. The credit component of OTTI recognized in earnings during a period is presented in two parts based upon whether the credit impairment in the current period is the first time the security was credit impaired (initial credit impairment) or if there is additional credit impairment on a security that was credit impaired in previous periods.

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	Debt Securities	Equity Securities	Total
Balance at January 1, 2013	$21,186	$4,813	$25,999
Additions:			
Initial credit impairment	—	—	—
Additional credit impairment	—	—	—
Deductions:			
Sold	—	(115)	(115)
Balance at December 31, 2013	21,186	4,698	25,884
Additions:			
Initial credit impairment	—	—	—
Additional credit impairment	—	—	—
Deductions:			
Sold	—	(2,060)	(2,060)
Balance at June 30, 2014	$21,186	$2,638	$23,824

The following table presents additional information about the Company’s trust preferred securities with a credit rating of below investment grade as of June 30, 2014 (dollars in thousands):

Deal Name	Type	Class	Original Cost	Amortized Cost	Fair Value	Difference (1)	Lowest Credit Rating	# of issuers currently performing	Actual deferrals/defaults (as a % of original dollar)	Expected deferrals/defaults (as a % of remaining performing collateral)	Excess Subordination as a Percentage of Current Performing Collateral (4)
	Pooled trust preferred securities:										
	Other-than-temporarily impaired										
	Available for Sale:										
P1	Pooled	Mezz	$826	$ 190	$352	162	Caa1	7	19.5 %	20.0 % [2]	52.1 %
P2	Pooled	Mezz	2,535	—	—	—	Ca	6	22.3 %	— % [2]	— %
P3	Pooled	Mezz	2,962	1,419	671	(748)	Caa3	22	24.1 %	8.2 % [2]	42.8 %
P4	Pooled	Mezz	4,060	400	151	(249)	Ca	9	19.2 %	7.1 % [3]	26.9 %
P5	Pooled	Mezz	6,062	678	477	(201)	Ca	9	22.7 %	20.0 % [2]	49.2 %
	Held to Maturity:										
P6	Pooled	Mezz	1,599	123	704	581	Caa1	7	19.5 %	20.0 % [2]	52.1 %
P7	Pooled	Mezz	3,367	—	—	—	Ca	6	22.3 %	— % [2]	— %
	Single issuer trust preferred securities										
	Available for sale:										
S5	Single		261	235	336	101	NR	1	— %	— %	
	Held to Maturity:										
S9	Single		4,000	4,000	4,000	—	NR	1	— %	— %	

(1)

The differences noted consist of unrealized gains (losses) recorded at June 30, 2014 and noncredit other-than-temporary impairment losses recorded subsequent to April 1, 2009 that have not been reclassified as credit losses.

(2) Performing collateral is defined as total collateral minus all collateral that has been called, is currently deferring, or currently in default. This model for this security assumes that all collateral that is currently deferring will default with a zero recovery rate. The underlying issuers can cure, thus this bond could recover at a higher percentage upon default than zero.

(3) Performing collateral is defined as total collateral minus all collateral that has been called, is currently deferring, or currently in default. The model for this security assumes that one of the banks that is currently deferring will cure. If additional underlying issuers cure, this bond could recover at a higher percentage.

(4) Excess subordination is defined as the additional defaults/deferrals necessary in the next reporting period to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a "break in yield." This amount assumes that all currently performing collateral continues to perform. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The "percent of current performing collateral" is the ratio of the "excess subordination amount" to current performing collateral—a higher percent means there is more excess subordination to absorb additional defaults/deferrals, and the better our security is protected from loss.

The amortized cost and estimated fair value of debt securities at June 30, 2014, by contractual maturity, are shown in the following table (in thousands). Expected maturities will differ from contractual maturities because the issuers of the securities

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may have the right to prepay obligations without prepayment penalties. Mortgage-backed securities have been allocated to their respective maturity groupings based on their contractual maturity.

	Cost	Estimated Fair Value
Securities Available-for-Sale		
Due in one year or less	$8,566	$8,606
Due after one year through five years	17,995	18,533
Due after five years through ten years	30,416	31,321
Due after ten years	196,777	194,943
	$253,754	$253,403
Securities Held-to-Maturity		
Due in one year or less	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	96,039	98,461
	$96,039	$98,461

Gross gains and gross losses realized by the Company from investment security transactions are summarized in the table below (in thousands). The specific identification method is used to determine the cost basis of securities sold.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Gross realized gains	$818	$9	$901	$93
Gross realized losses	—	—	—	
Net investment security gains	$818	$9	$901	$93

The carrying value of securities pledged to secure public deposits and for other purposes as required or permitted by law approximated $264 million and $278 million at June 30, 2014 and December 31, 2013, respectively.

