CENTRAL VALLEY COMMUNITY BANCORP
Form 10-Q
November 12, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2013

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 000—31977

CENTRAL VALLEY COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	77-0539125 (I.R.S. Employer Identification No.)
7100 N. Financial Dr, Suite 101, Fresno, California (Address of principal executive offices)	93720 (Zip code)

Registrant's telephone number (559) 298-1775

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 past 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 ý No o

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

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

Large accelerated filer o	Accelerated filer o

Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of November 8, 2013 there were 10,914,680 shares of the registrant’s common stock outstanding.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

2013 QUARTERLY REPORT ON FORM 10-Q

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PART 1: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Cash and due from banks	$32,190	$22,405
Interest-earning deposits in other banks	49,854	30,123
Federal funds sold	154	428
Total cash and cash equivalents	82,198	52,956
Available-for-sale investment securities (Amortized cost of $419,270 at September 30, 2013 and $381,074 at December 31, 2012)	417,833	393,965
Loans, less allowance for credit losses of $9,732 at September 30, 2013 and $10,133 at December 31, 2012	505,501	385,185
Bank premises and equipment, net	10,565	6,252
Other real estate owned	124	—
Bank owned life insurance	19,290	12,163
Federal Home Loan Bank stock	4,499	3,850
Goodwill	29,776	23,577
Core deposit intangibles	1,764	583
Accrued interest receivable and other assets	20,237	11,697
Total assets	$1,091,787	$890,228
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$327,099	$240,169
Interest bearing	616,690	511,263
Total deposits	943,789	751,432
Short-term borrowings	—	4,000
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	15,970	11,976
Total liabilities	964,914	772,563
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock, no par value, $1,000 per share liquidation preference; 10,000,000 shares authorized, Series C, issued and outstanding: 7,000 shares at September 30, 2013 and December 31, 2012	7,000	7,000
Common stock, no par value; 80,000,000 shares authorized; issued and outstanding: 10,913,550 at September 30, 2013 and 9,558,746 at December 31, 2012	53,948	40,583
Retained earnings	66,771	62,496
Accumulated other comprehensive (loss) income, net of tax	(846)	7,586
Total shareholders' equity	126,873	117,665
Total liabilities and shareholders' equity	$1,091,787	$890,228

See notes to unaudited consolidated financial statements.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands, except share and per share amounts)	2013	2012	2013	2012
INTEREST INCOME:				
Interest and fees on loans	$8,677	$6,111	$19,523	$18,248
Interest on deposits in other banks	45	36	104	70
Interest on Federal funds sold	—	—	—	1
Interest and dividends on investment securities:				
Taxable	588	741	1,341	2,694
Exempt from Federal income taxes	1,593	1,118	4,329	3,233
Total interest income	10,903	8,006	25,297	24,246
INTEREST EXPENSE:				
Interest on deposits	342	371	947	1,307
Interest on junior subordinated deferrable interest debentures	25	27	74	82
Other	—	36	17	109
Total interest expense	367	434	1,038	1,498
Net interest income before provision for credit losses	10,536	7,572	24,259	22,748
PROVISION FOR CREDIT LOSSES	—	—	—	500
Net interest income after provision for credit losses	10,536	7,572	24,259	22,248
NON-INTEREST INCOME:				
Service charges	911	690	2,282	2,055
Appreciation in cash surrender value of bank owned life insurance	149	101	342	291
Loan placement fees	128	181	507	408
Interchange fees	268	198	678	570
Net realized gain on sale of assets	—	—	1	4
Net gain on disposal of other real estate owned	—	—	—	12
Net realized gains on sales of investment securities	—	843	1,133	1,287
Federal Home Loan Bank dividends	59	4	113	11
Other income	298	267	811	775
Total non-interest income	1,813	2,284	5,867	5,413
NON-INTEREST EXPENSES:				
Salaries and employee benefits	5,048	3,773	12,916	11,859
Occupancy and equipment	1,134	906	2,936	2,664
Regulatory assessments	220	163	517	488
Data processing	357	274	949	851
Advertising	124	139	346	419
Audit and accounting fees	135	126	406	379
Legal fees	(18)	36	84	118
Acquisition and integration	271	—	784	—
Other real estate owned, net	5	6	5	78
Amortization of core deposit intangibles	84	50	184	150
Other	1,631	1,182	4,021	3,285
Total non-interest expenses	8,991	6,655	23,148	20,291

