

INDEPENDENT BANK CORP

Form 10-Q

May 08, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended March 31, 2014

Commission File Number: 1-9047

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Independent Bank Corp.

(Exact name of registrant as specified in its charter)

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Massachusetts

04-2870273

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

Office Address: 2036 Washington Street, Hanover Massachusetts 02339

Mailing Address: 288 Union Street, Rockland, Massachusetts 02370

(Address of principal executive offices, including zip code)

(781) 878-6100

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer

☒

Accelerated Filer

☐

Non-accelerated Filer

☐

Smaller Reporting Company

☐

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

As of May 1, 2014, there were 23,898,755 shares of the issuer's common stock outstanding, par value \$0.01 per share.

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## PART 1. FINANCIAL INFORMATION

## Item 1. Financial Statements

## INDEPENDENT BANK CORP.

## CONSOLIDATED BALANCE SHEETS

(Unaudited—Dollars in thousands)

|                                                                  | March 31,<br>2014 | December 31,<br>2013 |
|------------------------------------------------------------------|-------------------|----------------------|
| Assets                                                           |                   |                      |
| Cash and due from banks                                          | \$ 142,349        | \$ 168,106           |
| Interest-earning deposits with banks                             | 74,934            | 48,219               |
| Securities                                                       |                   |                      |
| Securities available for sale                                    | 348,258           | 356,862              |
| Securities held to maturity (fair value \$374,530 and \$346,455) | 375,556           | 350,652              |
| Total securities                                                 | 723,814           | 707,514              |
| Loans held for sale (at fair value)                              | 6,788             | 8,882                |
| Loans                                                            |                   |                      |
| Commercial and industrial                                        | 822,509           | 784,202              |
| Commercial real estate                                           | 2,282,939         | 2,249,260            |
| Commercial construction                                          | 239,536           | 223,859              |
| Small business                                                   | 78,147            | 77,240               |
| Residential real estate                                          | 538,626           | 541,443              |
| Home equity - 1st position                                       | 499,095           | 497,075              |
| Home equity - subordinate positions                              | 328,190           | 325,066              |
| Other consumer                                                   | 18,227            | 20,162               |
| Total loans                                                      | 4,807,269         | 4,718,307            |
| Less: allowance for loan losses                                  | (53,629)          | (53,239)             |
| Net loans                                                        | 4,753,640         | 4,665,068            |
| Federal Home Loan Bank stock                                     | 39,926            | 39,926               |
| Bank premises and equipment, net                                 | 64,433            | 64,950               |
| Goodwill                                                         | 170,421           | 170,421              |
| Identifiable intangible assets                                   | 11,630            | 12,221               |
| Cash surrender value of life insurance policies                  | 97,839            | 100,406              |
| Other real estate owned and other foreclosed assets              | 7,997             | 7,633                |
| Other assets                                                     | 132,149           | 105,888              |
| Total assets                                                     | \$6,225,920       | \$6,099,234          |
| Liabilities and Stockholders' Equity                             |                   |                      |
| Deposits                                                         |                   |                      |
| Demand deposits                                                  | \$ 1,399,717      | \$ 1,369,432         |
| Savings and interest checking accounts                           | 2,032,204         | 1,940,153            |
| Money market                                                     | 957,052           | 933,205              |
| Time certificates of deposit of \$100,000 and over               | 292,956           | 297,984              |
| Other time certificates of deposits                              | 432,330           | 445,644              |
| Total deposits                                                   | 5,114,259         | 4,986,418            |
| Borrowings                                                       |                   |                      |
| Federal Home Loan Bank borrowings                                | 140,228           | 140,294              |
| Customer repurchase agreements and other short-term borrowings   | 128,485           | 154,288              |
| Wholesale repurchase agreements                                  | 50,000            | 50,000               |



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|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
| Junior subordinated debentures                                                                                                                                                                                                                                                          | 73,852      | 73,906      |
| Subordinated debentures                                                                                                                                                                                                                                                                 | 30,000      | 30,000      |
| Total borrowings                                                                                                                                                                                                                                                                        | 422,565     | 448,488     |
| Other liabilities                                                                                                                                                                                                                                                                       | 86,540      | 72,788      |
| Total liabilities                                                                                                                                                                                                                                                                       | 5,623,364   | 5,507,694   |
| Commitments and contingencies                                                                                                                                                                                                                                                           |             |             |
| Stockholders' equity                                                                                                                                                                                                                                                                    |             |             |
| Preferred stock, \$.01 par value. authorized: 1,000,000 shares, outstanding: none                                                                                                                                                                                                       | —           | —           |
| Common stock, \$.01 par value. authorized: 75,000,000 shares,<br>issued and outstanding: 23,878,056 shares at March 31, 2014 and 23,805,984 shares<br>at December 31, 2013 (includes 284,453 and 268,290 shares of unvested participating 236<br>restricted stock awards, respectively) |             | 235         |
| Shares held in rabbi trust at cost: 172,048 shares at March 31, 2014 and 178,765<br>shares at December 31, 2013                                                                                                                                                                         | (3,456      | ) (3,404    |
| Deferred compensation obligation                                                                                                                                                                                                                                                        | 3,456       | 3,404       |
| Additional paid in capital                                                                                                                                                                                                                                                              | 306,156     | 305,179     |
| Retained earnings                                                                                                                                                                                                                                                                       | 301,218     | 293,560     |
| Accumulated other comprehensive loss, net of tax                                                                                                                                                                                                                                        | (5,054      | ) (7,434    |
| Total stockholders' equity                                                                                                                                                                                                                                                              | 602,556     | 591,540     |
| Total liabilities and stockholders' equity                                                                                                                                                                                                                                              | \$6,225,920 | \$6,099,234 |
| The accompanying condensed notes are an integral part of these unaudited consolidated financial statements                                                                                                                                                                              |             |             |

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## INDEPENDENT BANK CORP.

## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited—Dollars in thousands, except per share data)

|                                                             | Three Months Ended<br>March 31 |          |
|-------------------------------------------------------------|--------------------------------|----------|
|                                                             | 2014                           | 2013     |
| Interest income                                             |                                |          |
| Interest on loans                                           | \$48,204                       | \$46,978 |
| Taxable interest and dividends on securities                | 4,650                          | 3,529    |
| Nontaxable interest and dividends on securities             | 37                             | 11       |
| Interest on loans held for sale                             | 51                             | 268      |
| Interest on federal funds sold                              | 38                             | 34       |
| Total interest and dividend income                          | 52,980                         | 50,820   |
| Interest expense                                            |                                |          |
| Interest on deposits                                        | 2,791                          | 2,665    |
| Interest on borrowings                                      | 2,583                          | 3,293    |
| Total interest expense                                      | 5,374                          | 5,958    |
| Net interest income                                         | 47,606                         | 44,862   |
| Provision for loan losses                                   | 4,502                          | 1,300    |
| Net interest income after provision for loan losses         | 43,104                         | 43,562   |
| Noninterest income                                          |                                |          |
| Deposit account fees                                        | 4,359                          | 4,217    |
| Interchange and ATM fees                                    | 2,975                          | 2,328    |
| Investment management                                       | 4,603                          | 3,884    |
| Mortgage banking income                                     | 487                            | 2,281    |
| Loan level derivative income                                | 746                            | 532      |
| Increase in cash surrender value of life insurance policies | 722                            | 746      |
| Gain on life insurance benefits                             | 1,627                          | —        |
| Net gain on sale of equity securities                       | 91                             | —        |
| Other noninterest income                                    | 1,906                          | 1,736    |
| Total noninterest income                                    | 17,516                         | 15,724   |
| Noninterest expenses                                        |                                |          |
| Salaries and employee benefits                              | 23,080                         | 22,715   |
| Occupancy and equipment expenses                            | 6,146                          | 5,249    |
| Data processing and facilities management                   | 1,253                          | 1,184    |
| FDIC assessment                                             | 905                            | 821      |
| Advertising expense                                         | 824                            | 1,172    |
| Consulting expense                                          | 559                            | 710      |
| Debit card expense                                          | 614                            | 670      |
| Merger and acquisition expense                              | 77                             | 1,345    |
| Software maintenance                                        | 662                            | 681      |
| Telecommunication expense                                   | 548                            | 655      |
| Other noninterest expenses                                  | 7,219                          | 7,718    |
| Total noninterest expenses                                  | 41,887                         | 42,920   |
| Income before income taxes                                  | 18,733                         | 16,366   |
| Provision for income taxes                                  | 5,350                          | 4,114    |
| Net income                                                  | \$13,383                       | \$12,252 |
| Basic earnings per share                                    | 0.56                           | 0.54     |
| Diluted earnings per share                                  | 0.56                           | 0.54     |

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|                                          |            |            |
|------------------------------------------|------------|------------|
| Weighted average common shares (basic)   | 23,819,065 | 22,823,753 |
| Common shares equivalents                | 100,173    | 46,040     |
| Weighted average common shares (diluted) | 23,919,238 | 22,869,793 |
| Cash dividends declared per common share | 0.24       | 0.22       |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements

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INDEPENDENT BANK CORP.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited—Dollars in thousands)

|                                                                                                               | Three Months Ended<br>March 31 |          |
|---------------------------------------------------------------------------------------------------------------|--------------------------------|----------|
|                                                                                                               | 2014                           | 2013     |
| Net income                                                                                                    | \$13,383                       | \$12,252 |
| Other comprehensive income, net of tax                                                                        |                                |          |
| Unrealized gains (losses) on securities                                                                       |                                |          |
| Change in fair value of securities available for sale                                                         | 1,971                          | (777 )   |
| Less: net security gains reclassified into earnings                                                           | 54                             | —        |
| Net change in fair value of securities available for sale                                                     | 1,917                          | (777 )   |
| Unrealized gains (losses) on cash flow hedges                                                                 |                                |          |
| Change in fair value of cash flow hedges                                                                      | (177 )                         | (3 )     |
| Less: net cash flow hedge losses reclassified into earnings                                                   | (679 )                         | (836 )   |
| Net change in fair value of cash flow hedges                                                                  | 502                            | 833      |
| Net gain (loss) during the period and amortization of certain costs included in net periodic retirement costs | (39 )                          | 1        |
| Total other comprehensive income                                                                              | 2,380                          | 57       |
| Total comprehensive income                                                                                    | \$15,763                       | \$12,309 |
| The accompanying condensed notes are an integral part of these unaudited consolidated financial statements    |                                |          |

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## INDEPENDENT BANK CORP.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited—Dollars in thousands, except per share data)

|                                                                     | Common<br>Stock<br>Outstanding | Common<br>Stock | Value of<br>Shares<br>Held in<br>Rabbi Trust<br>at Cost | Deferred<br>Compensation<br>Obligation | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total     |
|---------------------------------------------------------------------|--------------------------------|-----------------|---------------------------------------------------------|----------------------------------------|----------------------------------|----------------------|-----------------------------------------------|-----------|
| Balance at<br>December 31,<br>2013                                  | 23,805,984                     | \$235           | \$ (3,404 )                                             | \$ 3,404                               | \$305,179                        | \$293,560            | \$ (7,434 )                                   | \$591,540 |
| Net income                                                          | —                              | —               | —                                                       | —                                      | —                                | 13,383               | —                                             | 13,383    |
| Other<br>comprehensive<br>income                                    | —                              | —               | —                                                       | —                                      | —                                | —                    | 2,380                                         | 2,380     |
| Common dividend<br>declared (\$0.24<br>per share)                   | —                              | —               | —                                                       | —                                      | —                                | (5,725 )             | —                                             | (5,725 )  |
| Proceeds from<br>exercise of stock<br>options                       | 7,911                          | —               | —                                                       | —                                      | 133                              | —                    | —                                             | 133       |
| Tax benefit related<br>to equity award<br>activity                  | —                              | —               | —                                                       | —                                      | 193                              | —                    | —                                             | 193       |
| Equity based<br>compensation                                        | —                              | —               | —                                                       | —                                      | 677                              | —                    | —                                             | 677       |
| Restricted stock<br>awards issued, net<br>of awards<br>surrendered  | 55,761                         | 1               | —                                                       | —                                      | (473 )                           | —                    | —                                             | (472 )    |
| Shares issued<br>under direct stock<br>purchase plan                | 8,400                          | —               | —                                                       | —                                      | 319                              | —                    | —                                             | 319       |
| Deferred<br>compensation<br>obligation                              | —                              | —               | (52 )                                                   | 52                                     | —                                | —                    | —                                             | —         |
| Tax benefit related<br>to deferred<br>compensation<br>distributions | —                              | —               | —                                                       | —                                      | 128                              | —                    | —                                             | 128       |
| Balance at March<br>31, 2014                                        | 23,878,056                     | \$236           | \$ (3,456 )                                             | \$ 3,456                               | \$306,156                        | \$301,218            | \$ (5,054 )                                   | \$602,556 |
| Balance at<br>December 31,<br>2012                                  | 22,774,009                     | \$225           | \$ (3,179 )                                             | \$ 3,179                               | \$269,950                        | \$263,671            | \$ (4,526 )                                   | \$529,320 |
| Net income                                                          | —                              | —               | —                                                       | —                                      | —                                | 12,252               | —                                             | 12,252    |
| Other<br>comprehensive                                              | —                              | —               | —                                                       | —                                      | —                                | —                    | 57                                            | 57        |

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|                     |            |       |           |   |          |           |           |           |
|---------------------|------------|-------|-----------|---|----------|-----------|-----------|-----------|
| income              |            |       |           |   |          |           |           |           |
| Common dividend     |            |       |           |   |          |           |           |           |
| declared (\$0.22    | —          | —     | —         | — | —        | (5,032    | )         | (5,032    |
| per share)          |            |       |           |   |          |           |           | )         |
| Proceeds from       |            |       |           |   |          |           |           |           |
| exercise of stock   | 17,450     | —     | —         | — | 451      | —         | —         | 451       |
| options             |            |       |           |   |          |           |           |           |
| Tax benefit related |            |       |           |   |          |           |           |           |
| to equity award     | —          | —     | —         | — | 166      | —         | —         | 166       |
| activity            |            |       |           |   |          |           |           |           |
| Equity based        |            |       |           |   |          |           |           |           |
| compensation        | —          | —     | —         | — | 760      | —         | —         | 760       |
| Restricted stock    |            |       |           |   |          |           |           |           |
| awards issued, net  | 79,636     | 1     | —         | — | (508     | )         | —         | (507      |
| of awards           |            |       |           |   |          |           |           | )         |
| surrendered         |            |       |           |   |          |           |           |           |
| Shares issued       |            |       |           |   |          |           |           |           |
| under direct stock  | 252        | —     | —         | — | 8        | —         | —         | 8         |
| purchase plan       |            |       |           |   |          |           |           |           |
| Deferred            |            |       |           |   |          |           |           |           |
| compensation        | —          | —     | (19       | ) | 19       | —         | —         | —         |
| obligation          |            |       |           |   |          |           |           |           |
| Tax benefit related |            |       |           |   |          |           |           |           |
| to deferred         |            |       |           |   |          |           |           |           |
| compensation        | —          | —     | —         | — | 100      | —         | —         | 100       |
| distributions       |            |       |           |   |          |           |           |           |
| Balance March       | 22,871,347 | \$226 | \$ (3,198 | ) | \$ 3,198 | \$270,927 | \$270,891 | \$ (4,469 |
| 31, 2013            |            |       |           |   |          |           |           | )         |
|                     |            |       |           |   |          |           |           | \$537,575 |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements

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INDEPENDENT BANK CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited—Dollars in thousands)

|                                                                                    | Three Months Ended<br>March 31 |            |
|------------------------------------------------------------------------------------|--------------------------------|------------|
|                                                                                    | 2014                           | 2013       |
| Cash flow from operating activities                                                |                                |            |
| Net income                                                                         | \$ 13,383                      | \$ 12,252  |
| Adjustments to reconcile net income to cash provided by operating activities       |                                |            |
| Depreciation and amortization                                                      | 2,671                          | 2,064      |
| Provision for loan losses                                                          | 4,502                          | 1,300      |
| Deferred income tax expense                                                        | 471                            | 2          |
| Net gain on sale of equity securities                                              | (91)                           | ) —        |
| Net loss on fixed assets                                                           | 353                            | 28         |
| Net loss on sale of other real estate owned and foreclosed assets                  | 184                            | 198        |
| Realized gain on sale leaseback transaction                                        | (258)                          | ) (258)    |
| Stock based compensation                                                           | 677                            | 760        |
| Excess tax benefit related to equity award activity                                | (193)                          | ) (166)    |
| Increase in cash surrender value of life insurance policies                        | (722)                          | ) (746)    |
| Gain on life insurance benefits                                                    | (1,627)                        | ) —        |
| Change in fair value on loans held for sale                                        | (51)                           | ) 140      |
| Net change in:                                                                     |                                |            |
| Loans held for sale                                                                | 2,145                          | 11,257     |
| Other assets                                                                       | 1,991                          | 11,394     |
| Other liabilities                                                                  | (8,722)                        | ) (11,862) |
| Total adjustments                                                                  | 1,330                          | 14,111     |
| Net cash provided by operating activities                                          | 14,713                         | 26,363     |
| Cash flows used in investing activities                                            |                                |            |
| Proceeds from sales of securities available for sale                               | 673                            | —          |
| Proceeds from maturities and principal repayments of securities available for sale | 11,705                         | 26,708     |
| Purchase of securities available for sale                                          | (766)                          | ) (34,725) |
| Proceeds from maturities and principal repayments of securities held to maturity   | 9,083                          | 13,950     |
| Purchase of securities held to maturity                                            | (34,017)                       | ) (44,902) |
| Redemption of Federal Home Loan Bank stock                                         | —                              | 3,093      |
| Investment in Low Income Housing Projects                                          | (2,561)                        | ) —        |
| Purchase of life insurance policies                                                | (93)                           | ) (93)     |
| Proceeds from life insurance policies                                              | 478                            | —          |
| Net (increase) decrease in loans                                                   | (93,858)                       | ) 29,167   |
| Purchase of bank premises and equipment                                            | (2,455)                        | ) (1,478)  |
| Proceeds from the sale of bank premises and equipment                              | 756                            | —          |
| Proceeds from the sale of other real estate owned and foreclosed assets            | 642                            | 1,206      |
| Capital improvements to other real estate owned                                    | (444)                          | ) (304)    |
| Net cash used in investing activities                                              | (110,857)                      | ) (7,378)  |
| Cash flows provided by (used in) financing activities                              |                                |            |
| Net increase (decrease) in time deposits                                           | (18,342)                       | ) 15,141   |
| Net increase (decrease) in other deposits                                          | 146,183                        | (10,408)   |



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|                                                                       |           |           |   |
|-----------------------------------------------------------------------|-----------|-----------|---|
| Net increase in short-term Federal Home Loan Bank borrowings          | —         | 305       |   |
| Repayments of long-term Federal Home Loan Bank borrowings             | —         | (9,134    | ) |
| Net decrease in customer repurchase agreements                        | (20,803   | ) (23,741 | ) |
| Net decrease in other borrowings                                      | (5,000    | ) (7,000  | ) |
| Proceeds from exercise of stock options, net of cash paid             | 133       | 451       |   |
| Restricted stock awards issued, net of awards surrendered             | (472      | ) (507    | ) |
| Excess tax benefit from stock based compensation                      | 193       | 166       |   |
| Tax benefit from deferred compensation distribution                   | 128       | 100       |   |
| Proceeds from shares issued under direct stock purchase plan          | 319       | 8         |   |
| Common dividends paid                                                 | (5,237    | ) —       |   |
| Net cash provided by (used in) financing activities                   | 97,102    | (34,619   | ) |
| Net increase (decrease) in cash and cash equivalents                  | 958       | (15,634   | ) |
| Cash and cash equivalents at beginning of year                        | 216,325   | 215,474   |   |
| Cash and cash equivalents at end of period                            | \$217,283 | \$199,840 |   |
| Supplemental schedule of noncash investing and financing activities   |           |           |   |
| Transfer of loans to other real estate owned & foreclosed assets      | \$746     | \$771     |   |
| Capital commitment relating to Low Income Housing Project investments | \$23,279  | \$—       |   |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

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CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

Independent Bank Corp. (the “Company”) is a state chartered, federally registered bank holding company, incorporated in 1985. The Company is the sole stockholder of Rockland Trust Company (“Rockland Trust” or the “Bank”), a Massachusetts trust company chartered in 1907.

All material intercompany balances and transactions have been eliminated in consolidation. Certain previously reported amounts may have been reclassified to conform to the current year’s presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements, primarily consisting of normal recurring adjustments, have been included. Operating results for the quarter ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014 or any other interim period.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission.

NOTE 2 – RECENT ACCOUNTING STANDARDS UPDATES

FASB ASC Subtopic 310-40 "Receivables - Troubled Debt Restructurings by Creditors" Update No. 2014-04. Update No. 2014-04 was issued in January 2014 to reduce diversity by clarifying when an in substance repossession of foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments in this update clarify 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 the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure 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 requirements of the applicable jurisdiction. The amendments in the update should be applied prospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic No. 323 "Investments - Equity Method and Joint Ventures" Update No. 2014-01. Update No. 2014-01 was issued in January 2014 to provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for low-income housing tax credit. The amendments in this update permit 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 to income tax expense (benefit). The amendments in the update should be applied retrospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted and the Company chose to early adopt this guidance effective January 1, 2014. The adoption of this standard did not have a material impact on the Company's consolidated financial

position.

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## NOTE 3 – SECURITIES

The following table presents a summary of the amortized cost, gross unrealized holding gains and losses, other-than-temporary impairment recorded in other comprehensive income and fair value of securities available for sale and securities held to maturity for the periods below:

|                                                                | March 31, 2014    |                              |                                        |                                        |               | December 31, 2013 |                              |                                        |                                        |               |
|----------------------------------------------------------------|-------------------|------------------------------|----------------------------------------|----------------------------------------|---------------|-------------------|------------------------------|----------------------------------------|----------------------------------------|---------------|
|                                                                | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses<br>Other | Other-Than-<br>Temporary<br>Impairment | Fair<br>Value | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses<br>Other | Other-Than-<br>Temporary<br>Impairment | Fair<br>Value |
| (Dollars in thousands)                                         |                   |                              |                                        |                                        |               |                   |                              |                                        |                                        |               |
| Available for sale securities                                  |                   |                              |                                        |                                        |               |                   |                              |                                        |                                        |               |
| U.S. Government agency securities                              | \$41,335          | \$4                          | \$(415)                                | ) \$—                                  | \$40,924      | \$41,331          | \$3                          | \$(885)                                | ) \$—                                  | \$40,449      |
| Agency mortgage-backed securities                              | 223,304           | 6,339                        | (2,878)                                | ) —                                    | 226,765       | 232,742           | 6,405                        | (4,556)                                | ) —                                    | 234,591       |
| Agency collateralized mortgage obligations                     | 56,277            | 259                          | (1,081)                                | ) —                                    | 55,455        | 58,765            | 490                          | (1,102)                                | ) —                                    | 58,153        |
| State, county, and municipal securities                        | 5,415             | 36                           | (1)                                    | ) —                                    | 5,450         | 5,439             | 1                            | (28)                                   | ) —                                    | 5,412         |
| Single issuer trust preferred securities issued by banks       | 2,949             | 68                           | —                                      | —                                      | 3,017         | 2,960             | 14                           | (22)                                   | ) —                                    | 2,952         |
| Pooled trust preferred securities issued by banks and insurers | 8,044             | —                            | (1,583)                                | ) (1,494)                              | 4,967         | 8,083             | —                            | (1,913)                                | ) (2,329)                              | 3,841         |
| Equity securities                                              | 11,182            | 745                          | (247)                                  | ) —                                    | 11,680        | 10,997            | 762                          | (295)                                  | ) —                                    | 11,464        |
| Total available for sale securities                            | \$348,506         | \$7,451                      | \$(6,205)                              | ) \$(1,494)                            | \$348,258     | \$360,317         | \$7,675                      | \$(8,801)                              | ) \$(2,329)                            | \$356,862     |
| Held to maturity securities                                    |                   |                              |                                        |                                        |               |                   |                              |                                        |                                        |               |
| U.S. Treasury securities                                       | \$1,011           | \$42                         | \$—                                    | \$—                                    | \$1,053       | \$1,011           | \$31                         | \$—                                    | \$—                                    | \$1,042       |
| Agency mortgage-backed securities                              | 175,069           | 2,523                        | (255)                                  | ) —                                    | 177,337       | 155,067           | 1,917                        | (1,033)                                | ) —                                    | 155,951       |
| Agency collateralized mortgage obligations                     | 192,293           | 1,627                        | (5,214)                                | ) —                                    | 188,706       | 187,388           | 824                          | (6,176)                                | ) —                                    | 182,036       |
| State, county, and municipal                                   | 678               | 11                           | —                                      | —                                      | 689           | 678               | 7                            | —                                      | —                                      | 685           |

securities

Single issuer trust

preferred

securities issued

by banks

Corporate debt

securities

Total held to

maturity

securities

Total

|           |          |            |           |           |           |          |            |           |           |
|-----------|----------|------------|-----------|-----------|-----------|----------|------------|-----------|-----------|
| 1,501     | 25       | —          | —         | 1,526     | 1,503     | 23       | —          | —         | 1,526     |
| 5,004     | 215      | —          | —         | 5,219     | 5,005     | 210      | —          | —         | 5,215     |
| \$375,556 | \$4,443  | \$(5,469 ) | \$—       | \$374,530 | \$350,652 | \$3,012  | \$(7,209 ) | \$—       | \$346,455 |
| \$724,062 | \$11,894 | \$(11,674) | \$(1,494) | \$722,788 | \$710,969 | \$10,687 | \$(16,010) | \$(2,329) | \$703,317 |

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on the sale.

The Company realized a net gain of \$91,000 on equity securities classified as available for sale during the three month period ending March 31, 2014. The Company did not realize any gain or loss on equity securities classified as available for sale during the three month period ending March 31, 2013.

The actual maturities of certain securities may differ from the contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. A schedule of the contractual maturities of securities available for sale and securities held to maturity as of March 31, 2014 is presented below:

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|                                   | Available for Sale     |               | Held to Maturity  |               |
|-----------------------------------|------------------------|---------------|-------------------|---------------|
|                                   | Amortized<br>Cost      | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|                                   | (Dollars in thousands) |               |                   |               |
| Due in one year or less           | \$—                    | \$—           | \$255             | \$256         |
| Due after one year to five years  | 36,382                 | 37,193        | 5,821             | 6,071         |
| Due after five years to ten years | 74,283                 | 72,842        | 27,163            | 27,354        |
| Due after ten years               | 226,659                | 226,543       | 342,317           | 340,849       |
| Total debt securities             | \$337,324              | \$336,578     | \$375,556         | \$374,530     |
| Equity securities                 | \$11,182               | \$11,680      | \$—               | \$—           |
| Total                             | \$348,506              | \$348,258     | \$375,556         | \$374,530     |

Inclusive in the table above is \$33.9 million of callable securities in the Company's investment portfolio at March 31, 2014.

The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law, was \$358.3 million and \$360.1 million at March 31, 2014 and December 31, 2013, respectively.

At March 31, 2014 and December 31, 2013, the Company had no investments in obligations of individual states, counties, or municipalities, which exceeded 10% of stockholders' equity.

**Other-Than-Temporary Impairment ("OTTI")**

The Company continually reviews investment securities for the existence of OTTI, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, the credit worthiness of the obligor of the security, volatility of earnings, current analysts' evaluations, the Company's intent to sell the security, or whether it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment.

The following tables show the gross unrealized losses and fair value of the Company's investments in an unrealized loss position, which the Company has not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

| March 31, 2014                                                 |               |               |                                             |                                      |                                             |                        |                      |
|----------------------------------------------------------------|---------------|---------------|---------------------------------------------|--------------------------------------|---------------------------------------------|------------------------|----------------------|
|                                                                | # of holdings | Fair<br>Value | Less than 12 months<br>Unrealized<br>Losses | 12 months or longer<br>Fair<br>Value | 12 months or longer<br>Unrealized<br>Losses | Total<br>Fair<br>Value | Unrealized<br>Losses |
| (Dollars in thousands)                                         |               |               |                                             |                                      |                                             |                        |                      |
| U.S. Government agency securities                              | 38            | \$38,961      | \$(415 )                                    | \$—                                  | \$—                                         | \$38,961               | \$(415 )             |
| Agency mortgage-backed securities                              | 110           | 165,251       | (2,797 )                                    | 6,193                                | (336 )                                      | 171,444                | (3,133 )             |
| Agency collateralized mortgage obligations                     | 15            | 125,217       | (4,766 )                                    | 21,186                               | (1,529 )                                    | 146,403                | (6,295 )             |
| State, county, and municipal securities                        | 1             | 289           | (1 )                                        | —                                    | —                                           | 289                    | (1 )                 |
| Pooled trust preferred securities issued by banks and insurers | 2             | —             | —                                           | 2,593                                | (1,583 )                                    | 2,593                  | (1,583 )             |
| Equity securities                                              | 16            | 2,262         | (58 )                                       | 3,593                                | (189 )                                      | 5,855                  | (247 )               |
| Total temporarily impaired securities                          | 182           | \$331,980     | \$(8,037 )                                  | \$33,565                             | \$(3,637 )                                  | \$365,545              | \$(11,674 )          |



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|                                                                       | December 31, 2013 |                        |                   |            |                   |                  |                   |
|-----------------------------------------------------------------------|-------------------|------------------------|-------------------|------------|-------------------|------------------|-------------------|
|                                                                       | # of holdings     | Fair Value             | Unrealized Losses | Fair Value | Unrealized Losses | Total Fair Value | Unrealized Losses |
|                                                                       |                   | (Dollars in thousands) |                   |            |                   |                  |                   |
| U.S. government agency securities                                     | 39                | \$39,950               | \$(885 )          | \$—        | \$—               | \$39,950         | \$(885 )          |
| Agency mortgage-backed securities                                     | 124               | 202,004                | (5,217 )          | 5,108      | (372 )            | 207,112          | (5,589 )          |
| Agency collateralized mortgage obligations                            | 19                | 183,721                | (7,278 )          | —          | —                 | 183,721          | (7,278 )          |
| State, county, and municipal securities                               | 13                | 3,838                  | (28 )             | —          | —                 | 3,838            | (28 )             |
| Single issuer trust preferred securities issued by banks and insurers | 2                 | 1,341                  | (22 )             | —          | —                 | 1,341            | (22 )             |
| Pooled trust preferred securities issued by banks and insurers        | 2                 | —                      | —                 | 2,300      | (1,913 )          | 2,300            | (1,913 )          |
| Equity securities                                                     | 22                | 2,376                  | (90 )             | 3,520      | (205 )            | 5,896            | (295 )            |
| Total temporarily impaired securities                                 | 221               | \$433,230              | \$(13,520 )       | \$10,928   | \$(2,490 )        | \$444,158        | \$(16,010 )       |

The Company does not intend to sell these investments and has determined based upon available evidence that it is more likely than not that the Company will not be required to sell the security before the recovery of its amortized cost basis. As a result, the Company does not consider these investments to be OTTI. The Company made this determination by reviewing various qualitative and quantitative factors regarding each investment category, such as current market conditions, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, and current analysts' evaluations.

As a result of the Company's review of these qualitative and quantitative factors, the causes of the impairments listed in the table above by category are as follows at March 31, 2014:

**U.S. Government Agency Securities, Agency Mortgage-Backed Securities and Collateralized Mortgage Obligations:** This portfolio has contractual terms that generally do not permit the issuer to settle the securities at a price less than the current par value of the investment. The decline in market value of these securities is attributable to changes in interest rates and not credit quality. Additionally, these securities are implicitly guaranteed by the U.S. Government or one of its agencies.

**Pooled Trust Preferred Securities:** This portfolio consists of two below investment grade securities both of which are performing. The unrealized loss on these securities is attributable to the illiquid nature of the trust preferred market and the significant risk premiums required in the current economic environment. Management evaluates collateral credit and instrument structure, including current and expected deferral and default rates and timing. In addition, discount rates are determined by evaluating comparable spreads observed currently in the market for similar instruments.

**Equity Securities:** This portfolio consists of mutual funds and other equity investments. During some periods, the mutual funds in the Company's investment portfolio may have unrealized losses resulting from market fluctuations as well as the risk premium associated with that particular asset class. For example, emerging market equities tend to trade at a higher risk premium than U.S. government bonds and thus, will fluctuate to a greater degree on both the upside and the downside. In the context of a well-diversified portfolio, however, the correlation amongst the various asset classes represented by the funds serves to minimize downside risk. The Company evaluates each mutual fund in the portfolio regularly and measures performance on both an absolute and relative basis. A reasonable recovery period for positions with an unrealized loss is based on management's assessment of general economic data, trends within a particular asset class, valuations, earnings forecasts and bond durations.