Statement of Cash Flows - Investing Activities - Supplemental Information

During the second quarter, the Company transferred certain securities from available-for-sale to held-to-maturity. The non-cash transfers of securities into the held-to-maturity categories from available-for-sale were made at fair value on the date of the transfer. The securities had an aggregate fair value of $83.4 million, with an aggregate net unrealized loss of $0.1 million on the date of transfer. The net unamortized, unrealized loss on the transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of June 30, 2014 totaled $0.1 million. This amount will be amortized out of accumulated other comprehensive income over the remaining life of the underlying securities as an adjustment of the yield on those securities.

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Note D –Loans

The following summarizes the Company's major classifications for loans (in thousands):

	June 30, 2014	December 31, 2013
Residential real estate	$1,242,972	$1,204,450
Home equity – junior liens	145,452	146,090
Commercial and industrial	149,442	164,484
Commercial real estate	993,552	1,040,866
Consumer	42,858	46,402
DDA overdrafts	3,501	3,905
Gross loans	2,577,777	2,606,197
Allowance for loan losses	(20,536)	(20,575)
Net loans	$2,557,241	$2,585,622

Construction loans of $20.1 million and $17.3 million are included within residential real estate loans at June 30, 2014 and December 31, 2013, respectively. Construction loans of $24.6 million and $24.0 million are included within commercial real estate loans at June 30, 2014 and December 31, 2013, respectively. The Company's commercial and residential real estate construction loans are primarily secured by real estate within the Company's principal markets. These loans were originated under the Company's loan policy, which is focused on the risk characteristics of the loan portfolio, including construction loans. Adequate consideration has been given to these loans in establishing the Company's allowance for loan losses.

The following table details the loans acquired in conjunction with the Virginia Savings Bancorp, Inc. ("Virginia Savings") and Community Financial Corporation ("Community") acquisitions (in thousands):

	Virginia Savings	Community	Total
June 30, 2014			
Outstanding loan balance	$43,261	$245,314	$288,575
Credit-impaired loans:			
Carrying value	3,098	17,902	21,000
Contractual principal and interest	3,735	27,394	31,129
December 31, 2013			
Outstanding loan balance	$48,833	$279,890	$328,723
Credit-impaired loans:			
Carrying value	3,182	26,330	29,512
Contractual principal and interest	3,932	38,566	42,498

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Changes in the accretable yield of the credit-impaired loans for the six months ended June 30, 2014 is as follows (in thousands):

	Virginia Savings		Community		Total	
	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans
Balance at the beginning of the period	$698	$3,182	$10,389	$26,330	$11,087	$29,512
Accretion	(127)	127	(1,289)	1,488	(1,416)	1,615
Net reclassifications to accretable yield from non-accretable yield	149	—	3,205	—	3,354	—
Payments received, net	—	(211)	—	(9,916)	—	(10,127)
Disposals	(2)	—	(242)	—	(244)	—
Balance at the end of period	$718	$3,098	$12,063	$17,902	$12,781	$21,000

Increases in expected cash flow subsequent to the acquisition are recognized first as a reduction of any previous impairment, then prospectively through adjustment of the yield on the loans or pools over its remaining life, while decreases in expected cash flows are recognized as impairment through a provision for loan loss and an increase in the allowance for purchased credit-impaired loans.

Note E – Allowance For Loan Losses

Management systematically monitors the loan portfolio and the adequacy of the allowance for loan losses on a quarterly basis to provide for probable losses inherent in the portfolio. Management assesses the risk in each loan type based on historical trends, the general economic environment of its local markets, individual loan performance and other relevant factors.

Individual credits are selected throughout the year for detailed loan reviews, which are utilized by management to assess the risk in the portfolio and the adequacy of the allowance. Due to the nature of commercial lending, evaluation of the adequacy of the allowance as it relates to these loan types is often based more upon specific credit reviews, with consideration given to the potential impairment of certain credits and historical loss rates, adjusted for economic conditions and other inherent risk factors.

The following table summarizes the activity in the allowance for loan loss, by portfolio segment, for the six months ended June 30, 2014 and 2013 (in thousands). The following table also presents the balance in the allowance for loan loss disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans, by portfolio segment, as of June 30, 2014 and December 31, 2013 (in thousands).