Income before provision for income taxes	3,358	3,201	6,978	7,370
Provision for income taxes	389	745	939	1,492
Net income	$2,969	$2,456	$6,039	$5,878
Preferred stock dividends and accretion	87	87	262	262
Net income available to common shareholders	$2,882	$2,369	$5,777	$5,616
Net income per common share:				
Basic earnings per share	$0.26	$0.25	$0.58	$0.59
Weighted average common shares used in basic computation	10,899,086	9,602,473	10,020,057	9,588,321
Diluted earnings per share	$0.26	$0.25	$0.57	$0.58
Weighted average common shares used in diluted computation	10,958,811	9,635,339	10,080,034	9,613,202
Cash dividend per common share	$0.05	$—	$0.15	$—

See notes to unaudited consolidated financial statements.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Net income	$2,969	$2,456	$6,039	$5,878
Other Comprehensive Income (Loss):				
Unrealized gains (losses) on securities:				
Unrealized holdings gains (losses)	797	3,858	(13,195)	8,050
Less: reclassification for net gains included in net income	—	843	1,133	1,287
Other comprehensive income (loss), before tax	797	3,015	(14,328)	6,763
Tax benefit (expense) related to items of other comprehensive income	(328)	(1,240)	5,896	(2,783)
Total other comprehensive income (loss)	469	1,775	(8,432)	3,980
Comprehensive income (loss)	$3,438	$4,231	$(2,393)	$9,858

See notes to unaudited consolidated financial statements.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	For the nine Months Ended September 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$6,039	$5,878
Adjustments to reconcile net income to net cash provided by operating activities:		
Net decrease in deferred loan fees	(217)	(178)
Depreciation	801	717
Accretion	(614)	(530)
Amortization	7,031	5,240
Stock-based compensation	73	83
Tax benefit from exercise of stock options	(16)	(25)
Provision for credit losses	—	500
Net realized gains on sales of available-for-sale investment securities	(1,133)	(1,287)
Net gain on sale and disposal of equipment	(1)	(4)
Net gain on sale of other real estate owned	—	(12)
Increase in bank owned life insurance, net of expenses	(342)	(291)
Net decrease in accrued interest receivable and other assets	873	701
Net decrease in prepaid FDIC assessments	1,542	384
Net (increase) decrease in accrued interest payable and other liabilities	(1,741)	4,410
(Benefit from) provision for deferred income taxes	(1,191)	514
Net cash provided by operating activities	11,104	16,100
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net cash and cash equivalents acquired in acquisition	40,729	—
Purchases of available-for-sale investment securities	(129,572)	(136,392)
Proceeds from sales or calls of available-for-sale investment securities	37,428	38,554
Proceeds from maturity and principal repayments of available-for-sale investment securities	63,666	64,933
Net (increase) decrease in loans	(6,633)	24,418
Proceeds from sale of other real estate owned	139	2,349
Purchases of premises and equipment	(852)	(1,142)
Purchases of bank owned life insurance	—	(116)
FHLB stock redeemed (purchased)	48	(957)
Proceeds from sale of premises and equipment	1	5
Net cash provided by (used in) investing activities	4,954	(8,348)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in demand, interest bearing and savings deposits	11,334	33,051
Net increase (decrease) in time deposits	6,816	(8,751)
Repayments of short-term borrowings to Federal Home Loan Bank	(4,000)	—
Purchase and retirement of common stock	—	(61)
Proceeds from exercise of stock options	782	361
Excess tax benefit from exercise of stock options	16	25
Cash dividend payments on common stock	(1,502)	—
Cash dividend payments on preferred stock	(262)	(262)
Net cash provided by financing activities	13,184	24,363

Increase in cash and cash equivalents	29,242	32,115
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	52,956	44,804
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$82,198	$76,919

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(In thousands)	For the Nine Months Ended September 30, 2013	2012
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Interest	$1,078	$1,571
Income taxes	$1,340	$760
Non-cash investing and financing activities:		
Transfer of loans to other real estate owned	$—	$2,337
Accrued preferred stock dividends	$87	$87
Common stock issued in Visalia Community Bank acquisition	$12,494	$—

See notes to unaudited consolidated financial statements.