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The following table shows the total OTTI that the Company recorded for the periods indicated:

|                                                         | Three Months Ended<br>March 31 |       |
|---------------------------------------------------------|--------------------------------|-------|
|                                                         | 2014                           | 2013  |
|                                                         | (Dollars in thousands)         |       |
| Gross change in OTTI recorded on certain investments    | \$833                          | \$281 |
| Portion of OTTI recognized in OCI                       | (833)                          | (281) |
| Total credit related OTTI losses recognized in earnings | \$—                            | \$—   |

The following table shows the cumulative credit related component of OTTI for the periods indicated:

|                                                     | Three Months Ended<br>March 31 |            |
|-----------------------------------------------------|--------------------------------|------------|
|                                                     | 2014                           | 2013       |
|                                                     | (Dollars in thousands)         |            |
| Balance at beginning of period                      | \$(9,997)                      | \$(10,847) |
| Add                                                 |                                |            |
| Incurred on securities not previously impaired      | —                              | —          |
| Incurred on securities previously impaired          | —                              | —          |
| Less                                                |                                |            |
| Securities sold during the period                   | —                              | —          |
| Reclassification due to changes in Company's intent | —                              | —          |
| Increases in cash flow expected to be collected     | —                              | —          |
| Balance at end of period                            | \$(9,997)                      | \$(10,847) |

## NOTE 4 – LOANS, ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY

The following tables bifurcate the amount of allowance allocated to each loan category based on the type of impairment analysis as of the periods indicated:

|                                                | March 31, 2014           |                           |                            |                   |                            |                      |          |                 |
|------------------------------------------------|--------------------------|---------------------------|----------------------------|-------------------|----------------------------|----------------------|----------|-----------------|
|                                                | (Dollars in thousands)   |                           |                            |                   |                            |                      |          |                 |
|                                                | Commercial<br>Industrial | Commercial<br>Real Estate | Commercial<br>Construction | Small<br>Business | Residential<br>Real Estate | Other<br>Home Equity | Consumer | Total           |
| Financing<br>receivables<br>ending<br>balance: |                          |                           |                            |                   |                            |                      |          |                 |
| Total loans by<br>group                        | \$822,509                | \$2,282,939               | \$239,536                  | \$78,147          | \$538,626                  | \$827,285            | \$18,227 | \$4,807,269 (1) |
| Individually<br>evaluated for<br>impairment    | \$8,554                  | \$37,076                  | \$100                      | \$1,852           | \$16,602                   | \$5,133              | \$1,186  | \$70,503        |
| Purchase<br>credit impaired<br>loans           | \$1                      | \$18,439                  | \$192                      | \$—               | \$10,170                   | \$315                | \$14     | \$29,131        |
| Collectively<br>evaluated for<br>impairment    | \$813,954                | \$2,227,424               | \$239,244                  | \$76,295          | \$511,854                  | \$821,837            | \$17,027 | \$4,707,635     |

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| December 31, 2013                     |                          |                           |                            |                   |                            |             |                   |                 |
|---------------------------------------|--------------------------|---------------------------|----------------------------|-------------------|----------------------------|-------------|-------------------|-----------------|
| (Dollars in thousands)                |                          |                           |                            |                   |                            |             |                   |                 |
|                                       | Commercial<br>Industrial | Commercial<br>Real Estate | Commercial<br>Construction | Small<br>Business | Residential<br>Real Estate | Home Equity | Other<br>Consumer | Total           |
| Financing receivables ending balance: |                          |                           |                            |                   |                            |             |                   |                 |
| Total loans by group                  | \$784,202                | \$2,249,260               | \$223,859                  | \$77,240          | \$541,443                  | \$822,141   | \$20,162          | \$4,718,307 (1) |
| Individually evaluated for impairment | \$9,148                  | \$39,516                  | \$100                      | \$1,903           | \$15,200                   | \$4,890     | \$1,298           | \$72,055        |
| Purchase credit impaired loans        | \$1                      | \$18,612                  | \$197                      | \$—               | \$10,389                   | \$326       | \$19              | \$29,544        |
| Collectively evaluated for impairment | \$775,053                | \$2,191,132               | \$223,562                  | \$75,337          | \$515,854                  | \$816,925   | \$18,845          | \$4,616,708     |

(1) The amount of net deferred fees included in the ending balance was \$2.3 million at both March 31, 2014 and December 31, 2013.

The following tables summarize changes in allowance for loan losses by loan category for the periods indicated:

| Three Months Ended March 31, 2014     |                          |                           |                            |                   |                            |             |                   |          |
|---------------------------------------|--------------------------|---------------------------|----------------------------|-------------------|----------------------------|-------------|-------------------|----------|
| (Dollars in thousands)                |                          |                           |                            |                   |                            |             |                   |          |
|                                       | Commercial<br>Industrial | Commercial<br>Real Estate | Commercial<br>Construction | Small<br>Business | Residential<br>Real Estate | Home Equity | Other<br>Consumer | Total    |
| Allowance for loan losses             |                          |                           |                            |                   |                            |             |                   |          |
| Beginning balance                     | \$15,622                 | \$24,541                  | \$3,371                    | \$1,215           | \$2,760                    | \$5,036     | \$694             | \$53,239 |
| Charge-offs                           | (783)                    | (2,922)                   | —                          | (268)             | (128)                      | (94)        | (371)             | (4,566)  |
| Recoveries                            | 79                       | 68                        | —                          | 47                | —                          | 93          | 167               | 454      |
| Provision                             | 683                      | 3,230                     | 199                        | 213               | 197                        | (277)       | 257               | 4,502    |
| Ending balance                        | \$15,601                 | \$24,917                  | \$3,570                    | \$1,207           | \$2,829                    | \$4,758     | \$747             | \$53,629 |
| Ending balance:                       |                          |                           |                            |                   |                            |             |                   |          |
| Individually evaluated for impairment | \$647                    | \$369                     | \$—                        | \$109             | \$1,641                    | \$114       | \$62              | \$2,942  |
| Ending balance:                       |                          |                           |                            |                   |                            |             |                   |          |
| Collectively evaluated for impairment | \$14,954                 | \$24,548                  | \$3,570                    | \$1,098           | \$1,188                    | \$4,644     | \$685             | \$50,687 |

| Three Months Ended March 31, 2013 |                          |                           |                            |                   |                            |             |                   |       |
|-----------------------------------|--------------------------|---------------------------|----------------------------|-------------------|----------------------------|-------------|-------------------|-------|
| (Dollars in thousands)            |                          |                           |                            |                   |                            |             |                   |       |
|                                   | Commercial<br>Industrial | Commercial<br>Real Estate | Commercial<br>Construction | Small<br>Business | Residential<br>Real Estate | Home Equity | Other<br>Consumer | Total |
| Allowance for loan losses         |                          |                           |                            |                   |                            |             |                   |       |

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|                                       |           |           |          |          |          |          |        |           |
|---------------------------------------|-----------|-----------|----------|----------|----------|----------|--------|-----------|
| Beginning balance                     | \$ 13,461 | \$ 22,598 | \$ 2,811 | \$ 1,524 | \$ 2,930 | \$ 7,703 | \$ 807 | \$ 51,834 |
| Charge-offs                           | (423 )    | (407 )    | —        | (145 )   | (61 )    | (277 )   | (261 ) | (1,574 )  |
| Recoveries                            | 136       | —         | —        | 39       | —        | 21       | 150    | 346       |
| Provision                             | 269       | 378       | 328      | (174 )   | 179      | 269      | 51     | 1,300     |
| Ending balance                        | \$ 13,443 | \$ 22,569 | \$ 3,139 | \$ 1,244 | \$ 3,048 | \$ 7,716 | \$ 747 | \$ 51,906 |
| Ending balance:                       |           |           |          |          |          |          |        |           |
| Individually evaluated for impairment | \$ 771    | \$ 385    | \$ —     | \$ 113   | \$ 1,577 | \$ 58    | \$ 119 | \$ 3,023  |
| Ending balance:                       |           |           |          |          |          |          |        |           |
| Collectively evaluated for impairment | \$ 12,672 | \$ 22,184 | \$ 3,139 | \$ 1,131 | \$ 1,471 | \$ 7,658 | \$ 628 | \$ 48,883 |

For the purpose of estimating the allowance for loan losses, management segregates the loan portfolio into the portfolio segments detailed in the above tables. Each of these loan categories possesses unique risk characteristics that are considered when

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determining the appropriate level of allowance for each segment. Some of the risk characteristics unique to each loan category include:

### Commercial Portfolio

**Commercial & Industrial:** Loans in this category consist of revolving and term loan obligations extended to business and corporate enterprises for the purpose of financing working capital and/or capital investment. Collateral generally consists of pledges of business assets including, but not limited to: accounts receivable, inventory, plant & equipment, or real estate, if applicable. Repayment sources consist of: primarily, operating cash flow, and secondarily, liquidation of assets.

**Commercial Real Estate:** Loans in this category consist of mortgage loans to finance investment in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and healthcare facilities and other specific use properties. Loans are typically written with amortizing payment structures. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy and regulatory guidelines. Repayment sources consist of: primarily, cash flow from operating leases and rents, and secondarily, liquidation of assets.

**Commercial Construction:** Loans in this category consist of short-term construction loans, revolving and nonrevolving credit lines and construction/permanent loans to finance the acquisition, development and construction or rehabilitation of real property. Project types include: residential 1-4 family condominium and multi-family homes, commercial/retail, office, industrial, hotels, educational and healthcare facilities and other specific use properties. Loans may be written with nonamortizing or hybrid payment structures depending upon the type of project. Collateral values are determined based upon third party appraisals and evaluations. Loan to value ratios at origination are governed by established policy and regulatory guidelines. Repayment sources vary depending upon the type of project and may consist of: sale or lease of units, operating cash flows or liquidation of other assets.

**Small Business:** Loans in this category consist of revolving, term loan and mortgage obligations extended to sole proprietors and small businesses for purposes of financing working capital and/or capital investment. Collateral generally consists of pledges of business assets including, but not limited to: accounts receivable, inventory, plant & equipment, or real estate if applicable. Repayment sources consist of: primarily, operating cash flows, and secondarily, liquidation of assets.

For the commercial portfolio it is the Bank's policy to obtain personal guarantees for payment from individuals holding material ownership interests of the borrowing entities.

### Consumer Portfolio

**Residential Real Estate:** Residential mortgage loans held in the Bank's portfolio are made to borrowers who demonstrate the ability to make scheduled payments with full consideration to underwriting factors such as current and expected income, employment status, current assets, other financial resources, credit history and the value of the collateral. Collateral consists of mortgage liens on 1-4 family residential properties. The Company does not originate sub-prime loans.

**Home Equity:** Home equity loans and lines are made to qualified individuals and are secured by senior or junior mortgage liens on owner-occupied 1-4 family homes, condominiums or vacation homes or on nonowner occupied 1-4 family homes with more restrictive loan to value requirements. The home equity loan has a fixed rate and is billed in equal payments comprised of principal and interest. The home equity line of credit has a variable rate and is billed in interest-only payments during the draw period. At the end of the draw period, the home equity line of credit is billed as a percentage of the principal balance plus all accrued interest. Additionally, the Bank has the option of renewing the line of credit for additional draw periods. Borrower qualifications include favorable credit history combined with supportive income requirements and combined loan to value ratios within established policy guidelines.

**Other Consumer:** Other consumer loan products including personal lines of credit and amortizing loans made to qualified individuals for various purposes such as education, auto loans, debt consolidation, personal expenses or overdraft protection. Borrower qualifications include favorable credit history combined with supportive income and collateral requirements within established policy guidelines. These loans may be secured or unsecured.

### Credit Quality

The Company continually monitors the asset quality of the loan portfolio using all available information. Based on this information, loans demonstrating certain payment issues or other weaknesses may be categorized as delinquent, impaired, nonperforming and/or put on nonaccrual status. Additionally, in the course of resolving such loans, the Company may choose to restructure the contractual terms of certain loans to match the borrower's ability to repay the loan based on their current financial condition. If a restructured loan meets certain criteria, it may be categorized as a troubled debt restructuring ("TDR").

The Company reviews numerous credit quality indicators when assessing the risk in its loan portfolio. For the commercial portfolio, the Company utilizes a 10-point commercial risk-rating system, which assigns a risk-grade to each borrower based on

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a number of quantitative and qualitative factors associated with a commercial loan transaction. Factors considered include industry and market conditions, position within the industry, earnings trends, operating cash flow, asset/liability values, debt capacity, guarantor strength, management and controls, financial reporting, collateral, and other considerations. The risk-ratings categories are defined as follows:

1- 6 Rating — Pass: Risk-rating grades “1” through “6” comprise those loans ranging from ‘Substantially Risk Free’ which indicates borrowers are of unquestioned credit standing and the pinnacle of credit quality, well established companies with a very strong financial condition, and loans fully secured by cash collateral, through ‘Acceptable Risk’, which indicates borrowers may exhibit declining earnings, strained cash flow, increasing leverage and/or weakening market fundamentals that indicate above average or below average asset quality, margins and market share. Collateral coverage is protective.

7 Rating — Potential Weakness: Borrowers exhibit potential credit weaknesses or downward trends deserving management’s close attention. If not checked or corrected, these trends will weaken the Bank’s asset and position. While potentially weak, currently these borrowers are marginally acceptable; no loss of principal or interest is envisioned.

8 Rating — Definite Weakness: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. Loan may be inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. However, there is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Collateral coverage may be inadequate to cover the principal obligation.

9 Rating — Partial Loss Probable: Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt with the added provision that the weaknesses make collection of the debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely.

10 Rating — Definite Loss: Borrowers deemed incapable of repayment. Loans to such borrowers are considered uncollectible and of such little value that continuation as active assets of the Bank is not warranted.

The credit quality of the commercial loan portfolio is actively monitored and any changes in credit quality are reflected in risk-rating changes. Risk-ratings are assigned or reviewed for all new loans, when advancing significant additions to existing relationships (over \$50,000), at least quarterly for all actively managed loans, and any time a significant event occurs, including at renewal of the loan.

The Company utilizes a comprehensive strategy for monitoring commercial credit quality. Borrowers are required to provide updated financial information at least annually which is carefully evaluated for any changes in credit quality. Larger loan relationships are subject to a full annual credit review by an experienced credit analysis group.

Additionally, the Company retains an independent loan review firm to evaluate the credit quality of the commercial loan portfolio. The independent loan review process achieves significant penetration into the commercial loan portfolio and reports the results of these reviews to the Audit Committee of the Board of Directors on a quarterly basis.

The following table details the amount of outstanding principal balances relative to each of the risk-rating categories for the Company’s commercial portfolio:

|                                 |             | March 31, 2014            |                        |                         |                |             |
|---------------------------------|-------------|---------------------------|------------------------|-------------------------|----------------|-------------|
| Category                        | Risk Rating | Commercial and Industrial | Commercial Real Estate | Commercial Construction | Small Business | Total       |
| (Dollars in thousands)          |             |                           |                        |                         |                |             |
| Pass                            | 1 - 6       | \$752,417                 | \$2,096,405            | \$223,947               | \$ 73,045      | \$3,145,814 |
| Potential weakness              | 7           | 44,354                    | 104,090                | 10,929                  | 3,086          | 162,459     |
| Definite weakness-loss unlikely | 8           | 23,303                    | 72,774                 | 4,560                   | 1,846          | 102,483     |
| Partial loss probable           | 9           | 2,435                     | 9,670                  | 100                     | 170            | 12,375      |
| Definite loss                   | 10          | —                         | —                      | —                       | —              | —           |
| Total                           |             | \$822,509                 | \$2,282,939            | \$239,536               | \$ 78,147      | \$3,423,131 |



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| Category                        | Risk Rating | December 31, 2013         |                        |                         |                |             |
|---------------------------------|-------------|---------------------------|------------------------|-------------------------|----------------|-------------|
|                                 |             | Commercial and Industrial | Commercial Real Estate | Commercial Construction | Small Business | Total       |
|                                 |             | (Dollars in thousands)    |                        |                         |                |             |
| Pass                            | 1 - 6       | \$736,996                 | \$2,068,995            | \$210,372               | \$ 71,514      | \$3,087,877 |
| Potential weakness              | 7           | 21,841                    | 91,984                 | 8,608                   | 3,031          | 125,464     |
| Definite weakness-loss unlikely | 8           | 24,409                    | 85,767                 | 4,779                   | 2,552          | 117,507     |
| Partial loss probable           | 9           | 956                       | 2,514                  | 100                     | 143            | 3,713       |
| Definite loss                   | 10          | —                         | —                      | —                       | —              | —           |
| Total                           |             | \$784,202                 | \$2,249,260            | \$223,859               | \$ 77,240      | \$3,334,561 |

For the Company's consumer portfolio, the quality of the loan is best indicated by the repayment performance of an individual borrower. However, the Company does supplement performance data with current Fair Isaac Corporation ("FICO") and Loan to Value ("LTV") estimates. Current FICO data is purchased and appended to all consumer loans on a quarterly basis. In addition, automated valuation services and broker opinions of value are used to supplement original value data for the residential and home equity portfolios, periodically. The following table shows the weighted average FICO scores and the weighted average combined LTV ratios as of the periods indicated below:

|                            | March 31,<br>2014 | December 31,<br>2013 |   |
|----------------------------|-------------------|----------------------|---|
| Residential portfolio      |                   |                      |   |
| FICO score (re-scored) (1) | 738               | 738                  |   |
| LTV (re-valued) (2)        | 67.1              | % 67.0               | % |
| Home equity portfolio      |                   |                      |   |
| FICO score (re-scored) (1) | 764               | 763                  |   |
| LTV (re-valued) (2)        | 53.1              | % 53.0               | % |

(1) The average FICO scores for March 31, 2014 are based upon rescues available from February 28, 2014 and origination score data for loans booked between March 1, 2014 and March 31, 2014. The average FICO scores for December 31, 2013 are based upon rescues available from November 30, 2013 and origination score data for loans booked between December 1, 2013 and December 31, 2013.