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	Commercial & Industrial	Commercial Real Estate	Residential Real Estate	Home equity	Consumer	DDA Overdrafts	Total
Six months ended June 30, 2014							
Allowance for loan loss							
Beginning balance	$1,139	$10,775	$6,057	$1,672	$77	$855	$20,575
Charge-offs	5	969	743	146	122	662	2,647
Recoveries	81	83	63	—	129	454	810
Provision	(248)	508	1,087	(83)	(3)	399	1,660
Provision for acquired loans	$138	$—	$—	$—	$—	$—	138
Ending balance	$1,105	$10,397	$6,464	$1,443	$81	$1,046	$20,536
Six months ended June 30, 2013							
Allowance for loan loss							
Beginning balance	$498	$10,440	$5,229	$1,699	$81	$862	$18,809
Charge-offs	392	622	1,111	270	224	687	3,306
Recoveries	21	34	68	—	217	477	817
Provision	939	642	1,792	222	7	147	3,749
Ending balance	$1,066	$10,494	$5,978	$1,651	$81	$799	$20,069
As of June 30, 2014							
Allowance for loan loss							
Evaluated for impairment:							
Individually	$—	$240	$—	$—	$—	$—	$240
Collectively	1,063	9,500	6,428	1,443	81	1,046	19,561
Acquired with deteriorated credit quality	42	657	36	—	—	—	735
Total	$1,105	$10,397	$6,464	$1,443	$81	$1,046	$20,536
Loans							
Evaluated for impairment:							
Individually	$—	$7,239	$453	$297	$—	$—	$7,989
Collectively	147,711	970,095	1,242,007	142,736	42,738	3,501	2,548,788
Acquired with deteriorated credit quality	1,731	16,218	512	2,419	120	—	21,000
Total	$149,442	$993,552	$1,242,972	$145,452	$42,858	$3,501	$2,577,777

As of December 31, 2013							
Allowance for loan loss							
Evaluated for impairment:							
Individually	$—	$880	$—	$—	$—	$—	$880
Collectively	827	9,615	6,054	1,672	77	855	19,100
Acquired with deteriorated							
credit quality	312	280	3	—	—	—	595
Total	$1,139	$10,775	$6,057	$1,672	$77	$855	$20,575
Loans							
Evaluated for impairment:							
Individually	$—	$11,837	$459	$298	$—	$—	$12,594
Collectively	162,500	1,004,475	1,201,894	145,025	46,292	3,905	2,564,091
Acquired with deteriorated							
credit quality	1,984	24,554	2,097	767	110	—	29,512
Total	$164,484	$1,040,866	$1,204,450	$146,090	$46,402	$3,905	$2,606,197

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Credit Quality Indicators

All commercial loans within the portfolio are subject to internal risk grading. All non-commercial loans are evaluated based on payment history. The Company's internal risk ratings for commercial loans are: Pass, Special Mention, Substandard and Doubtful. Each internal risk rating is defined in the loan policy using the following criteria: balance sheet yields, ratios and leverage, cash flow spread and coverage, prior history, capability of management, market position/industry, potential impact of changing economic, legal, regulatory or environmental conditions, purpose, structure, collateral support, and guarantor support. Risk grades are generally assigned by the primary lending officer and are periodically evaluated by the Company's internal loan review process. Based on an individual loan's risk grade, estimated loss percentages are applied to the outstanding balance of the loan to determine the amount of probable loss.

The Company categorizes loans into risk categories based on relevant information regarding the customer's debt service ability, capacity, overall collateral position along with other economic trends, and historical payment performance. The risk grades for each credit are updated when the Company receives current financial information, the loan is reviewed by the Company's internal loan review/credit administration departments, or the loan becomes delinquent or impaired. The risk grades are updated a minimum of annually for loans rated exceptional, good, acceptable, or pass/watch. Loans rated special mention, substandard or doubtful are reviewed at least quarterly. The Company uses the following definitions for its risk ratings:

Risk Rating	Description
Pass ratings:	
(a) Exceptional	Loans classified as exceptional are secured with liquid collateral conforming to the internal loan policy. Loans rated within this category pose minimal risk of loss to the bank and the risk grade within this pool of loans is generally updated on an annual basis.
(b) Good	Loans classified as good have similar characteristics that include a strong balance sheet, satisfactory debt service coverage ratios, strong management and/or guarantors, and little exposure to economic cycles. Loans within this category are generally reviewed on an annual basis. Loans in this category generally have a low chance of loss to the bank.
(c) Acceptable	Loans classified as acceptable have acceptable liquidity levels, adequate debt service coverage ratios, experienced management, and have average exposure to economic cycles. Loans within this category generally have a low risk of loss to the bank.
(d) Pass/watch	Loans classified as pass/watch have erratic levels of leverage and/or liquidity, cash flow is volatile and the borrower is subject to moderate economic risk. A borrower in this category poses a low to moderate risk of loss to the bank.
Special mention	Loans classified as special mention have a potential weakness(es) that deserves management's close attention. The potential weakness could result in deterioration of the loan repayment or the bank's credit position at some future date. A loan rated in this category poses a moderate loss risk to the bank.
Substandard	Loans classified as substandard reflect a customer with a well defined weakness that jeopardizes the liquidation of the debt. Loans in this category have the possibility that the bank will sustain some loss if the deficiencies are not corrected and the bank's collateral value is weakened by the financial deterioration of the borrower.
Doubtful	Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that make collection of the full contract amount highly improbable. Loans rated in this category are most likely to cause the bank to have a loss due to a collateral shortfall or a negative capital position.