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Note 1. Basis of Presentation

The interim unaudited consolidated financial statements of Central Valley Community Bancorp and subsidiary have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). These interim consolidated financial statements include the accounts of Central Valley Community Bancorp and its wholly owned subsidiary Central Valley Community Bank (the Bank) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. As discussed in Note 12, on July 1, 2013, the Company completed an acquisition under which Visalia Community Bank merged with and into Central Valley Community Bancorp's subsidiary, Central Valley Community Bank. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted. The Company believes that the disclosures are adequate to make the information presented not misleading. These interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2012 Annual Report to Shareholders on Form 10-K. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company's financial position at September 30, 2013, and the results of its operations and its cash flows for the three and nine month interim periods ended September 30, 2013 and 2012 have been included. Certain reclassifications have been made to prior year amounts to conform to the 2013 presentation. Reclassifications had no effect on prior period net income or shareholders' equity. The results of operations for interim periods are not necessarily indicative of results for the full year.

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Management has determined that since all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment, and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Impact of New Financial Accounting Standards

Presentation of Comprehensive Income

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income ("Topic 220") - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). 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 GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. ASU 2013-02 is effective prospectively for annual and interim periods beginning after December 15, 2012. The Company adopted this standard on January 1, 2013. The adoption of this ASU did not have a material impact on the Company's financial position, results of operations, or cash flows.

Note 2. Share-Based Compensation

For the nine month periods ended September 30, 2013 and 2012, share-based compensation cost recognized was $73,000 and $83,000, respectively. For the three month periods ended September 30, 2013 and 2012, share-based compensation cost recognized was $23,000 and $19,000, respectively. The recognized tax benefits for stock option compensation expense were $13,000 and $14,000, respectively, for the nine month periods ended September 30, 2013 and 2012. For the quarter ended September 30, 2013 and 2012, the recognized tax benefits for stock option compensation expense were $4,000 and $3,000, respectively.

The Company bases the fair value of the options granted on the date of grant using a Black-Scholes Merton option pricing model that uses assumptions based on expected option life and the level of estimated forfeitures, expected stock volatility, risk free interest rate, and dividend yield. The expected term and level of estimated forfeitures of the Company’s options are based on the Company’s own historical experience. Stock volatility is based on the historical volatility of the Company’s stock. The risk-free rate is based on the U. S. Treasury yield curve for the periods within the contractual life of the

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options in effect at the time of grant. The compensation cost for options granted is based on the weighted average grant date fair value per share.

No options to purchase shares of the Company's common stock were issued in the first nine months of 2013 from either of the Company's stock based compensation plans. During the quarter ended September 30, 2012, options to purchase 91,150 shares of the Company's common stock were issued from the Central Valley Community Bancorp 2005 Omnibus Plan (2005 Plan) at an exercise price of $8.02.

A summary of the combined activity of the Company's Stock Based Compensation Plans for the nine month period ended September 30, 2013 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Options outstanding at January 1, 2013	499,289	$8.78		
Options exercised	(92,199)	$8.48		
Options forfeited	(25,470)	$9.15		
Options outstanding at September 30, 2013	381,620	$8.82	4.96	$889
Options vested or expected to vest at September 30, 2013	376,118	$8.83	4.91	$874
Options exercisable at September 30, 2013	278,820	$9.38	3.74	$597

The total intrinsic value of 92,199 options exercised in the nine months ended September 30, 2013 was $77,000. Cash received from options exercised for the nine months ended September 30, 2013 and 2012 was $782,000 and $361,000, respectively. The actual tax benefit realized for the tax deductions from options exercised totaled $16,000 and $25,000 for the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, there was $292,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under both plans. The cost is expected to be recognized over a weighted average period of 3.35 years.

Note 3. Earnings Per Share

Basic earnings per share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, stock appreciation rights settled in stock or restricted stock awards, result in the issuance of common stock which shares in the earnings of the Company. A reconciliation of the numerators and denominators of the basic and diluted EPS computations is as follows:

Basic Earnings Per Share	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands, except share and per share amounts)	2013	2012	2013	2012
Net Income	$2,969	$2,456	$6,039	$5,878
Less: Preferred stock dividends and accretion	(87)	(87)	(262)	(262)
Income available to common shareholders	$2,882	$2,369	$5,777	$5,616
Weighted average shares outstanding	10,899,086	9,602,473	10,020,057	9,588,321
Basic earnings per share	$0.26	$0.25	$0.58	$0.59

Diluted Earnings Per Share	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands, except share and per share amounts)	2013	2012	2013	2012