(2) The combined LTV ratios for March 31, 2014 are based upon updated automated valuations as of February 28, 2013 and origination value data for loans booked between March 1, 2013 and March 31, 2014. The combined LTV ratios for December 31, 2013 are based upon updated automated valuations as of February 28, 2013 and origination value data for loans booked from March 1, 2013 through December 31, 2013. For home equity loans and lines in a subordinate lien, the LTV data represents a combined LTV, taking into account the senior lien data for loans and lines.

The Bank's philosophy toward managing its loan portfolios is predicated upon careful monitoring, which stresses early detection and response to delinquent and default situations. Delinquent loans are managed by a team of seasoned collection specialists and the Bank seeks to make arrangements to resolve any delinquent or default situation over the shortest possible time frame. As a general rule, loans more than 90 days past due with respect to principal or interest are classified as nonaccrual loans. As permitted by banking regulations, certain consumer loans 90 days or more past due may continue to accrue interest. The Company also may use discretion regarding other loans over 90 days delinquent if the loan is well secured and in process of collection. Set forth is information regarding the Company's nonaccrual, delinquent, TDRs, and impaired loans at the period shown.

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The following table shows nonaccrual loans at the dates indicated:

|                            | March 31, 2014         | December 31, 2013 |
|----------------------------|------------------------|-------------------|
|                            | (Dollars in thousands) |                   |
| Commercial and industrial  | \$3,299                | \$4,178           |
| Commercial real estate     | 13,870                 | 11,734            |
| Commercial construction    | 100                    | 100               |
| Small business             | 788                    | 633               |
| Residential real estate    | 10,632                 | 10,329            |
| Home equity                | 7,062                  | 7,068             |
| Other consumer             | 28                     | 92                |
| Total nonaccrual loans (1) | \$35,779               | \$34,134          |

(1) Included in these amounts were \$7.0 million and \$7.5 million of nonaccruing TDRs at March 31, 2014 and December 31, 2013, respectively.

The following table shows the age analysis of past due financing receivables as of the dates indicated:

| Loan Portfolio            | March 31, 2014         |                   |                 |                   |                 |                   |                 |                   |             |                             |                                           |  |
|---------------------------|------------------------|-------------------|-----------------|-------------------|-----------------|-------------------|-----------------|-------------------|-------------|-----------------------------|-------------------------------------------|--|
|                           | 30-59 days             |                   | 60-89 days      |                   | 90 days or more |                   | Total Past Due  |                   | Current     | Total Financing Receivables | Recorded Investment >90 Days and Accruing |  |
|                           | Number of Loans        | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance |             |                             |                                           |  |
|                           | (Dollars in thousands) |                   |                 |                   |                 |                   |                 |                   |             |                             |                                           |  |
| Commercial and industrial | 18                     | \$1,491           | 9               | \$1,460           | 19              | \$3,021           | 46              | \$5,972           | \$816,537   | \$822,509                   | \$ —                                      |  |
| Commercial real estate    | 18                     | 5,144             | 8               | 3,917             | 19              | 9,230             | 45              | 18,291            | 2,264,648   | 2,282,939                   | —                                         |  |
| Commercial construction   | —                      | —                 | —               | —                 | 1               | 100               | 1               | 100               | 239,436     | 239,536                     | —                                         |  |
| Small business            | 11                     | 276               | —               | —                 | 16              | 354               | 27              | 630               | 77,517      | 78,147                      | —                                         |  |
| Residential real estate   | 20                     | 2,760             | 9               | 1,737             | 39              | 6,293             | 68              | 10,790            | 527,836     | 538,626                     | 368                                       |  |
| Home equity               | 19                     | 1,604             | 6               | 278               | 27              | 2,749             | 52              | 4,631             | 822,654     | 827,285                     | —                                         |  |
| Other consumer            | 89                     | 476               | 17              | 32                | 16              | 49                | 122             | 557               | 17,670      | 18,227                      | 24                                        |  |
| Total                     | 175                    | \$11,751          | 49              | \$7,424           | 137             | \$21,796          | 361             | \$40,971          | \$4,766,298 | \$4,807,269                 | \$ 392                                    |  |
| Loan Portfolio            | December 31, 2013      |                   |                 |                   |                 |                   |                 |                   |             |                             |                                           |  |
|                           | 30-59 days             |                   | 60-89 days      |                   | 90 days or more |                   | Total Past Due  |                   | Current     | Total Financing Receivables | Recorded Investment >90 Days and Accruing |  |
|                           | Number of Loans        | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance |             |                             |                                           |  |
|                           | (Dollars in thousands) |                   |                 |                   |                 |                   |                 |                   |             |                             |                                           |  |
| Commercial and industrial | 9                      | \$743             | 6               | \$327             | 20              | \$3,763           | 35              | \$4,833           | \$779,369   | \$784,202                   | \$ —                                      |  |

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|                         |     |          |    |         |     |          |     |          |             |             |        |
|-------------------------|-----|----------|----|---------|-----|----------|-----|----------|-------------|-------------|--------|
| Commercial real estate  | 21  | 8,643    | 2  | 356     | 30  | 8,155    | 53  | 17,154   | 2,232,106   | 2,249,260   | —      |
| Commercial construction | 1   | 847      | —  | —       | 1   | 100      | 2   | 947      | 222,912     | 223,859     | —      |
| Small business          | 18  | 353      | 6  | 227     | 14  | 247      | 38  | 827      | 76,413      | 77,240      | —      |
| Residential real estate | 23  | 2,903    | 8  | 1,630   | 39  | 6,648    | 70  | 11,181   | 530,262     | 541,443     | 462    |
| Home equity             | 27  | 1,922    | 8  | 852     | 23  | 2,055    | 58  | 4,829    | 817,312     | 822,141     | —      |
| Other consumer          | 110 | 514      | 30 | 106     | 34  | 148      | 174 | 768      | 19,394      | 20,162      | 63     |
| Total                   | 209 | \$15,925 | 60 | \$3,498 | 161 | \$21,116 | 430 | \$40,539 | \$4,677,768 | \$4,718,307 | \$ 525 |

In the course of resolving nonperforming loans, the Bank may choose to restructure the contractual terms of certain loans. The Bank attempts to work out an alternative payment schedule with the borrower in order to avoid foreclosure actions. Any

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loans that are modified are reviewed by the Bank to identify if a TDR has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two.

The following table shows the Company's total TDRs and other pertinent information as of the dates indicated:

|                                                                                             | March 31, 2014         | December 31, 2013 |
|---------------------------------------------------------------------------------------------|------------------------|-------------------|
|                                                                                             | (Dollars in thousands) |                   |
| TDRs on accrual status                                                                      | \$40,329               | \$38,410          |
| TDRs on nonaccrual                                                                          | 6,998                  | 7,454             |
| Total TDRs                                                                                  | \$47,327               | \$45,864          |
| Amount of specific reserves included in the allowance for loan losses associated with TDRs: | \$2,044                | \$2,474           |
| Additional commitments to lend to a borrower who has been a party to a TDR:                 | \$2,071                | \$1,877           |

The Bank's policy is to have any restructured loan which is on nonaccrual status prior to being modified remain on nonaccrual status for six months, subsequent to being modified, before management considers its return to accrual status. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. Additionally, loans classified as TDRs are adjusted to reflect the changes in value of the recorded investment in the loan, if any, resulting from the granting of a concession. For all residential loan modifications, the borrower must perform during a 90 day trial period before the modification is finalized.

The following table shows the modifications which occurred during the periods indicated and the change in the recorded investment subsequent to the modifications occurring:

|                              | Three Months Ended<br>March 31, 2014 |                                            |                                                 |
|------------------------------|--------------------------------------|--------------------------------------------|-------------------------------------------------|
|                              | Number of<br>Contracts               | Pre-Modification<br>Recorded<br>Investment | Post-Modification<br>Recorded<br>Investment (1) |
|                              | (Dollars in thousands)               |                                            |                                                 |
| Troubled debt restructurings |                                      |                                            |                                                 |
| Commercial & industrial      | 9                                    | \$ 424                                     | \$ 424                                          |
| Commercial real estate       | 6                                    | 1,883                                      | 1,883                                           |
| Small business               | 1                                    | 58                                         | 58                                              |
| Residential real estate      | 2                                    | 513                                        | 542                                             |
| Other consumer               | 1                                    | 8                                          | 8                                               |
| Total                        | 19                                   | \$ 2,886                                   | \$ 2,915                                        |

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|                              | Three Months Ended<br>March 31, 2013 |                                                           |                                                                |
|------------------------------|--------------------------------------|-----------------------------------------------------------|----------------------------------------------------------------|
|                              | Number of<br>Contracts               | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment (1) |
|                              |                                      | (Dollars in thousands)                                    |                                                                |
| Troubled debt restructurings |                                      |                                                           |                                                                |
| Small business               | 4                                    | \$ 268                                                    | \$ 268                                                         |
| Residential real estate      | 4                                    | 1,156                                                     | 1,182                                                          |
| Home equity                  | 2                                    | 165                                                       | 165                                                            |
| Other consumer               | 2                                    | 11                                                        | 11                                                             |
| Total                        | 12                                   | \$ 1,600                                                  | \$ 1,626                                                       |

(1) The post-modification balances represent the balance of the loan on the date of modifications. These amounts may show an increase when modifications include a capitalization of interest.

The following table shows the Company's post-modification balance of TDRs listed by type of modification as of the periods indicated:

|                             | Three Months Ended<br>March 31 |         |
|-----------------------------|--------------------------------|---------|
|                             | 2014                           | 2013    |
|                             | (Dollars in thousands)         |         |
| Extended maturity           | \$835                          | \$268   |
| Adjusted interest rate      | 728                            | —       |
| Combination rate & maturity | 1,344                          | 1,347   |
| Court ordered concession    | 8                              | 11      |
| Total                       | \$2,915                        | \$1,626 |

The following table shows the loans that have been modified during the past twelve months which have subsequently defaulted during the periods indicated. The Company considers a loan to have defaulted when it reaches 90 days past due.

|                                                          | Three Months Ended March 31 |                        |                        |                        |
|----------------------------------------------------------|-----------------------------|------------------------|------------------------|------------------------|
|                                                          | 2014                        |                        | 2013                   |                        |
|                                                          | Number<br>of Contracts      | Recorded<br>Investment | Number<br>of Contracts | Recorded<br>Investment |
| (Dollars in thousands)                                   |                             |                        |                        |                        |
| Troubled debt restructurings that subsequently defaulted |                             |                        |                        |                        |
| Commercial & industrial                                  | 2                           | \$52                   | 2                      | \$201                  |
| Commercial real estate                                   | 1                           | 176                    | 2                      | 494                    |
| Residential real estate                                  | 1                           | 327                    | —                      | —                      |
| Total                                                    | 4                           | \$555                  | 4                      | \$695                  |

All TDR loans are considered impaired and therefore are subject to a specific review for impairment. The impairment analysis appropriately discounts the present value of the anticipated cash flows by the loan's contractual rate of interest in effect prior to the loan's modification. The amount of impairment, if any, is recorded as a specific loss allocation to each individual loan in the allowance for loan losses. Commercial loans (commercial and industrial, commercial construction, commercial real estate and small business loans), residential loans, and home equity loans that have been classified as TDRs and which subsequently default are reviewed to determine if the loan should be deemed collateral dependent. In such an instance, any shortfall between the value of the collateral and the carrying value of the loan is determined by measuring the recorded investment in the loan against the fair value of the collateral less estimated

costs to sell. The Bank charges off the amount of any confirmed loan loss in the period when the loans, or portion of loans, are deemed uncollectible. Smaller balance consumer TDR loans are reviewed for performance to determine when a charge-off is appropriate.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

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Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

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The tables below set forth information regarding the Company's impaired loans by loan portfolio at the dates indicated:

|                                    | March 31, 2014         |                                |                      |
|------------------------------------|------------------------|--------------------------------|----------------------|
|                                    | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
|                                    | (Dollars in thousands) |                                |                      |
| With no related allowance recorded |                        |                                |                      |
| Commercial & industrial            | \$5,064                | \$5,615                        | \$—                  |
| Commercial real estate             | 21,227                 | 22,908                         | —                    |
| Commercial construction            | 100                    | 408                            | —                    |
| Small business                     | 1,401                  | 1,603                          | —                    |
| Residential real estate            | 2,930                  | 3,095                          | —                    |
| Home equity                        | 4,514                  | 4,580                          | —                    |
| Other consumer                     | 402                    | 408                            | —                    |
| Subtotal                           | 35,638                 | 38,617                         | —                    |
| With an allowance recorded         |                        |                                |                      |
| Commercial & industrial            | \$3,490                | \$3,545                        | \$647                |
| Commercial real estate             | 15,849                 | 16,889                         | 369                  |
| Small business                     | 451                    | 566                            | 109                  |
| Residential real estate            | 13,672                 | 14,717                         | 1,641                |
| Home equity                        | 619                    | 690                            | 114                  |
| Other consumer                     | 784                    | 786                            | 62                   |
| Subtotal                           | 34,865                 | 37,193                         | 2,942                |
| Total                              | \$70,503               | \$75,810                       | \$2,942              |

|                                    | December 31, 2013      |                                |                      |
|------------------------------------|------------------------|--------------------------------|----------------------|
|                                    | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
|                                    | (Dollars in thousands) |                                |                      |
| With no related allowance recorded |                        |                                |                      |
| Commercial & industrial            | \$7,147                | \$7,288                        | \$—                  |
| Commercial real estate             | 14,283                 | 15,891                         | —                    |
| Commercial construction            | 100                    | 408                            | —                    |
| Small business                     | 1,474                  | 1,805                          | —                    |
| Residential real estate            | 1,972                  | 2,026                          | —                    |
| Home equity                        | 4,263                  | 4,322                          | —                    |
| Other consumer                     | 446                    | 446                            | —                    |
| Subtotal                           | 29,685                 | 32,186                         | —                    |
| With an allowance recorded         |                        |                                |                      |
| Commercial & industrial            | \$2,001                | \$2,045                        | \$1,150              |
| Commercial real estate             | 25,233                 | 25,377                         | 765                  |
| Small business                     | 429                    | 462                            | 109                  |
| Residential real estate            | 13,228                 | 14,197                         | 1,564                |
| Home equity                        | 627                    | 694                            | 116                  |
| Other consumer                     | 852                    | 856                            | 70                   |
| Subtotal                           | 42,370                 | 43,631                         | 3,774                |
| Total                              | \$72,055               | \$75,817                       | \$3,774              |

The following tables set forth information regarding interest income recognized on impaired loans, by portfolio, for the periods indicated:



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|                                    | Three Months Ended<br>March 31, 2014 |                                  |
|------------------------------------|--------------------------------------|----------------------------------|
|                                    | Average<br>Recorded<br>Investment    | Interest<br>Income<br>Recognized |
|                                    | (Dollars in thousands)               |                                  |
| With no related allowance recorded |                                      |                                  |
| Commercial & industrial            | \$5,409                              | \$68                             |
| Commercial real estate             | 21,522                               | 333                              |
| Commercial construction            | 100                                  | 3                                |
| Small business                     | 1,456                                | 24                               |
| Residential real estate            | 2,938                                | 28                               |
| Home equity                        | 4,529                                | 52                               |
| Other consumer                     | 413                                  | 8                                |
| Subtotal                           | 36,367                               | 516                              |
| With an allowance recorded         |                                      |                                  |
| Commercial & industrial            | \$3,516                              | \$39                             |
| Commercial real estate             | 16,640                               | 207                              |
| Small business                     | 460                                  | 8                                |
| Residential real estate            | 13,679                               | 132                              |
| Home equity                        | 623                                  | 7                                |
| Other consumer                     | 800                                  | 7                                |
| Subtotal                           | 35,718                               | 400                              |
| Total                              | \$72,085                             | \$916                            |
|                                    | Three Months Ended<br>March 31, 2013 |                                  |
|                                    | Average<br>Recorded<br>Investment    | Interest<br>Income<br>Recognized |
|                                    | (Dollars in thousands)               |                                  |
| With no related allowance recorded |                                      |                                  |
| Commercial & industrial            | \$5,111                              | \$73                             |
| Commercial real estate             | 13,945                               | 222                              |
| Commercial construction            | 1,609                                | 13                               |
| Small business                     | 1,241                                | 20                               |
| Residential real estate            | 2,532                                | 23                               |
| Home equity                        | 4,019                                | 46                               |
| Other consumer                     | 670                                  | 13                               |
| Subtotal                           | 29,127                               | 410                              |
| With an allowance recorded         |                                      |                                  |
| Commercial & industrial            | \$2,760                              | \$40                             |
| Commercial real estate             | 17,381                               | 268                              |
| Small business                     | 891                                  | 13                               |
| Residential real estate            | 13,930                               | 135                              |
| Home equity                        | 441                                  | 6                                |
| Other consumer                     | 1,283                                | 12                               |
| Subtotal                           | 36,686                               | 474                              |
| Total                              | \$65,813                             | \$884                            |



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Certain loans acquired by the Company may have shown evidence of deterioration of credit quality since origination and it was therefore deemed unlikely that the Bank would be able to collect all contractually required payments. As such, these loans were deemed to be Purchase Credit Impaired (“PCI”) loans and the carrying value and prospective income recognition are predicated upon future cash flows expected to be collected. The following table displays certain information pertaining to purchased credit impaired loans at the dates indicated:

|                     | March 31, 2014         | December 31, 2013 |
|---------------------|------------------------|-------------------|
|                     | (Dollars in thousands) |                   |
| Outstanding balance | \$33,168               | \$33,555          |
| Carrying amount     | \$29,131               | \$29,544          |

The following table summarizes activity in the accretable yield for the PCI loan portfolio:

|                                                                                       | (Dollars in thousands) |   |
|---------------------------------------------------------------------------------------|------------------------|---|
| Balance at January 1, 2013                                                            | \$2,464                |   |
| Acquisition                                                                           | 386                    |   |
| Accretion                                                                             | (1,812)                | ) |
| Other change in expected cash flows (2)                                               | 1,142                  |   |
| Reclassification from nonaccretable difference for loans with improved cash flows (1) | 334                    |   |
| Balance at December 31, 2013                                                          | 2,514                  |   |
| Balance at January 1, 2014                                                            | \$2,514                |   |
| Accretion                                                                             | (377)                  | ) |
| Other change in expected cash flows (2)                                               | 541                    |   |
| Reclassification from nonaccretable difference for loans with improved cash flows (1) | —                      |   |
| Balance at March 31, 2014                                                             | \$2,678                |   |

(1) Results in increased interest income during the period in which the loan paid off.

(2) Represents changes in cash flows expected to be collected and resulting in increased interest income as a prospective yield adjustment over the remaining life of the loan(s).

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## NOTE 5 – EARNINGS PER SHARE

Earnings per share consisted of the following components for the periods indicated:

|                              | Three Months Ended<br>March 31                |            |
|------------------------------|-----------------------------------------------|------------|
|                              | 2014                                          | 2013       |
|                              | (Dollars in thousands, except per share data) |            |
| Net income                   | \$ 13,383                                     | \$ 12,252  |
| Weighted Average Shares      |                                               |            |
| Basic shares                 | 23,819,065                                    | 22,823,753 |
| Effect of diluted securities | 100,173                                       | 46,040     |
| Dilutive shares              | 23,919,238                                    | 22,869,793 |
| Net income per share         |                                               |            |
| Basic EPS                    | \$0.56                                        | \$0.54     |
| Effect of diluted securities | —                                             | —          |
| Dilutive EPS                 | \$0.56                                        | \$0.54     |

The following table illustrates the options to purchase common stock and the shares of performance-based restricted stock that were excluded from the calculation of diluted earnings per share because they were anti-dilutive:

|                                    | Three Months Ended<br>March 31 |         |
|------------------------------------|--------------------------------|---------|
|                                    | 2014                           | 2013    |
| Stock options                      | —                              | 268,400 |
| Performance-based restricted stock | 1,242                          | —       |

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## NOTE 6 – STOCK BASED COMPENSATION

## Time Vested Restricted Stock Awards

During 2014, the Company made the following awards of restricted stock:

| Date      | Shares Granted | Plan                     | Grant Date<br>Fair Value | Vesting Period                       |
|-----------|----------------|--------------------------|--------------------------|--------------------------------------|
| 3/20/2014 | 65,950         | 2005 Employee Stock Plan | \$39.82                  | Ratably over 5 years from grant date |
| 3/31/2014 | 3,000          | 2005 Employee Stock Plan | \$39.00                  | Ratably over 3 years from grant date |

The fair value of the restricted stock awards is based upon the average of the high and low price at which the Company's common stock traded on the date of grant. The holders of restricted stock awards participate fully in the rewards of stock ownership of the Company, including voting and dividend rights.

## Performance-Based Restricted Stock Awards

On March 20, 2014, the Company granted 20,700 performance-based restricted stock awards to certain executive level employees. These performance-based restricted stock awards were issued from the 2005 Employee Stock Plan and were determined to have a grant date fair value per share of \$39.82. The number of shares to be vested will be contingent upon the Company's attainment of certain performance measures outlined in the award agreement and will be measured as of the end of the three year performance period, or March 20, 2017. These awards will be accounted for as equity awards due to the nature of these awards and the fact that these shares will not be settled in cash.

The fair value of the performance-based restricted stock awards is based upon the average of the high and low price at which the Company's common stock traded on the date of grant. The holders of these awards are not entitled to receive dividends on or vote shares of performance-based restricted shares until vested.

## Stock Options

The Company has not issued any awards of options to purchase shares of common stock during 2014.

## NOTE 7 – DERIVATIVE AND HEDGING ACTIVITIES

The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally to manage the Company's interest rate risk. Additionally, the Company enters into interest rate derivatives and foreign exchange contracts to accommodate the business requirements of its customers ("customer related positions"). The Company minimizes the market and liquidity risks of customer related positions by entering into similar offsetting positions with broker-dealers. Derivative instruments are carried at fair value in the Company's financial statements. The accounting for changes in the fair value of a derivative instrument is dependent upon whether or not it qualifies as a hedge for accounting purposes, and further, by the type of hedging relationship.

The Company does not enter into proprietary trading positions for any derivatives.

## Interest Rate Positions

The Company currently utilizes interest rate swap agreements as hedging instruments against interest rate risk associated with the Company's borrowings. An interest rate swap is an agreement whereby one party agrees to pay a floating rate of interest on a notional principal amount in exchange for receiving a fixed rate of interest on the same notional amount, for a predetermined period of time, from a second party. The amounts relating to the notional principal amount are not actually exchanged. The maximum length of time over which the Company is currently hedging its exposure to the variability in future cash flows for forecasted transactions related to the payment of variable interest on existing financial instruments is five years.



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The following table reflects the Company's derivative positions for the periods indicated below for interest rate swaps which qualify as cash flow hedges for accounting purposes:

## March 31, 2014

| Notional Amount        | Trade Date | Effective Date | Maturity Date | Receive (Variable) Index | Current Rate Received | Pay Fixed Swap Rate | Fair Value   |
|------------------------|------------|----------------|---------------|--------------------------|-----------------------|---------------------|--------------|
| (Dollars in thousands) |            |                |               |                          |                       |                     |              |
| \$25,000               | 16-Feb-06  | 28-Dec-06      | 28-Dec-16     | 3 Month LIBOR            | 0.23                  | % 5.04              | % \$(2,894 ) |
| 25,000                 | 16-Feb-06  | 28-Dec-06      | 28-Dec-16     | 3 Month LIBOR            | 0.23                  | % 5.04              | % (2,895 )   |
| 25,000                 | 9-Dec-08   | 10-Dec-08      | 10-Dec-18     | 3 Month LIBOR            | 0.24                  | % 2.94              | % (1,485 )   |
| 50,000                 | 17-Nov-09  | 20-Dec-10      | 20-Dec-14     | 3 Month LIBOR            | 0.23                  | % 3.04              | % (1,019 )   |
| 25,000                 | 5-May-11   | 10-Jun-11      | 10-Jun-15     | 3 Month LIBOR            | 0.24                  | % 1.71              | % (427 )     |
| \$150,000              |            |                |               |                          |                       |                     | \$(8,720 )   |

## December 31, 2013

| Notional Amount        | Trade Date | Effective Date | Maturity Date | Receive (Variable) Index | Current Rate Received | Pay Fixed Swap Rate | Fair Value   |
|------------------------|------------|----------------|---------------|--------------------------|-----------------------|---------------------|--------------|
| (Dollars in thousands) |            |                |               |                          |                       |                     |              |
| \$25,000               | 16-Feb-06  | 28-Dec-06      | 28-Dec-16     | 3 Month LIBOR            | 0.24                  | % 5.04              | % \$(3,151 ) |
| 25,000                 | 16-Feb-06  | 28-Dec-06      | 28-Dec-16     | 3 Month LIBOR            | 0.24                  | % 5.04              | % (3,152 )   |
| 25,000                 | 9-Dec-08   | 10-Dec-08      | 10-Dec-18     | 3 Month LIBOR            | 0.24                  | % 2.94              | % (1,493 )   |
| 50,000                 | 17-Nov-09  | 20-Dec-10      | 20-Dec-14     | 3 Month LIBOR            | 0.25                  | % 3.04              | % (1,341 )   |
| 25,000                 | 5-May-11   | 10-Jun-11      | 10-Jun-15     | 3 Month LIBOR            | 0.24                  | % 1.71              | % (493 )     |
| \$150,000              |            |                |               |                          |                       |                     | \$(9,630 )   |

For derivative instruments that are designated and qualify as cash flow hedging instruments, the effective portion of the gains or losses is reported as a component of OCI, and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Company expects approximately \$4.2 million (pre-tax) to be reclassified to interest expense from OCI related to the Company's cash flow hedges in the next twelve months. This reclassification is due to anticipated payments that will be made and/or received on the swaps based upon the forward curve as of March 31, 2014.

The Company recognized \$61,000 of net amortization income that was an offset to interest expense related to previously terminated swaps for the periods ended March 31, 2014 and 2013.

The Company had no fair value hedges as of March 31, 2014 or December 31, 2013.

## Customer Related Positions

Interest rate derivatives, primarily interest rate swaps, offered to commercial borrowers through the Bank's loan level derivative program do not qualify as hedges for accounting purposes. The Bank believes that its exposure to commercial customer derivatives is limited because these contracts are simultaneously matched at inception with an offsetting dealer transaction. The commercial customer derivative program allows the Bank to retain variable-rate commercial loans while allowing the customer to synthetically fix the loan rate by entering into a variable-to-fixed interest rate swap.

Foreign exchange contracts offered to commercial borrowers through the Bank's derivative program do not qualify as hedges for accounting purposes. The Bank acts as a seller and buyer of foreign exchange contracts to accommodate its customers. To mitigate the market and liquidity risk associated with these derivatives, the Bank enters into similar offsetting positions.

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The following table reflects the Company's customer related derivative positions for the periods indicated below for those derivatives not designated as hedging:

|                                          |               | Notional Amount Maturing |        |        |        |            |           |             |
|------------------------------------------|---------------|--------------------------|--------|--------|--------|------------|-----------|-------------|
|                                          | Number of     | Less than                | Less   | Less   | Less   | Thereafter | Total     | Fair Value  |
|                                          | Positions (1) | 1 year                   | than 2 | than 3 | than 4 |            |           |             |
|                                          |               |                          | years  | years  | years  |            |           |             |
| March 31, 2014                           |               |                          |        |        |        |            |           |             |
| (Dollars in thousands)                   |               |                          |        |        |        |            |           |             |
| Loan level swaps                         |               |                          |        |        |        |            |           |             |
| Receive fixed, pay variable              | 172           | \$54,500                 | 93,550 | 44,183 | 42,593 | 356,467    | \$591,293 | \$11,802    |
| Pay fixed, receive variable              | 166           | \$54,500                 | 93,550 | 44,183 | 42,593 | 356,467    | \$591,293 | \$(11,823 ) |
| Foreign exchange contracts               |               |                          |        |        |        |            |           |             |
| Buys foreign currency, sells US currency | 12            | \$35,584                 | —      | —      | —      | —          | \$35,584  | \$479       |
| Buys US currency, sells foreign currency | 12            | \$35,584                 | —      | —      | —      | —          | \$35,584  | \$(463 )    |
| December 31, 2013                        |               |                          |        |        |        |            |           |             |
| (Dollars in thousands)                   |               |                          |        |        |        |            |           |             |
| Loan level swaps                         |               |                          |        |        |        |            |           |             |
| Receive fixed, pay variable              | 168           | \$48,882                 | 97,975 | 42,957 | 42,116 | 329,554    | \$561,484 | \$9,484     |
| Pay fixed, receive variable              | 162           | \$48,882                 | 97,975 | 42,957 | 42,116 | 329,554    | \$561,484 | \$(9,523 )  |
| Foreign exchange contracts               |               |                          |        |        |        |            |           |             |
| Buys foreign currency, sells US currency | 6             | \$11,367                 | —      | —      | —      | —          | \$11,367  | \$396       |
| Buys US currency, sells foreign currency | 6             | \$11,367                 | —      | —      | —      | —          | \$11,367  | \$(390 )    |

(1) The Company may enter into one swap agreement which offsets multiple reverse swap agreements. The positions will offset and the terms will be identical.

**Mortgage Derivatives**

Prior to closing and funding certain one-to-four family residential mortgage loans, an interest rate lock commitment is generally extended to the borrower. During the period from commitment date to closing date, the Company is subject to the risk that market rates of interest may change. If market rates rise, investors generally will pay less to purchase such loans resulting in a reduction in the gain on sale of the loans or, possibly, a loss. In an effort to mitigate such risk, forward delivery sales commitments are executed, under which the Company agrees to deliver whole mortgage loans to various investors. In addition, the Company may also enter into additional Forward To Be Announced ("TBA") mortgage contracts, also considered derivative instruments, which are purchased by the Company from a diversified list of counterparties in order to hedge customer rate locks. These forward contracts carry a market price that has a strong inverse relationship to that of mortgage prices. When the Company locks a rate to the customer, the rate can be held for the benefit of the customer for a certain period of time until the mortgage is sold. During that time, the Company may not have agreed on a price with a mortgage investor and fluctuations in market conditions may cause the mortgage to lose market value. Within a short period after the rate is locked with the customer, the Company may,

depending upon the effectiveness of existing hedges, execute a Forward TBA trade with a counterparty to hedge that market risk. Certain assumptions, including pull through rates and rate lock periods, are used in managing the existing and future hedges. The effectiveness of the hedges rely on the accuracy of these assumptions.

The change in fair value on the interest rate lock commitments, forward delivery sale commitments, and forward TBA mortgage contracts are recorded in current period earnings as a component of mortgage banking income. In addition, the Company has elected the fair value option to carry loans held for sale at fair value. The change in fair value of loans held for sale is recorded in current period earnings as a component of mortgage banking income in accordance with the Company's fair value election.