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The following table presents loans by the Company’s commercial loans by credit quality indicators, by class (in thousands):

	Commercial and industrial	Commercial real estate	Total
June 30, 2014			
Pass	$132,766	$920,647	$1,053,413
Special mention	10,643	19,771	30,414
Substandard	5,611	52,703	58,314
Doubtful	422	431	853
Total	$149,442	$993,552	$1,142,994
December 31, 2013			
Pass	$158,000	$958,186	$1,116,186
Special mention	648	20,072	20,720
Substandard	5,416	62,139	67,555
Doubtful	420	469	889
Total	$164,484	$1,040,866	$1,205,350

The following table presents the Company's non-commercial loans by payment performance, by class (in thousands):

	Performing	Non-Performing	Total
June 30, 2014			
Residential real estate	$1,239,717	$3,255	$1,242,972
Home equity - junior lien	145,217	235	145,452
Consumer	42,841	17	42,858
DDA overdrafts	3,501	—	3,501
Total	$1,431,276	$3,507	$1,434,783
December 31, 2013			
Residential real estate	$1,201,631	$2,819	$1,204,450
Home equity - junior lien	145,812	278	146,090
Consumer	46,353	49	46,402
DDA overdrafts	3,900	5	3,905
Total	$1,397,696	$3,151	$1,400,847

Aging Analysis of Accruing and Non-Accruing Loans

Interest income on loans is accrued and credited to operations based upon the principal amount outstanding, using methods that generally result in level rates of return. Loan origination fees, and certain direct costs, are deferred and amortized as an adjustment to the yield over the term of the loan. The accrual of interest generally is discontinued when a loan becomes 90 days past due as to principal or interest for all loan types. However, any loan may be placed on non-accrual if the Company receives information that indicates a borrower is unable to meet the contractual terms of their respective loan agreement. Other indicators considered for placing a loan on non-accrual status include the borrower’s involvement in bankruptcies, foreclosures, repossessions, litigation and any other situation resulting in doubt as to whether full collection of contractual principal and interest is attainable. When interest accruals are discontinued, unpaid interest recognized in income in the current year is reversed, and interest accrued in prior years is charged to the allowance for loan losses. Management may elect to continue the accrual of interest when the net realizable value of collateral exceeds the principal balance and related accrued interest, and the loan is in the process of collection.

Generally for all loan classes, interest income during the period the loan is non-performing is recorded on a cash basis after recovery of principal is reasonably assured. Cash payments received on nonperforming loans are typically applied directly against the outstanding principal balance until the loan is fully repaid. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Generally, all loan types are considered past due when the contractual terms of a loan are not met and the borrower is 30 days or more past due on a payment. Furthermore, residential and home equity loans are generally subject to charge-off

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when the loan becomes 120 days past due, depending on the estimated fair value of the collateral less cost to dispose, versus the outstanding loan balance. Commercial loans are generally charged off when the loan becomes 120 days past due. Open-end consumer loans are generally charged off when the loan becomes 180 days past due.

A loan acquired and accounted for under ASC Topic 310-30 is reported as an accruing loan and a performing asset provided that the loan is performing in accordance with the initial expectations. The loan would be considered non-performing if the loan's performance deteriorates below the initial expectations.

The following table presents an aging analysis of the Company's accruing and non-accruing loans, by class, as of June 30, 2014 and December 31, 2013 (in thousands):

	Originated Loans June 30, 2014 Accruing						
	Current	30-59 days	60-89 days	Over 90 days	Purchased-Credit Impaired	Non-accrual	Total
Residential real estate	$1,140,373	$4,421	$789	$584	$ —	$2,240	$1,148,407
Home equity - junior lien	141,927	761	120	44	—	191	143,043
Commercial and industrial	133,028	—	25	—	—	137	133,190
Commercial real estate	817,777	443	—	—	—	9,087	827,307
Consumer	33,674	79	1	—	—	—	33,754
DDA overdrafts	3,220	276	5	—	—	—	3,501
Total	$2,269,999	$5,980	$940	$628	$ —	$11,655	$2,289,202