Net Income	$2,969	$2,456	$6,039	$5,878
Less: Preferred stock dividends and accretion	(87)	(87)	(262)	(262)
Income available to common shareholders	$2,882	$2,369	$5,777	$5,616
Weighted average shares outstanding	10,899,086	9,602,473	10,020,057	9,588,321
Effect of dilutive stock options	59,725	32,866	59,977	24,881
Weighted average shares of common stock and common stock equivalents	10,958,811	9,635,339	10,080,034	9,613,202
Diluted earnings per share	$0.26	$0.25	$0.57	$0.58

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During the nine month periods ended September 30, 2013 and 2012, options to purchase 202,355 and 364,209 shares of common stock, respectively, were not factored into the calculation of dilutive stock options because they were anti-dilutive.

Note 4. Investments

The investment portfolio consists primarily of U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations, private label residential mortgage backed securities (PLRMBS), and obligations of states and political subdivisions securities, all of which are classified as available-for-sale. As of September 30, 2013, $109,500,000 of these securities were held as collateral for borrowing arrangements, public funds, and for other purposes.

The fair value of the available-for-sale investment portfolio reflected a net unrealized loss of $1,437,000 at September 30, 2013 compared to an unrealized gain of $12,891,000 at December 31, 2012.

The following table sets forth the carrying values and estimated fair values of our investment securities portfolio at the dates indicated (in thousands):

	September 30, 2013			
Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$16,410	$198	$(29)	$16,579
Obligations of states and political subdivisions	186,818	4,598	(6,821)	184,595
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	203,728	1,295	(1,662)	203,361
Private label residential mortgage backed securities	4,718	954	—	5,672
Other equity securities	7,596	30	—	7,626
	$419,270	$7,075	$(8,512)	$417,833

	December 31, 2012			
Available-for-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	$9,443	$34	$(23)	$9,454
Obligations of states and political subdivisions	151,312	10,751	(385)	161,678
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	206,465	3,152	(1,107)	208,510
Private label residential mortgage backed securities	6,258	323	(206)	6,375
Other equity securities	7,596	352	—	7,948
	$381,074	$14,612	$(1,721)	$393,965

Proceeds and gross realized gains (losses) from the sales or calls of investment securities for the periods ended September 30, 2013 and 2012 are shown below (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Available-for-Sale Securities	2013	2012	2013	2012
Proceeds from sales or calls	$1,575	$31,055	$37,428	$38,554
Gross realized gains from sales or calls	—	1,128	1,401	1,694

Gross realized losses from sales or calls	—	(285)	(268)	(407)

The provision for income taxes includes $466,000 and $530,000 income tax impact from the reclassification of unrealized net gains on available-for-sale securities to realized net gains on available-for-sale securities for the nine months ended September 30, 2013 and 2012. The provision for income taxes includes $0 and $348,000 of income tax impact from the reclassification of unrealized net gains on available-for-sale securities to realized net gains on available-for-sale securities for the three months ended September 30, 2013 and 2012. respectively.

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Investment securities with unrealized losses as of the dates indicated are summarized and classified according to the duration of the loss period as follows (in thousands):

	September 30, 2013					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	$3,039	$(29)	$—	$—	$3,039	$(29)
Obligations of states and political subdivisions	101,937	(6,510)	2,597	(311)	104,534	(6,821)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	83,339	(1,339)	21,806	(323)	105,145	(1,662)
	$188,315	$(7,878)	$24,403	$(634)	$212,718	$(8,512)

	December 31, 2012					
	Less than 12 Months		12 Months or More		Total	
Available-for-Sale Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government agencies	$3,590	$(23)	$—	$—	$3,590	$(23)
Obligations of states and political subdivisions	30,572	(385)	—	—	30,572	(385)
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	76,764	(809)	18,024	(298)	94,788	(1,107)
Private label residential mortgage backed securities	—	—	2,886	(206)	2,886	(206)
	$110,926	$(1,217)	$20,910	$(504)	$131,836	$(1,721)

We periodically evaluate each investment security for other-than-temporary impairment, relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. Under ASC 320-10, the portion of the impairment that is attributable to a shortage in the present value of expected future cash flows relative to the amortized cost should be recorded as a current period charge to earnings. The discount rate in this analysis is the original yield expected at time of purchase.