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The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet at the periods indicated:

|                                      | Asset Derivatives      |                              |                                 | Liability Derivatives  |                              |                                 |
|--------------------------------------|------------------------|------------------------------|---------------------------------|------------------------|------------------------------|---------------------------------|
|                                      | Balance Sheet Location | Fair Value at March 31, 2014 | Fair Value at December 31, 2013 | Balance Sheet Location | Fair Value at March 31, 2014 | Fair Value at December 31, 2013 |
| (Dollars in thousands)               |                        |                              |                                 |                        |                              |                                 |
| Derivatives designated as hedges     |                        |                              |                                 |                        |                              |                                 |
| Interest rate swaps                  | Other assets           | \$—                          | \$ —                            | Other liabilities      | \$8,720                      | \$ 9,630                        |
| Derivatives not designated as hedges |                        |                              |                                 |                        |                              |                                 |
| Customer Related Positions:          |                        |                              |                                 |                        |                              |                                 |
| Loan level swaps                     | Other assets           | \$15,958                     | \$ 16,301                       | Other liabilities      | \$15,979                     | \$ 16,340                       |
| Foreign exchange contracts           | Other assets           | 479                          | 396                             | Other liabilities      | 463                          | 390                             |
| Mortgage Derivatives:                |                        |                              |                                 |                        |                              |                                 |
| Interest rate lock commitments       | Other assets           | 262                          | 204                             | Other liabilities      | —                            | —                               |
| Forward TBA mortgage contracts       | Other assets           | 9                            | 64                              | Other liabilities      | —                            | —                               |
| Forward sales agreements             | Other assets           | —                            | —                               | Other liabilities      | 78                           | 35                              |
| Total                                |                        | \$16,708                     | \$ 16,965                       |                        | \$16,520                     | \$ 16,765                       |

The table below presents the effect of the Company's derivative financial instruments included in OCI and current earnings for the periods indicated:

|                                                                                                             | Three Months Ended March 31 |            |
|-------------------------------------------------------------------------------------------------------------|-----------------------------|------------|
|                                                                                                             | 2014                        | 2013       |
| (Dollars in thousands)                                                                                      |                             |            |
| Derivatives designated as hedges                                                                            |                             |            |
| Loss in OCI on derivatives (effective portion), net of tax                                                  | \$(177 )                    | \$(3 )     |
| Loss reclassified from OCI into interest expense (effective portion)                                        | \$(1,148 )                  | \$(1,414 ) |
| Loss recognized in income on derivatives (ineffective portion & amount excluded from effectiveness testing) |                             |            |
| Interest expense                                                                                            | \$—                         | \$—        |
| Other expense                                                                                               | —                           | —          |
| Total                                                                                                       | \$—                         | \$—        |
| Derivatives not designated as hedges                                                                        |                             |            |
| Changes in fair value of customer related positions                                                         |                             |            |
| Other income                                                                                                | \$29                        | \$12       |
| Other expense                                                                                               | (1 )                        | (25 )      |
| Changes in fair value of mortgage derivatives                                                               |                             |            |
| Mortgage banking income                                                                                     | (40 )                       | 140        |
| Total                                                                                                       | \$(12 )                     | \$127      |

By using derivatives, the Company is exposed to credit risk to the extent that counterparties to the derivative contracts do not perform as required. Should a counterparty fail to perform under the terms of a derivative contract, the Company's credit exposure on interest rate swaps is limited to the net positive fair value and accrued interest of all

swaps with each counterparty. The Company seeks to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, and obtaining collateral, where appropriate. Institutional counterparties must have an investment grade credit rating and be approved by the

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Company's Board of Directors. As such, management believes the risk of incurring credit losses on derivative contracts with those counterparties is remote and losses, if any, would be immaterial. The Company had \$2.1 million and \$3.4 million in exposure relating to institutional counterparties at March 31, 2014 and December 31, 2013, respectively. The Company's exposure relating to customer counterparties was approximately \$14.6 million and \$13.6 million at March 31, 2014 and December 31, 2013, respectively. Credit exposure may be reduced by the amount of collateral pledged by the counterparty.

**NOTE 8 – BALANCE SHEET OFFSETTING**

The Company does not offset fair value amounts recognized for derivative instruments or repurchase agreements. The Company does net the amount recognized for the right to reclaim cash collateral against the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement. Collateral legally required to be maintained at dealer banks by the Company is monitored and adjusted as necessary. At March 31, 2014, it was determined that no additional collateral would have to be posted to immediately settle these instruments.

The following tables present the Company's asset and liability derivative positions and the potential effect of netting arrangements on its financial position, as of the periods indicated:

|                                     |                                                                                   |                                                                            |                                                                          | Gross Amounts Not<br>Offset in the Statement<br>of Financial Position |                                     |               |
|-------------------------------------|-----------------------------------------------------------------------------------|----------------------------------------------------------------------------|--------------------------------------------------------------------------|-----------------------------------------------------------------------|-------------------------------------|---------------|
|                                     | Gross<br>Amounts<br>Recognized<br>in the<br>Statement of<br>Financial<br>Position | Gross<br>Amounts<br>Offset in the<br>Statement of<br>Financial<br>Position | Net Amounts<br>Presented in<br>the Statement<br>of Financial<br>Position | Financial<br>Instruments<br>(1)                                       | Collateral<br>Pledged<br>(Received) | Net<br>Amount |
|                                     | March 31, 2014<br>(Dollars in thousands)                                          |                                                                            |                                                                          |                                                                       |                                     |               |
| <b>Derivative Assets</b>            |                                                                                   |                                                                            |                                                                          |                                                                       |                                     |               |
| Interest rate swaps                 | \$—                                                                               | \$—                                                                        | \$—                                                                      | \$—                                                                   | \$—                                 | \$—           |
| Loan level swaps                    | 15,958                                                                            | —                                                                          | 15,958                                                                   | 2,078                                                                 | —                                   | 13,880        |
| Customer foreign exchange contracts | 479                                                                               | —                                                                          | 479                                                                      | —                                                                     | —                                   | 479           |
|                                     | \$ 16,437                                                                         | \$—                                                                        | \$ 16,437                                                                | \$ 2,078                                                              | \$—                                 | \$ 14,359     |
| <b>Derivative Liabilities</b>       |                                                                                   |                                                                            |                                                                          |                                                                       |                                     |               |
| Interest rate swaps                 | \$ 8,720                                                                          | \$—                                                                        | \$ 8,720                                                                 | \$—                                                                   | \$ 8,720                            | \$—           |
| Loan level swaps                    | 15,979                                                                            | —                                                                          | 15,979                                                                   | 2,078                                                                 | 11,823                              | 2,078         |
| Customer foreign exchange contracts | 463                                                                               | —                                                                          | 463                                                                      | —                                                                     | —                                   | 463           |
| <b>Repurchase agreements</b>        |                                                                                   |                                                                            |                                                                          |                                                                       |                                     |               |
| Customer repurchase agreements      | 128,485                                                                           | —                                                                          | 128,485                                                                  | —                                                                     | (128,485)                           | —             |
| Wholesale repurchase agreements     | 50,000                                                                            | —                                                                          | 50,000                                                                   | —                                                                     | (50,000)                            | —             |
|                                     | \$ 203,647                                                                        | \$—                                                                        | \$ 203,647                                                               | \$ 2,078                                                              | \$(157,942)                         | \$ 2,541      |

(1) Includes loan level swaps which are not subject to a master netting arrangement and thus are not offset in the statement of financial position.

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|                                     | Gross Amounts Not<br>Offset in the Statement<br>of Financial Position                                                            |                                                                            |                                                                          |                          |                                     |               |
|-------------------------------------|----------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|--------------------------------------------------------------------------|--------------------------|-------------------------------------|---------------|
|                                     | Gross<br>Amounts<br>Recognized<br>in the<br>Statement of<br>Financial<br>Position<br>December 31, 2013<br>(Dollars in thousands) | Gross<br>Amounts<br>Offset in the<br>Statement of<br>Financial<br>Position | Net Amounts<br>Presented in<br>the Statement<br>of Financial<br>Position | Financial<br>Instruments | Collateral<br>Pledged<br>(Received) | Net<br>Amount |
| <b>Derivative Assets</b>            |                                                                                                                                  |                                                                            |                                                                          |                          |                                     |               |
| Interest rate swaps                 | \$—                                                                                                                              | \$—                                                                        | \$—                                                                      | \$—                      | \$—                                 | \$—           |
| Loan level swaps                    | 16,301                                                                                                                           | —                                                                          | 16,301                                                                   | 2,823                    | —                                   | 13,478        |
| Customer foreign exchange contracts | 396                                                                                                                              | —                                                                          | 396                                                                      | —                        | —                                   | 396           |
|                                     | \$ 16,697                                                                                                                        | \$—                                                                        | \$ 16,697                                                                | \$ 2,823                 | \$—                                 | \$ 13,874     |
| <b>Derivative Liabilities</b>       |                                                                                                                                  |                                                                            |                                                                          |                          |                                     |               |
| Interest rate swaps                 | \$ 9,630                                                                                                                         | \$—                                                                        | \$ 9,630                                                                 | \$—                      | \$ 9,630                            | \$—           |
| Loan level swaps                    | 16,340                                                                                                                           | —                                                                          | 16,340                                                                   | 2,823                    | 10,108                              | 3,409         |
| Customer foreign exchange contracts | 390                                                                                                                              | —                                                                          | 390                                                                      | —                        | —                                   | 390           |
| Repurchase agreements               |                                                                                                                                  |                                                                            |                                                                          |                          |                                     |               |
| Customer repurchase agreements      | 149,288                                                                                                                          | —                                                                          | 149,288                                                                  | —                        | (149,288 )                          | —             |
| Wholesale repurchase agreements     | 50,000                                                                                                                           | —                                                                          | 50,000                                                                   | —                        | (50,000 )                           | —             |
|                                     | \$ 225,648                                                                                                                       | \$—                                                                        | \$ 225,648                                                               | \$ 2,823                 | \$ (179,550 )                       | \$ 3,799      |

The Company has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well capitalized institution, then the Company could be required to terminate any outstanding derivatives with the counterparty. All liability position interest rate swap and customer loan level swap counterparties have credit-risk contingent features as of the dates indicated in the table above. In addition, derivative instruments that contain credit-risk related contingent features that are in a net liability position require the Company to assign collateral as noted in the table above.

**NOTE 9 – FAIR VALUE MEASUREMENTS**

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level to another.

The Fair Value Measurements and Disclosures Topic of the FASB ASC defines fair value and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under the

Fair Value Measurements and Disclosures Topic of the FASB ASC are described below:

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

### Valuation Techniques

There have been no changes in the valuation techniques used during the current period.

### Securities:

#### U.S. Government Agency Securities

Fair value is estimated using either multi-dimensional spread tables or benchmarks. The inputs used include benchmark yields, reported trades, and broker/dealer quotes. These securities are classified as Level 2.

#### Agency Mortgage-Backed Securities

Fair value is estimated using either a matrix or benchmarks. The inputs used include benchmark yields, reported trades, broker/dealer quotes, and issuer spreads. These securities are categorized as Level 2.

#### Agency Collateralized Mortgage Obligations and Private Mortgage-Backed Securities

The valuation model for these securities is volatility-driven and ratings based, and uses multi-dimensional spread tables. The inputs used include benchmark yields, recent reported trades, new issue data, broker and dealer quotes, and collateral performance. If there is at least one significant model assumption or input that is not observable, these securities are categorized as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

#### State, County, and Municipal Securities

The fair value is estimated using a valuation matrix with inputs including bond interest rate tables, recent transaction, and yield relationships. These securities are categorized as Level 2.

#### Single and Pooled Issuer Trust Preferred Securities

The fair value of trust preferred securities, including pooled and single issuer preferred securities, is estimated using external pricing models, discounted cash flow methodologies or similar techniques. The inputs used in these valuations include benchmark yields, recent reported trades, new issue data, broker and dealer quotes and collateral performance. If there is at least one significant model assumption or input that is not observable, these securities are categorized as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

### Equity Securities

These equity securities and mutual funds are valued based on market quoted prices. These securities are categorized in Level 1 as they are actively traded and no valuation adjustments have been applied.

### Loans Held for Sale

The Company elects to account for new originations of loans held for sale at fair value, which is measured using quoted market prices when available. If quoted market prices are not available, comparable market values or discounted cash flow analysis may be utilized. These assets are typically categorized as Level 2.

### Derivative Instruments

#### Derivatives

The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The Company incorporates credit valuation adjustments to appropriately reflect nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings. Additionally, in conjunction with fair value measurement guidance, the Company has made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio. Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of March 31, 2014 and December 31,



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2013, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2.

**Mortgage Derivatives**

The fair value of the commitments and agreements are estimated using the anticipated market price based on pricing indications provided from syndicate banks. These commitments and agreements are categorized as Level 2.

**Impaired Loans**

Loans that are deemed to be impaired are valued based upon the lower of cost or fair value of the underlying collateral. The inputs used in the appraisals of the collateral are not always observable, and therefore the loans may be categorized as Level 3 within the fair value hierarchy; otherwise, they are classified as Level 2.

**Other Real Estate Owned**

The fair values are estimated based upon recent appraisal values of the property less costs to sell the property. Certain inputs used in appraisals are not always observable, and therefore Other Real Estate Owned ("OREO") may be categorized as Level 3 within the fair value hierarchy. When inputs in appraisals are observable, they are classified as Level 2.

**Goodwill and Other Intangible Assets**

Goodwill and identified intangible assets are subject to impairment testing. The Company conducts an annual impairment test of goodwill in the third quarter of each year, or more frequently if necessary, and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. To estimate the fair value of goodwill and, if necessary, other intangible assets the Company utilizes both a comparable analysis of relevant price multiples in recent market transactions and discounted cash flow analysis. Both valuation models require a significant degree of management judgment. In the event the fair value as determined by the valuation model is less than the carrying value, the intangibles may be impaired. If the impairment testing resulted in impairment, the Company would classify the impaired goodwill and other intangible assets subjected to nonrecurring fair value adjustments as Level 3.

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Assets and liabilities measured at fair value at the periods indicated were as follows:

|                                                                | Balance                | Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1) |  |           | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|----------------------------------------------------------------|------------------------|----------------------------------------------------------------------------------------------------------------|--|-----------|-----------------------------------------------|-------------------------------------------|
|                                                                | March 31, 2014         |                                                                                                                |  |           |                                               |                                           |
|                                                                | (Dollars in thousands) |                                                                                                                |  |           |                                               |                                           |
| Recurring fair value measurements                              |                        |                                                                                                                |  |           |                                               |                                           |
| Assets                                                         |                        |                                                                                                                |  |           |                                               |                                           |
| Securities available for sale                                  |                        |                                                                                                                |  |           |                                               |                                           |
| U.S. Government agency securities                              | \$40,924               | \$—                                                                                                            |  | \$40,924  |                                               | \$—                                       |
| Agency mortgage-backed securities                              | 226,765                | —                                                                                                              |  | 226,765   |                                               | —                                         |
| Agency collateralized mortgage obligations                     | 55,455                 | —                                                                                                              |  | 55,455    |                                               | —                                         |
| State, county, and municipal securities                        | 5,450                  | —                                                                                                              |  | 5,450     |                                               | —                                         |
| Single issuer trust preferred securities issued by banks       | 3,017                  | —                                                                                                              |  | 3,017     |                                               | —                                         |
| Pooled trust preferred securities issued by banks and insurers | 4,967                  | —                                                                                                              |  | —         |                                               | 4,967                                     |
| Equity securities                                              | 11,680                 | 11,680                                                                                                         |  | —         |                                               | —                                         |
| Loans held for sale                                            | 6,788                  | —                                                                                                              |  | 6,788     |                                               | —                                         |
| Derivative instruments                                         | 16,708                 | —                                                                                                              |  | 16,708    |                                               | —                                         |
| Liabilities                                                    |                        |                                                                                                                |  |           |                                               |                                           |
| Derivative instruments                                         | 25,240                 | —                                                                                                              |  | 25,240    |                                               | —                                         |
| Total recurring fair value measurements                        | \$346,514              | \$11,680                                                                                                       |  | \$329,867 |                                               | \$4,967                                   |
| Nonrecurring fair value measurements                           |                        |                                                                                                                |  |           |                                               |                                           |
| Assets                                                         |                        |                                                                                                                |  |           |                                               |                                           |
| Collateral dependent impaired loans                            | \$12,096               | \$—                                                                                                            |  | \$—       |                                               | \$12,096                                  |
| Other real estate owned                                        | 7,830                  | —                                                                                                              |  | —         |                                               | 7,830                                     |
| Total nonrecurring fair value measurements                     | \$19,926               | \$—                                                                                                            |  | \$—       |                                               | \$19,926                                  |

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December 31, 2013  
(Dollars in thousands)

## Recurring fair value measurements

## Assets

## Securities available for sale

|                                                                |           |          |           |         |
|----------------------------------------------------------------|-----------|----------|-----------|---------|
| U.S. government agency securities                              | \$40,449  | \$—      | \$40,449  | \$—     |
| Agency mortgage-backed securities                              | 234,591   | —        | 234,591   | —       |
| Agency collateralized mortgage obligations                     | 58,153    | —        | 58,153    | —       |
| State, county, and municipal securities                        | 5,412     | —        | 5,412     | —       |
| Single issuer trust preferred securities issued by banks       | 2,952     | —        | 2,952     | —       |
| Pooled trust preferred securities issued by banks and insurers | 3,841     | —        | —         | 3,841   |
| Equity securities                                              | 11,464    | 11,464   | —         | —       |
| Loans held for sale                                            | 8,882     | —        | 8,882     | —       |
| Derivative instruments                                         | 16,965    | —        | 16,965    | —       |
| Liabilities                                                    |           |          |           |         |
| Derivative instruments                                         | 26,395    | —        | 26,395    | —       |
| Total recurring fair value measurements                        | \$356,314 | \$11,464 | \$341,009 | \$3,841 |

## Nonrecurring fair value measurements

## Assets

|                                            |          |     |     |          |
|--------------------------------------------|----------|-----|-----|----------|
| Collateral dependent impaired loans        | \$10,328 | \$— | \$— | \$10,328 |
| Other real estate owned                    | 7,466    | —   | —   | 7,466    |
| Total nonrecurring fair value measurements | \$17,794 | \$— | \$— | \$17,794 |

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3). These instruments were valued using pricing models and discounted cash flow methodologies.

|                                          | Securities Available for Sale:    |                                    |         |
|------------------------------------------|-----------------------------------|------------------------------------|---------|
|                                          | Pooled Trust Preferred Securities | Private Mortgage-Backed Securities | Total   |
|                                          | (Dollars in thousands)            |                                    |         |
| Balance at January 1, 2014               | \$3,841                           | \$—                                | \$3,841 |
| Gains and (losses) (realized/unrealized) |                                   |                                    |         |
| Included in other comprehensive income   | 1,162                             | —                                  | 1,162   |
| Settlements                              | (36)                              | ) —                                | (36)    |
| Balance at March 31, 2014                | \$4,967                           | \$—                                | \$4,967 |
| Balance at January 1, 2013               | \$2,981                           | \$3,532                            | \$6,513 |
| Gains and (losses) (realized/unrealized) |                                   |                                    |         |
| Included in other comprehensive income   | 480                               | (38)                               | ) 442   |
| Settlements                              | (169)                             | ) (124)                            | ) (293) |
| Balance at March 31, 2013                | \$3,292                           | \$3,370                            | \$6,662 |

It is the Company's policy to recognize the transfers between levels of the fair value hierarchy as of the end of the reporting period. There were no transfers between the levels of the fair value hierarchy for any assets or liabilities measured at fair value on a recurring basis during the first quarter of 2014 or 2013.