	Acquired Loans June 30, 2014 Accruing						
	Current	30-59 days	60-89 days	Over 90 days	Purchased-Credit Impaired	Non-accrual	Total
Residential real estate	$93,392	$699	$42	$132	$ —	$300	$94,565
Home equity - junior lien	2,406	3	—	—	—	—	2,409
Commercial and industrial	14,119	43	15	—	—	2,075	16,252
Commercial real estate	159,741	1,010	165	18	917	4,394	166,245
Consumer	8,730	330	27	17	—	—	9,104
DDA overdrafts	—	—	—	—	—	—	—
Total	$278,388	$2,085	$249	$167	$ 917	$6,769	$288,575

	Total Loans June 30, 2014 Accruing						
	Current	30-59 days	60-89 days	Over 90 days	Purchased-Credit Impaired	Non-accrual	Total
Residential real estate	$1,233,765	$5,120	$831	$716	$ —	$2,540	$1,242,972
Home equity - junior lien	144,333	764	120	44	—	191	145,452
Commercial and industrial	147,147	43	40	—	—	2,212	149,442
Commercial real estate	977,518	1,453	165	18	917	13,481	993,552

Consumer	42,404	409	28	17	—	—	42,858
DDA overdrafts	3,220	276	5	—	—	—	3,501
Total	$2,548,387	$8,065	$1,189	$795	$ 917	$18,424	$2,577,777

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	Originated Loans December 31, 2013 Accruing						
	Current	30-59 days	60-89 days	Over 90 days	Purchased-Credit Impaired	Non-accrual	Total
Residential real estate	$1,096,911	$4,123	$495	$231	$ —	$1,905	$1,103,665
Home equity - junior lien	141,967	880	—	42	—	236	143,125
Commercial and industrial	144,197	—	—	—	—	79	144,276
Commercial real estate	835,908	668	—	—	—	13,097	849,673
Consumer	32,647	172	7	4	—	—	32,830
DDA overdrafts	3,511	374	15	5	—	—	3,905
Total	$2,255,141	$6,217	$517	$282	$ —	$15,317	$2,277,474

	Acquired Loans December 31, 2013 Accruing						
	Current	30-59 days	60-89 days	Over 90 days	Purchased-Credit Impaired	Non-accrual	Total
Residential real estate	$99,089	$842	$172	$—	$ —	$682	$100,785
Home equity - junior lien	2,965	—	—	—	—	—	2,965
Commercial and industrial	18,253	—	80	—	—	1,875	20,208
Commercial real estate	176,018	2,772	273	109	7,534	4,487	191,193
Consumer	12,876	622	29	45	—	—	13,572
DDA overdrafts	—	—	—	—	—	—	—
Total	$309,201	$4,236	$554	$154	$ 7,534	$7,044	$328,723

	Total Loans December 31, 2013 Accruing						
	Current	30-59 days	60-89 days	Over 90 days	Purchased-Credit Impaired	Non-accrual	Total
Residential real estate	$1,196,000	$4,965	$667	$231	$ —	$2,587	$1,204,450
Home equity - junior lien	144,932	880	—	42	—	236	146,090
Commercial and industrial	162,450	—	80	—	—	1,954	164,484
Commercial real estate	1,011,926	3,440	273	109	7,534	17,584	1,040,866
Consumer	45,523	794	36	49	—	—	46,402
DDA overdrafts	3,511	374	15	5	—	—	3,905
Total	$2,564,342	$10,453	$1,071	$436	$ 7,534	$22,361	$2,606,197

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The following table presents the Company's impaired loans, by class, as of June 30, 2014 and December 31, 2013 (in thousands). The difference between the unpaid principal balance and the recorded investment generally reflects amounts that have been previously charged-off.

	June 30, 2014			December 31, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential real estate	$453	$453	$—	$459	$459	$—
Home equity - junior liens	297	297	—	298	298	—
Commercial and industrial	—	—	—	—	—	—
Commercial real estate	5,837	6,629	—	8,421	8,361	—
Consumer	—	—	—	—	—	—
DDA overdrafts	—	—	—	—	—	—
Total	$6,587	$7,379	$—	$9,178	$9,118	$—
With an allowance recorded						
Residential real estate	$—	$—	$—	$—	$—	$—
Home equity - junior liens	—	—	—	—	—	—
Commercial and industrial	—	—	—	—	—	—
Commercial real estate	1,403	4,333	240	3,416	3,416	880
Consumer	—	—	—	—	—	—
DDA overdrafts	—	—	—	—	—	—
Total	$1,403	$4,333	$240	$3,416	$3,416	$880