As of September 30, 2013, the Company performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment (OTTI). Management evaluated all available-for-sale investment securities with an unrealized loss at September 30, 2013 and identified those that had an unrealized loss for at least a consecutive 12 month period, which had an unrealized loss at September 30, 2013 greater than 10% of the recorded book value on that date, or which had an unrealized loss of more than $10,000. Management also analyzed any securities that may have been downgraded by credit rating agencies.

For those bonds that met the evaluation criteria, management obtained and reviewed the most recently published national credit ratings for those bonds. For those bonds that were municipal debt securities with an investment grade rating by the rating agencies, management also evaluated the financial condition of the municipality and any applicable municipal bond insurance provider and concluded that no credit related impairment existed.

The evaluation for PLRMBS includes estimating projected cash flows that the Company is likely to collect based on an assessment of all available information about the applicable security on an individual basis, the structure of the security, and certain assumptions, such as the remaining payment terms for the security, prepayment speeds, default rates, loss severity on the collateral supporting the security based on underlying loan-level borrower and loan characteristics, expected housing price changes, and interest rate assumptions, to determine whether the Company will recover the entire amortized cost basis of the security. In performing a detailed cash flow analysis, the Company identified the best estimate of the cash flows expected to be collected. If this estimate results in a present value of expected cash flows (discounted at the security's original yield) that is less than the amortized cost basis of the security, an OTTI is considered to have occurred.

To assess whether it expects to recover the entire amortized cost basis of its PLRMBS, the Company performed a cash flow analysis for all of its PLRMBS as of September 30, 2013. In performing the cash flow analysis for each security, the Company uses a third-party model. The model considers borrower characteristics and the particular attributes of the loans

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underlying the Company's securities, in conjunction with assumptions about future changes in home prices and other assumptions, to project prepayments, default rates, and loss severities.

The month-by-month projections of future loan performance are allocated to the various security classes in each securitization structure in accordance with the structure's prescribed cash flow and loss allocation rules. When the credit enhancement for the senior securities in a securitization is derived from the presence of subordinated securities, losses are allocated first to the subordinated securities until their principal balance is reduced to zero. The projected cash flows are based on a number of assumptions and expectations, and the results of these models can vary significantly with changes in assumptions and expectations. The scenario of cash flows determined based on the model approach described above reflects a best-estimate scenario.

At each quarter end, the Company compares the present value of the cash flows expected to be collected on its PLRMBS to the amortized cost basis of the securities to determine whether a credit loss exists.
Based upon management's assessment of the expected credit losses of these securities given the performance of the underlying collateral compared with our credit enhancement (which occurs as a result of credit loss protection provided by subordinated tranches), the Company expects to recover the entire amortized cost basis of these securities, with the exception of certain securities for which OTTI was previously recorded.

U.S. Government Agencies

At September 30, 2013, the Company held six U.S. Government agency securities, of which two were in a loss position for less than 12 months and none were in a loss position nor had been in a loss position for 12 months or more. The unrealized losses on the Company's investments in direct obligations of U.S. government agencies were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized costs of the investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2013.

Obligations of States and Political Subdivisions

At September 30, 2013, the Company held 213 obligations of states and political subdivision securities of which 76 were in a loss position for less than 12 months and two were in a loss position and had been in a loss position for 12 months or more. The unrealized losses on the Company's investments in obligations of states and political subdivision securities were caused by interest rate changes. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2013.

U.S. Government Sponsored Entities and Agencies Collateralized by Residential Mortgage Obligations

At September 30, 2013, the Company held 197 U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations of which 41 were in a loss position for less than 12 months and 21 have been in a loss position for more than 12 months. The unrealized losses on the Company's investments in U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations were caused by interest rate changes. The contractual cash flows of those investments are guaranteed by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2013.

Private Label Residential Mortgage Backed Securities

At September 30, 2013, the Company had a total of 21 PLRMBS with a remaining principal balance of $4,718,000 and a net unrealized gain of approximately $954,000. None of these securities were recorded with an unrealized loss at September 30, 2013. Eight of these PLRMBS with a remaining principal balance of $3,713,000 had credit ratings below investment grade. The Company continues to perform extensive analyses on these securities.

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PLRMBS as of September 30, 2013 with credit ratings below investment grade are summarized in the table below (dollars in thousands):

Description	Book Value	Market Value	Unrealized Gain (Loss)	Rating	Agency	12 Month Historical Prepayment Rates %	Projected Default Rates %	Projected Severity Rates %	Original Purchase Price %	Current Credit Enhancement %
PHHAM	$1,471	1,684	$213	D	Fitch					