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The following table sets forth certain unobservable inputs regarding the Company's investment in securities that are classified as Level 3 for the periods indicated:

|                                   | March 31,<br>2014 | December<br>31,<br>2013 |                        | March 31,<br>2014 | December<br>31,<br>2013 | March<br>31,<br>2014 | December<br>31,<br>2013 |
|-----------------------------------|-------------------|-------------------------|------------------------|-------------------|-------------------------|----------------------|-------------------------|
| Valuation Technique               | Fair Value        |                         | Unobservable<br>Inputs | Range             |                         | Weighted Average     |                         |
| (Dollars in Thousands)            |                   |                         |                        |                   |                         |                      |                         |
| Discounted cash flow methodology  |                   |                         |                        |                   |                         |                      |                         |
| Pooled trust preferred securities | \$4,967           | \$3,841                 | Cumulative prepayment  | 0% - 75%          | 0% - 76%                | 7.0%                 | 7.2%                    |
|                                   |                   |                         | Cumulative default     | 3% - 100%         | 3% - 100%               | 16.5%                | 18.1%                   |
|                                   |                   |                         | Loss given default     | 85% - 100%        | 85% - 100%              | 95.9%                | 95.7%                   |
|                                   |                   |                         | Cure given default     | 0% - 75%          | 0% - 75%                | 37.4%                | 39.9%                   |
| Appraisals of collateral (1)      |                   |                         |                        |                   |                         |                      |                         |
| Impaired loans                    | \$12,096          | \$10,328                |                        |                   |                         |                      |                         |
| Other real estate owned           | \$7,830           | \$7,466                 |                        |                   |                         |                      |                         |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable. Appraisals may be adjusted by management for qualitative factors such as economic factors and estimated liquidation expenses. The range of these possible adjustments may vary.

For the fair value measurements in the table above, which are classified as Level 3 within the fair value hierarchy, the Company's Treasury and Finance groups determine the valuation policies and procedures. For the pricing of the securities, the Company uses third-party pricing information, without adjustment. Depending on the type of the security, management employs various techniques to analyze the pricing it receives from third parties, such as analyzing changes in market yields and in certain instances reviewing the underlying collateral of the security. Management reviews changes in fair value from period to period and performs testing to ensure that prices received from the third parties are consistent with their expectation of the market. For the securities whose market is deemed to be inactive and which are categorized as Level 3, the fair value models are calibrated and significant inputs are back tested on a quarterly basis, to the extent possible. This testing is done by the third party service provider, who performs this testing by comparing anticipated inputs to actual results. Significant changes in fair value from period to period are closely scrutinized to ensure fair value models are not flawed. The driver(s) of the respective change in fair value and the method for forecasting the driver(s) is closely considered by management.

The significant unobservable inputs used in the fair value measurement of the Company's pooled trust preferred securities are cumulative prepayment rates, cumulative defaults, loss given defaults and cure given defaults. Significant increases (decreases) in deferrals or defaults, in isolation, would result in a significantly lower (higher) fair value measurement. Alternatively, significant increases (decreases) in cure rates, in isolation, would result in a significantly higher (lower) fair value measurement.

Additionally, the Company has financial instruments which are marked to fair value on a nonrecurring basis which are categorized within Level 3. These instruments include collateral dependent impaired loans and OREO. The determination of the fair value amount is derived from the use of independent third party appraisals and evaluations, prepared by firms from a predetermined list of qualified and approved appraisers or evaluators. Upon receipt of an appraisal or evaluation, the internal Commercial Real Estate Appraisal Department will review the report for compliance with regulatory and Bank standards, as well as reasonableness and acceptance of the value conclusions. Any issues or concerns regarding compliance or value conclusions will be addressed with the engaged firm and the

report may be adjusted or revised. If a disagreement cannot be resolved, the Commercial Real Estate Appraisal Department will either address the key issues and modify the report for acceptance or reject the report and re-order a new report. Ultimately the Company's Commercial Real Estate Appraisal Department will confirm the collateral value as part of its review process.

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The estimated fair values and related carrying amounts for assets and liabilities for which fair value is only disclosed are shown below as of the periods indicated:

|                                                                       | Carrying<br>Value                        | Fair<br>Value | Fair Value Measurements at Reporting Date Using<br>Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) |  |            | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-----------------------------------------------------------------------|------------------------------------------|---------------|----------------------------------------------------------------------------------------------------------------------------------|--|------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                                       | March 31, 2014<br>(Dollars in thousands) |               |                                                                                                                                  |  |            |                                                           |                                                    |
| Financial assets                                                      |                                          |               |                                                                                                                                  |  |            |                                                           |                                                    |
| Securities held to maturity (a)                                       |                                          |               |                                                                                                                                  |  |            |                                                           |                                                    |
| U.S. Treasury securities                                              | \$1,011                                  | \$1,053       | —                                                                                                                                |  | \$ 1,053   | —                                                         |                                                    |
| Agency mortgage-backed securities                                     | 175,069                                  | 177,336       | —                                                                                                                                |  | 177,336    | —                                                         |                                                    |
| Agency collateralized mortgage obligations                            | 192,293                                  | 188,704       | —                                                                                                                                |  | 188,704    | —                                                         |                                                    |
| State, county, and municipal securities                               | 678                                      | 689           | —                                                                                                                                |  | 689        | —                                                         |                                                    |
| Single issuer trust preferred securities issued<br>by banks           | 1,501                                    | 1,526         | —                                                                                                                                |  | 1,526      | —                                                         |                                                    |
| Corporate debt securities                                             | 5,004                                    | 5,219         | —                                                                                                                                |  | 5,219      | —                                                         |                                                    |
| Loans, net of allowance for loan losses (b)                           | 4,753,640                                | 4,738,582     | —                                                                                                                                |  | —          |                                                           | 4,738,582                                          |
| Financial liabilities                                                 |                                          |               |                                                                                                                                  |  |            |                                                           |                                                    |
| Time certificates of deposits (c)                                     | \$725,286                                | \$728,262     | —                                                                                                                                |  | \$ 728,262 | —                                                         |                                                    |
| Federal Home Loan Bank borrowings (c)                                 | 140,228                                  | 140,324       | —                                                                                                                                |  | 140,324    | —                                                         |                                                    |
| Customer repurchase agreements and other<br>short-term borrowings (c) | 128,485                                  | 128,485       | —                                                                                                                                |  | —          |                                                           | 128,485                                            |
| Wholesale repurchase agreements (c)                                   | 50,000                                   | 51,132        | —                                                                                                                                |  | —          |                                                           | 51,132                                             |
| Junior subordinated debentures (d)                                    | 73,852                                   | 70,895        | —                                                                                                                                |  | 70,895     | —                                                         |                                                    |
| Subordinated debentures (c)                                           | 30,000                                   | 28,482        | —                                                                                                                                |  | —          |                                                           | 28,482                                             |

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|                                                                    | Carrying Value                              | Fair Value | Fair Value Measurements at Reporting Date Using                |                                               |                                           |
|--------------------------------------------------------------------|---------------------------------------------|------------|----------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                                                    |                                             |            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|                                                                    | December 31, 2013<br>(Dollars in thousands) |            |                                                                |                                               |                                           |
| Financial assets                                                   |                                             |            |                                                                |                                               |                                           |
| Securities held to maturity (a)                                    |                                             |            |                                                                |                                               |                                           |
| U.S. Treasury securities                                           | \$ 1,011                                    | \$ 1,042   | \$ —                                                           | \$ 1,042                                      | \$ —                                      |
| Agency mortgage-backed securities                                  | 155,067                                     | 155,951    | —                                                              | 155,951                                       | —                                         |
| Agency collateralized mortgage obligations                         | 187,388                                     | 182,036    | —                                                              | 182,036                                       | —                                         |
| State, county, and municipal securities                            | 678                                         | 685        | —                                                              | 685                                           | —                                         |
| Single issuer trust preferred securities issued by banks           | 1,503                                       | 1,526      | —                                                              | 1,526                                         | —                                         |
| Corporate debt securities                                          | 5,005                                       | 5,215      | —                                                              | 5,215                                         | —                                         |
| Loans, net of allowance for loan losses (b)                        | 4,665,068                                   | 4,655,920  | —                                                              | —                                             | 4,655,920                                 |
| Financial liabilities                                              |                                             |            |                                                                |                                               |                                           |
| Time certificates of deposits (c)                                  | \$ 743,628                                  | \$ 746,908 | \$ —                                                           | \$ 746,908                                    | \$ —                                      |
| Federal Home Loan Bank borrowings (c)                              | 140,294                                     | 140,321    | —                                                              | 140,321                                       | —                                         |
| Customer repurchase agreements and other short-term borrowings (c) | 154,288                                     | 154,349    | —                                                              | —                                             | 154,349                                   |
| Wholesale repurchase agreements (c)                                | 50,000                                      | 51,298     | —                                                              | —                                             | 51,298                                    |
| Junior subordinated debentures (d)                                 | 73,906                                      | 67,481     | —                                                              | 67,481                                        | —                                         |
| Subordinated debentures (c)                                        | 30,000                                      | 28,396     | —                                                              | —                                             | 28,396                                    |

The fair values presented are based on quoted market prices, where available. If quoted market prices are not (a) available, fair values are based on quoted market prices of comparable instruments and/or discounted cash flow analyses.

(b) Fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities or cash flows.

(c) Fair value was determined by discounting anticipated future cash payments using rates currently available for instruments with similar remaining maturities.

(d) Fair value was determined based upon market prices of securities with similar terms and maturities.

This summary excludes financial assets and liabilities for which the carrying value approximates fair value. For financial assets, these include cash and due from banks, federal funds sold, short-term investments, Federal Home Loan Bank stock, and cash surrender value of life insurance policies. For financial liabilities, these include demand, savings, money market deposits, and federal funds purchased. The estimated fair value of demand, savings and money market deposits is the amount payable at the reporting date. These instruments would all be considered to be classified within Level 1 of the fair value hierarchy. Also excluded from the summary are financial instruments measured at fair value on a recurring and nonrecurring basis, as previously described.

The Company believes its financial instruments current use is considered to be the highest and best use of the instruments.

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## NOTE 10 – COMPREHENSIVE INCOME/LOSS

Information on the Company's comprehensive income (loss), presented net of taxes, is set forth below for the periods indicated:

|                                                                                                            | Three Months Ended March 31,<br>2014 |                             |                     |
|------------------------------------------------------------------------------------------------------------|--------------------------------------|-----------------------------|---------------------|
|                                                                                                            | Pre Tax<br>Amount                    | Tax<br>(Expense)<br>Benefit | After Tax<br>Amount |
|                                                                                                            | (Dollars in thousands)               |                             |                     |
| Change in fair value of securities available for sale                                                      | \$3,287                              | \$(1,316 )                  | \$1,971             |
| Less: net security gains reclassified into other noninterest income                                        | 91                                   | (37 )                       | 54                  |
| Net change in fair value of securities available for sale                                                  | 3,196                                | (1,279 )                    | 1,917               |
| Change in fair value of cash flow hedges (1)                                                               | (300 )                               | 123                         | (177 )              |
| Less: net cash flow hedge losses reclassified into interest on borrowings expense                          | (1,148 )                             | 469                         | (679 )              |
| Net change in fair value of cash flow hedges                                                               | 848                                  | (346 )                      | 502                 |
| Net loss during the period and amortization of certain costs included in net periodic retirement costs (2) | (66 )                                | 27                          | (39 )               |
| Total other comprehensive income                                                                           | \$3,978                              | \$(1,598 )                  | \$2,380             |

  

|                                                                                                            | Three Months Ended March 31,<br>2013 |                             |                     |
|------------------------------------------------------------------------------------------------------------|--------------------------------------|-----------------------------|---------------------|
|                                                                                                            | Pre Tax<br>Amount                    | Tax<br>(Expense)<br>Benefit | After Tax<br>Amount |
|                                                                                                            | (Dollars in thousands)               |                             |                     |
| Change in fair value of securities available for sale                                                      | \$(1,232 )                           | \$455                       | \$(777 )            |
| Less: net security losses reclassified into other noninterest income                                       | —                                    | —                           | —                   |
| Change in fair value of securities available for sale                                                      | (1,232 )                             | 455                         | (777 )              |
| Change in fair value of cash flow hedges (1)                                                               | (5 )                                 | 2                           | (3 )                |
| Less: net cash flow hedge losses reclassified into interest on borrowings expense                          | (1,414 )                             | 578                         | (836 )              |
| Net change in fair value of cash flow hedges                                                               | 1,409                                | (576 )                      | 833                 |
| Net gain during the period and amortization of certain costs included in net periodic retirement costs (2) | 22                                   | (21 )                       | 1                   |
| Total other comprehensive income                                                                           | \$199                                | \$(142 )                    | \$57                |

(1) The change in fair value of cash flow hedges includes the remaining balance of a realized but unrecognized gain, net of tax, from the termination of interest rate swaps in June 2009. The original gain of \$1.4 million, net of tax, is being recognized in earnings through December 2018, the original maturity date of the swap. The balance of this gain has amortized to \$678,000 and \$823,000 at March 31, 2014 and 2013, respectively.

(2) The amortization of prior service costs is included in the computation of net periodic pension cost as disclosed in the Employee Benefit Plans footnote in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission.

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Information on the Company's accumulated other comprehensive income (loss), net of tax is comprised of the following components as of the periods indicated:

|                                          | Unrealized<br>Gain (Loss)<br>on<br>Securities<br>2014 | Unrealized<br>Loss on<br>Cash Flow<br>Hedge<br>2014 | Deferred<br>Gain on<br>Hedge<br>Transactions<br>2014 | Defined<br>Benefit<br>Pension<br>Plans<br>2014 | Accumulated<br>Other<br>Comprehensive<br>Loss<br>2014 |
|------------------------------------------|-------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|------------------------------------------------|-------------------------------------------------------|
| (Dollars in thousands)                   |                                                       |                                                     |                                                      |                                                |                                                       |
| Beginning balance January 1, 2014        | \$ (2,023 )                                           | \$ (5,698 )                                         | \$ 715                                               | \$ (428 )                                      | \$ (7,434 )                                           |
| Net change in other comprehensive income | \$ 1,917                                              | \$ 539                                              | \$ (37 )                                             | \$ (39 )                                       | \$ 2,380                                              |
| Ending balance March 31, 2014            | (106 )                                                | (5,159 )                                            | 678                                                  | (467 )                                         | (5,054 )                                              |
| 2013                                     |                                                       |                                                     |                                                      |                                                |                                                       |
| Beginning balance January 1, 2013        | \$ 5,478                                              | \$ (9,577 )                                         | \$ 859                                               | \$ (1,286 )                                    | \$ (4,526 )                                           |
| Net change in other comprehensive income | \$ (777 )                                             | \$ 869                                              | \$ (36 )                                             | \$ 1                                           | \$ 57                                                 |
| Ending balance March 31, 2013            | 4,701                                                 | (8,708 )                                            | 823                                                  | (1,285 )                                       | (4,469 )                                              |

## NOTE 11 – COMMITMENTS AND CONTINGENCIES

### Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, the Company enters into various transactions to meet the financing needs of its customers, which, in accordance with generally accepted accounting principles are not included in its consolidated balance sheets. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of these commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Standby letters of credit are written conditional commitments issued to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Company would be entitled to seek recovery from the customer. The Company's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

The fees collected in connection with the issuance of standby letters of credit are representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, fees collected in connection with the issuance of standby letters of credit are deferred. The fees are then recognized in income proportionately over the life of the standby letter of credit agreement. The deferred standby letter of credit fees represent the fair value of the Company's potential obligations under the standby letter of credit guarantees.