The following table presents information related to the average recorded investment and interest income recognized on the Company's impaired loans, by class (in thousands):

	For the six months ended			
	June 30, 2014		June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Residential real estate	$455	$—	$464	$—
Home equity - junior liens	297	—	297	—
Commercial and industrial	—	—	—	—
Commercial real estate	8,120	9	9,450	—
Consumer	—	—	—	—
DDA overdrafts	—	—	—	—
Total	$8,872	$9	$10,211	$—
With an allowance recorded				
Residential real estate	$—	$—	$—	$—
Home equity - junior liens	—	—	—	—
Commercial and industrial	—	—	—	—
Commercial real estate	2,055	68	3,103	—
Consumer	—	—	—	—

DDA overdrafts	—	—	—	—
Total	$2,055	$68	$3,103	$—

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Approximately $0.2 million and $0.3 million of interest income would have been recognized during the six months ended June 30, 2014 and 2013, if such loans had been current in accordance with their original terms. There were no commitments to provide additional funds on non-accrual, impaired or other potential problem loans at June 30, 2014.

Loan Modifications

The Company's policy on loan modifications typically does not allow for modifications that would be considered a concession from the Company. However, when there is a modification, the Company evaluates each modification to determine if the modification constitutes a troubled debt restructuring ("TDR") in accordance with ASU 2011-2, whereby a modification of a loan would be considered a TDR when both of the following conditions are met: (1) a borrower is experiencing financial difficulty and (2) the modification constitutes a concession. When determining whether the borrower is experiencing financial difficulties, the Company reviews whether the debtor is currently in payment default on any of its debt or whether it is probable that the debtor would be in payment default in the foreseeable future without the modification. Other indicators of financial difficulty include whether the debtor has declared or is in the process of declaring bankruptcy, the debtor's ability to continue as a going concern, or the debtor's projected cash flow to service its debt (including principal and interest) in accordance with the contractual terms for the foreseeable future, without a modification.

Regulatory guidance requires loans to be accounted for as collateral-dependent loans when borrowers have filed Chapter 7 bankruptcy, the debt has been discharged by the bankruptcy court and the borrower has not reaffirmed the debt. The filing of bankruptcy is deemed to be evidence that the borrower is in financial difficulty and the discharge of the debt by the bankruptcy court is deemed to be a concession granted to the borrower.

The following tables set forth the Company's TDRs (in thousands):

	June 30, 2014			December 31, 2013		
	Accruing	Non-Accruing	Total	Accruing	Non-Accruing	Total
Commercial and industrial	$86	$—	$86	$88	$—	$88
Commercial real estate	2,281	—	2,281	1,783	—	1,783
Residential real estate	18,893	320	19,213	18,651	1,693	20,344
Home equity	2,803	55	2,858	2,859	14	2,873
Consumer	—	—	—	—	—	—
	$24,063	$375	$24,438	$23,381	$1,707	$25,088

	New TDRs For the six months ended June 30, 2014			New TDRs For the six months ended June 30, 2013		
	Number of Contracts	Pre Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment	Number of Contracts	Pre Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment
Commercial and industrial	1	$5	$5	1	$95	$95
Commercial real estate	1	434	434	3	1,571	1,571
Residential real estate	16	1,209	1,209	26	2,845	2,845
Home equity	7	170	170	8	185	185
Consumer	—	—	—	—	—	—
	25	$1,818	$1,818	38	$4,696	$4,696

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Note F – Long-Term Debt

The components of long-term debt are summarized below (in thousands):

	June 30, 2014	December 31, 2013
Junior subordinated debentures owed to City Holding Capital Trust III, due 2038, interest at a rate of 3.73% and 3.74%, respectively	$16,495	$16,495

The Company formed a statutory business trust, City Holding Capital Trust III ("Capital Trust III"), under the laws of Delaware. Capital Trust III was created for the exclusive purpose of (i) issuing trust-preferred capital securities ("Capital Securities"), which represent preferred undivided beneficial interests in the assets of the trust, (ii) using the proceeds from the sale of the Capital Securities to acquire junior subordinated debentures ("Debentures") issued by the Company, and (iii) engaging in only those activities necessary or incidental thereto. The trust is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, the accounts of the trusts are not included in the Company's consolidated financial statements.

Distributions on the Debentures are cumulative and will be payable quarterly at an interest rate of 3.50% over the three month LIBOR rate, reset quarterly. Interest payments are due in March, June, September and December. The Debentures are redeemable prior to maturity at the option of the Company (i) in whole or at any time or in part from time-to-time, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of certain pre-defined events.

Payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities are guaranteed by the Company. The Company also entered into an agreement as to expenses and liabilities with the trust pursuant to which it agreed, on a subordinated basis, to pay any cost, expenses or liabilities of the trust other than those arising under the trust preferred securities. The obligations of the Company under the junior subordinated debentures, the related indentures, the trust agreement establishing the trust, the guarantees and the agreements as to expenses and liabilities, in the aggregate, constitute a full and unconditional guarantee by the Company of the trust's obligations under the trust preferred securities. The Capital Securities issued by the statutory business trusts qualify as Tier 1 capital for the Company under current Federal Reserve Board guidelines.

Note G – Derivative Instruments

As of June 30, 2014 and December 31, 2013, the Company has derivative financial instruments not included in hedge relationships. These derivatives consist of interest rate swaps used for interest rate management purposes and derivatives executed with commercial banking customers to facilitate their interest rate management strategies.

The following table summarizes the fair value of these derivative instruments (in thousands):

Fair Value:	June 30, 2014	December 31, 2013
Other Assets	$8,383	$3,538
Other Liabilities	8,383	3,538

The following table summarizes the change in fair value of these derivative instruments (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Change in Fair Value:				
Other income - derivative asset	$2,552	$(6,211)	$4,606	$(7,790)

Other income - derivative liability	(2,552)	6,211	(4,606)	7,790

Certain financial instruments, including derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements. The Company's derivative transactions with financial institution counterparties are generally executed under International Swaps and Derivative Association ("ISDA") master agreements which include "right of setoff" provisions. In such cases there is generally a legally enforceable right to offset recognized amounts and there may be an intention to settle such amounts on a net basis. Nonetheless, the Company does not generally offset financial instruments for
financial reporting purposes. Information about financial instruments that are eligible for offset in the consolidated balance sheet as of June 30, 2014 is presented in the following tables (in thousands):

				Gross Amounts Not Offset in the Statement of Financial Position			
Description	Gross Amounts of Recognized Assets (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets presented in the Statement of Financial Position (c)=(a)-(b)	Netting Adjustment per Applicable Master Netting Arrangements	Fair Value of Financial Collateral	Total of Gross Amounts Not Offset in the Statement of Financial Position Including Applicable Netting Agreement and Fair Value of Collateral (d)	Net Amount (c)-(d)
Derivative assets:							
Interest rate swap agreements	$8,383	$—	$8,383	$—	$8,383	$8,383	$—

				Gross Amounts Not Offset in the Statement of Financial Position			
Description	Gross Amounts of Recognized Liabilities (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Liabilities presented in the Statement of Financial Position (c)=(a)-(b)	Netting Adjustment per Applicable Master Netting Arrangements	Fair Value of Financial Collateral	Total of Gross Amounts Not Offset in the Statement of Financial Position Including Applicable Netting Agreement and Fair Value of Collateral (d)	Net Amount (c)-(d)

Derivative liabilities:							
Interest rate swap agreements	$8,383	$—	$8,383	$—	$11,720	$11,720	$—

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Note H – Employee Benefit Plans

Pursuant to the terms of the City Holding Company 2003 Incentive Plan and the City Holding Company 2013 Incentive Plan (the "2003 Plan" and "2013 Plan", respectively), the Compensation Committee of the Board of Directors, or its delegate, may, from time-to-time, grant stock options, stock appreciation rights ("SARs"), or stock awards to employees, directors and individuals who provide service to the Company (collectively, "Plan Participants"). The 2003 Plan expired in April of 2013 and the 2013 Plan was approved by the shareholders in April 2013. A maximum of 750,000 shares of the Company's common stock may be issued upon the exercise of stock options, SARs and stock awards. These limitations may be adjusted in the event of a change in the number of outstanding shares of common stock by reason of a stock dividend, stock split or other similar event. Specific terms of options and SARs awarded, including vesting periods, exercise prices (stock price at date of grant) and expiration dates are determined at the date of grant and are evidenced by agreements between the Company and the awardee. The exercise price of the option grants equals the market price of the Company's stock on the date of grant. All incentive stock options and SARs will be exercisable up to 10 years from the date granted and all options and SARs are exercisable for the period specified in the individual agreement. As of June 30, 2014, under the 2003 Plan and 2013 Plan, 411,601 stock options had been awarded and 228,009 restricted stock awards had been awarded, respectively.

Each award from the Plan is evidenced by an award agreement that specifies the option price, the duration of the option, the number of shares to which the option pertains, and such other provisions as the Compensation Committee, or its delegate, determines. The option price for each grant is equal to the fair market value of a share of the Company's common stock on the date of the grant. Options granted expire at such time as the Compensation Committee, or its delegate, determines at the date of the grant and in no event does the exercise period exceed a maximum of ten years. Upon a change-in-control of the Company, as defined in the Plan, all outstanding options and awards shall immediately vest.

Stock Options

A summary of the Company's stock option activity and related information is presented below:

	Six months ended June 30, 2014		2013	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at January 1	173,601	$ 35.26	289,544	$ 34.38
Granted	13,953	44.43	15,475	37.74
Exercised	(19,000)	29.13	(62,685)	32.89
Forfeited	—	—	(1,500)	36.90
Outstanding at June 30	168,554	$ 36.71	240,834	$ 34.96

Additional information regarding stock options outstanding and exercisable at June 30, 2014, is provided in the following table:

Ranges of Exercise Prices	No. of Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)	No. of Options Currently Exercisable	Weighted-Average Exercise Price of Options Currently Exercisable	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value of Options Currently Exercisable (in thousands)

$26.62 - $33.90	40,250	$ 30.83	4.1	$575	19,332	$ 30.46	2.7	$ 283
$35.09 - $44.43	128,304	38.55	5.3	843	66,000	39.15	2.6	394
	168,554			$1,418	85,332			$ 677

Proceeds from stock option exercises were $0.6 million and $1.4 million during the six months ended June 30, 2014 and 2013, respectively. Shares issued in connection with stock option exercises are issued from available treasury shares. If no treasury shares are available, new shares are issued from available authorized shares. During the six months ended June 30, 2014 and 2013 all shares issued in connection with stock option exercises and restricted stock awards were issued from available treasury stock.

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The total intrinsic value of stock options exercised was $0.3 million and $0.2 million during the six months ended June 30, 2014 and 2013, respectively.

Stock-based compensation expense was approximately $0.1 million for the both the six months ended June 30, 2014 and 2013. Unrecognized stock-based compensation expense related to stock options approximated $0.5 million at June 30, 2014. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 1.6 years.

The fair value of the options is estimated at the date of grant using a Black-Scholes option-pricing model. The following weighted average assumptions were used to estimate the fair value of options granted:

	Six months ended June 30,			
	2014		2013	
Risk-free interest rate	2.42	%	1.88	%
Expected dividend yield	3.60	%	3.70	%
Volatility factor	48.75	%	41.35	%
Expected life of option	8.0 years		8.0 years	

Restricted Shares

The Company records compensation expense with respect to restricted shares in an amount equal to the fair value of the common stock covered by each award on the date of grant. The restricted shares awarded become fully vested after various periods of continued employment from the respective dates of grant. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted shares when the restrictions are released and the shares are issued. Compensation is being charged to expense over the respective vesting periods.

Restricted shares are forfeited if officers and employees terminate prior to the lapsing of restrictions. The Company records forfeitures of restricted stock as treasury share repurchases and any compensation cost previously recognized is reversed in the period of forfeiture. Recipients of restricted shares do not pay any cash consideration to the Company for the shares, have the right to vote all shares subject to such grant and receive all dividends with respect to such shares, whether or not the shares have vested. Stock-based compensation expense related to restricted shares was approximately $0.5 million and $0.3 million for the six months ended June 30, 2014 and 2013, respectively. Unrecognized stock-based compensation expense related to non-vested restricted shares was $3.3 million at June 30, 2014. At June 30, 2014, this unrecognized expense is expected to be recognized over 3.7 years based on the weighted average-life of the restricted shares.

A summary of the Company's restricted shares activity and related information is presented below:

	Six months ended June 30,					
	2014			2013		
	Restricted Awards		Average Market Price at Grant	Restricted Awards		Average Market Price at Grant
Outstanding at January 1	142,469			116,711		
Granted	25,062		$43.05	32,083		$37.57
Forfeited/Vested	(6,200	)		(8,075	)	
Outstanding at June 30	161,331			140,719		

Benefit Plans

The Company provides retirement benefits to its employees through the City Holding Company 401(k) Plan and Trust ("the 401(k) Plan"), which is intended to be compliant with Employee Retirement Income Security Act (ERISA) section 404(c). The Company's total expense associated with the retirement benefit plan approximated $0.4 million for both the six months ended June 30, 2014 and 2013.

The Company maintains two frozen defined benefit pension plans ("the Defined Benefit Plans"), which were inherited from the Company's acquisition of the plan sponsors (Horizon Bancorp, Inc. and Community Financial Corporation). The Company made contributions of approximately $0.2 million to the Defined Benefit Plans during the six months ended June 30, 2014 and 2013.

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The following table presents the components of the net periodic pension cost of the Defined Benefit Plans (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Components of net periodic cost:				