Financial instruments with off-balance-sheet risk were as follows at the dates indicated:

|                                        | March 31, 2014<br>(Dollars In thousands) | December 31, 2013 |
|----------------------------------------|------------------------------------------|-------------------|
| Commitments to extend credit           | \$ 1,590,051                             | \$ 1,621,873      |
| Standby letters of credit              | 21,387                                   | 18,923            |
| Deferred standby letter of credit fees | 60                                       | 87                |



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## Lease Commitments

The Company leases office space, space for ATM locations, and certain branch locations under noncancelable operating leases.

Rent expense incurred under operating leases was approximately \$1.9 million at both March 31, 2014 and March 31, 2013. Renewal options ranging from 1-10 years exist for several of these leases. The Company has entered into lease agreements with related third parties on substantially the same terms as those prevailing at the time for comparable transactions with unrelated parties. Rent expense incurred under related third party leases was approximately \$251,000 and \$249,000, at March 31, 2014 and 2013, respectively. There has been no significant change in the future minimum lease payments payable by the Company since December 31, 2013. See the Company's annual Report on Form 10-K for the fiscal year ended December 31, 2013 for information regarding commitments.

## Other Contingencies

At March 31, 2014, Rockland Trust was involved in pending lawsuits that arose in the ordinary course of business. Management has reviewed these pending lawsuits with legal counsel and has taken into consideration the view of counsel as to their outcome. In the opinion of management, the final disposition of pending lawsuits is not expected to have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Bank is required to maintain certain reserve requirements of vault cash and/or deposits with the Federal Reserve Bank of Boston. The amount of this reserve requirement was \$14.1 million and \$21.0 million at March 31, 2014 and December 31, 2013, respectively.

## NOTE 12 – LOW INCOME HOUSING PROJECT INVESTMENTS

The Company's investment in Low Income Housing Projects that generate Low Income Housing Tax Credits ("LIHTC") at March 31, 2014 was \$26.9 million with a recorded liability of \$23.3 million in funding obligations. The Company has invested in three separate LIHTC projects which provide the Company with tax credits and with operating loss tax benefits over a remaining approximate 15 year period. None of the original investment will be repaid. The investment in LIHTC projects is being accounted for using the proportional amortization method, under which the Company amortizes the initial cost of the investment in proportion to the amount of 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).

The following table presents the pertinent information related to the Company's investments in low income housing projects as of the date indicated:

|                                 | March 31, 2014<br>(dollars in thousands) |
|---------------------------------|------------------------------------------|
| Original investment value       | \$27,543                                 |
| Current recorded investment     | 26,946                                   |
| Unfunded liability obligation   | 23,279                                   |
| Tax credits and benefits (1)    | 1,629                                    |
| Amortization of investments (2) | 1,101                                    |
| Net income tax benefit (3)      | 528                                      |

(1) The amount reflected in this row represent both the tax credits as well as the tax benefits expected to be generated by the Low Income Housing Projects operating loss for the year ended December 31, 2014.

(2) This amount reduces the tax credits and benefits expected to be generated by the Low Income Housing Projects for the year ended December 31, 2014.

(3) This amount represents the net tax benefit expected to be realized for the year ended December 31, 2014 in determining the Company's effective tax rate as of March 31, 2014.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the Securities and Exchange Commission.

Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, both in the MD&A and elsewhere, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management's confidence and strategies and management's expectations about new and existing programs and products, acquisitions, relationships, opportunities, taxation, technology, market conditions and economic expectations. These statements may be identified by such forward-looking terminology as "should," "expect," "believe," "view," "opportunity," "allow," "continues," "reflects," "typically," "usually," "anticipate," or similar statements or of such terms. Such forward-looking statements involve certain risks and uncertainties and our actual results may differ materially from such forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements in addition to those risk factors listed under the "Risk Factors" section of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 include, but are not limited to:

- a weakening in the United States economy in general and the regional and local economies within the New England region and the Company's market area;
- adverse changes in the local real estate market;
- a further deterioration of the credit rating for U.S. long-term sovereign debt;
- acquisitions may not produce results at levels or within time frames originally anticipated and may result in unforeseen integration issues or impairment of goodwill and/or other intangibles;
- changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;
- higher than expected tax expense, resulting from failure to comply with general tax laws, changes in tax laws or failure to comply with requirements of the federal New Markets Tax Credit program;
- unexpected changes in market interest rates for interest earning assets and/or interest bearing liabilities;
- adverse changes in asset quality including an unanticipated credit deterioration in our loan portfolio;
- unexpected increased competition in the Company's market area;
- unanticipated loan delinquencies, loss of collateral, decreased service revenues, and other potential negative effects on our business caused by severe weather or other external events;
- a deterioration in the conditions of the securities markets;
- our inability to adapt to changes in information technology;
- electronic fraudulent activity within the financial services industry, especially in the commercial banking sector;
- adverse changes in consumer spending and savings habits;
- the effect of new laws and regulations regarding the financial services industry including, but not limited to, the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) generally applicable to the Company's business;
- changes in accounting policies, practices and standards, as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters; and
- other unexpected material adverse changes in our operations or earnings.

Except as required by law, the Company disclaims any intent or obligation to update publicly any such forward-looking statements, whether in response to new information, future events or otherwise. Any public statements or disclosures by the Company following this Quarterly Report on Form 10-Q which modify or impact any of the forward-looking statements contained in this Quarterly Report on Form 10-Q will be deemed to modify or supersede such statements in this Quarterly Report on Form 10-Q.

#### Selected Quarterly Financial Data

The selected consolidated financial and other data of the Company set forth below does not purport to be complete and should be read in conjunction with, and is qualified in its entirety by, the more detailed information, including the Consolidated Financial Statements and related notes, appearing elsewhere herein.

Three Months Ended

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|                                                               | March 31,<br>2014 | December 31,<br>2013 | September 30,<br>2013 | June 30,<br>2013 | March 31,<br>2013 |
|---------------------------------------------------------------|-------------------|----------------------|-----------------------|------------------|-------------------|
| (Dollars in thousands, except per share data)                 |                   |                      |                       |                  |                   |
| Financial condition data                                      |                   |                      |                       |                  |                   |
| Securities available for sale                                 | \$348,258         | \$356,862            | \$284,398             | \$303,855        | \$335,693         |
| Securities held to maturity                                   | 375,556           | 350,652              | 317,373               | 225,278          | 209,090           |
| Loans                                                         | 4,807,269         | 4,718,307            | 4,556,029             | 4,530,111        | 4,487,478         |
| Allowance for loan losses                                     | (53,629 )         | (53,239 )            | (53,562 )             | (52,976 )        | (51,906 )         |
| Goodwill and core deposit intangibles                         | 182,051           | 182,642              | 160,562               | 161,089          | 161,616           |
| Total assets                                                  | 6,225,920         | 6,099,234            | 5,895,464             | 5,852,595        | 5,721,120         |
| Total deposits                                                | 5,114,259         | 4,986,418            | 4,757,309             | 4,676,463        | 4,551,410         |
| Total borrowings                                              | 422,565           | 448,488              | 507,681               | 557,300          | 550,782           |
| Stockholders' equity                                          | 602,556           | 591,540              | 555,744               | 543,605          | 537,575           |
| Income statement                                              |                   |                      |                       |                  |                   |
| Interest income                                               | \$52,980          | \$52,571             | \$51,027              | \$51,495         | \$50,820          |
| Interest expense                                              | 5,374             | 5,666                | 5,831                 | 5,880            | 5,958             |
| Net interest income                                           | 47,606            | 46,905               | 45,196                | 45,615           | 44,862            |
| Provision for loan losses                                     | 4,502             | 3,150                | 2,650                 | 3,100            | 1,300             |
| Noninterest income                                            | 17,516            | 17,464               | 18,130                | 16,692           | 15,724            |
| Noninterest expenses                                          | 41,887            | 47,845               | 40,722                | 42,164           | 42,920            |
| Net income                                                    | 13,383            | 10,588               | 14,655                | 12,758           | 12,252            |
| Per share data                                                |                   |                      |                       |                  |                   |
| Net income—basic                                              | \$0.56            | \$0.45               | \$0.64                | \$0.56           | \$0.54            |
| Net income—diluted                                            | 0.56              | 0.45                 | 0.64                  | 0.56             | 0.54              |
| Cash dividends declared                                       | 0.24              | 0.22                 | 0.22                  | 0.22             | 0.22              |
| Book value                                                    | 25.23             | 24.85                | 24.21                 | 23.73            | 23.50             |
| Performance ratios                                            |                   |                      |                       |                  |                   |
| Return on average assets                                      | 0.88              | % 0.70               | % 1.00                | % 0.89           | % 0.88            |
| Return on average common equity                               | 9.02              | % 7.29               | % 10.53               | % 9.40           | % 9.25            |
| Net interest margin (on a fully tax equivalent basis)         | 3.49              | % 3.45               | % 3.43                | % 3.57           | % 3.58            |
| Equity to assets                                              | 9.68              | % 9.70               | % 9.43                | % 9.29           | % 9.40            |
| Dividend payout ratio                                         | 39.13             | % 47.70              | % 34.38               | % 39.50          | % —               |
| Asset quality                                                 |                   |                      |                       |                  |                   |
| Nonperforming loans                                           | 36,171            | 34,659               | 37,887                | 36,549           | 33,091            |
| Nonperforming assets                                          | 46,521            | 43,833               | 48,879                | 48,105           | 46,815            |
| Nonperforming loans as a percent of gross loans               | 0.75              | % 0.73               | % 0.83                | % 0.81           | % 0.74            |
| Nonperforming assets as a percent of total assets             | 0.75              | % 0.72               | % 0.83                | % 0.82           | % 0.82            |
| Allowance for loan losses as a percent of total loans         | 1.12              | % 1.13               | % 1.18                | % 1.17           | % 1.16            |
| Allowance for loan losses as a percent of nonperforming loans | 148.27            | % 153.61             | % 141.37              | % 144.95         | % 156.86          |
| Capital ratios                                                |                   |                      |                       |                  |                   |
| Tier 1 leverage capital ratio                                 | 8.60              | % 8.64               | % 8.64                | % 8.56           | % 8.51            |
| Tier 1 risk-based capital ratio                               | 10.76             | % 10.78              | % 10.82               | % 10.62          | % 10.57           |

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|                                |       |   |       |   |       |   |       |   |       |   |
|--------------------------------|-------|---|-------|---|-------|---|-------|---|-------|---|
| Total risk-based capital ratio | 12.52 | % | 12.58 | % | 12.69 | % | 12.49 | % | 12.43 | % |
|--------------------------------|-------|---|-------|---|-------|---|-------|---|-------|---|

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### Executive Level Overview

Management evaluates the Company's operating results and financial condition using measures that include net income, earnings per share, return on assets and equity, return on tangible common equity, net interest margin, tangible book value per share, asset quality indicators, and many others. These metrics help management make key decisions regarding the Bank's balance sheet, liquidity, interest rate sensitivity, and capital resources and assist with identifying areas to improve. The Company is focused on organic growth, but will consider acquisition opportunities that provide a satisfactory financial return.

### Loans and Asset Quality

Management's balance sheet strategy emphasizes commercial and home equity lending. The results depicted in the following table reflect the focus on those asset classes:

Commercial lending continued to drive loan growth during the first quarter of 2014, with March 31, 2014 commercial lending balances up 10.8% on an annualized basis compared to December 31, 2013.

Management strives to be disciplined about loan pricing and generates loan assets with interest rate sensitivity in mind. The Company has gradually and intentionally shifted its balance sheet composition so that its interest-rate risk position is fundamentally asset-sensitive.

Management takes a disciplined approach to credit underwriting seeking to avoid undue credit risk and loan losses. For first quarter 2014, net charge-offs were 0.35% of average loans, representing a five basis point increase over the prior quarter. The increase was driven by a relatively large charge off on a previously acquired commercial real estate loan. That same loan drove an increase in nonperforming loans during the quarter, and the ratio of nonperforming loans to total loans was 0.75% at March 31, 2014.

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Funding and the Net Interest Margin

Management emphasizes core deposit growth to fund loans, as depicted by the following chart:

Core deposits grew by 3.5% during the first quarter of 2014 and at March 31, 2014 represented 85.6% of total deposits.

The net interest margin was 3.49% for the quarter ended March 31, 2014, representing a slight increase from the linked quarter, benefiting from stable earning asset yields, a slightly lower cost of funds and a lower average cash position, as some excess cash was used to pay down borrowings.

Noninterest Income

Management continues to focus on growing noninterest income, however, seasonal fluctuations in deposit account fees and a significant decline in mortgage banking income, due to a reduction in volume experienced industry wide, impacted first quarter results. As such, noninterest income in the quarter, when excluding non-core items, was 25.02% of total revenue (net interest income plus noninterest income) on an operating basis. The following chart depicts noninterest income as a percentage of total revenue on an operating basis over the last five quarters:

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Expense Control

Management takes a balanced approach to noninterest expense control by paying close attention to the management of ongoing operating expenses while making needed capital expenditures and prudently investing in growth initiatives. The Company's primary expenses arise from Rockland Trust's employee salaries and benefits and expenses associated with buildings and equipment. During the first quarter of 2014, noninterest expense was well contained, as evidenced by a 2.4% decrease from the three month period ended March 31, 2013. The following chart shows the trend in the Company's efficiency ratio, on an operating basis (calculated by dividing noninterest expense by the sum of net interest income and noninterest income), over the past five quarters:

Tax Effectiveness

The Company participates in federal and state tax credit programs designed to promote economic development, affordable housing, and job creation. During 2014, the Company continues to participate in the federal New Markets Tax Credit program and has also made commitments into additional low-income housing tax credit investments. The Company has also established security corporation subsidiaries and, through its subsidiaries, purchased tax-exempt bonds. Federal and state tax credit program participation and other tax strategies permit the Company to operate in a tax effective manner and sometimes also creates a competitive advantage for Rockland Trust and its community development subsidiaries. During the first quarter of 2014, the Company achieved an effective tax rate of 28.6%.

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### Capital

The Company's disciplined approach with respect to revenue, expense, and tax effectiveness is designed to promote long-term shareholder value. The Company's consistent profitability has steadily increased tangible book value per share and helped create the Company's strong capital position. The following chart shows the trend of the Company's tangible book value per share over the past five quarters:

This strong growth in capital has led to a consistent cash dividend which increased from \$0.22 per share in each quarter of 2013 to \$0.24 per share in the first quarter of 2014, a 9.1% increase.

### 2014 Results

Net income for the first quarter of 2014 computed in accordance with Generally Accepted Accounting Principles ("GAAP") was \$13.4 million, or \$0.56 on a diluted earnings per share basis, as compared to \$12.3 million, or \$0.54 for the prior year quarter. First quarter 2014 net operating earnings were \$12.1 million, or \$0.51 on a diluted earnings per share basis, a decrease of 8.9% and 12.1%, respectively, when compared to net operating earnings of \$13.3 million, or \$0.58 per diluted share, for the first quarter of 2013. The Company's GAAP net income during the first quarter of 2014 were impacted by a relatively large commercial real estate charge-off and the associated higher provisioning levels, as well as a tax exempt gain on life insurance benefits which is excluded from operating earnings.

### 2014 Earnings Outlook

Based upon the Company's assumptions over loan and deposit growth and despite the challenging interest rate environment, the Company anticipates 2014 diluted earnings per share performance to be in a range between \$2.42 and \$2.52.

Key assumptions in the 2014 outlook include:

• Total loan growth of 4-5%;

• Total deposit growth of 2-3%;

• A net interest margin in the mid to low 3.40% range;

• Stable asset quality outlook, with a provision for loan loss in the range of \$11-\$14 million and net charge-offs in the range of \$9-\$12 million;

• Noninterest income growing by 3-4%;

• Noninterest expense increasing by 3-4%;

• An effective tax rate of 28-29%; and,

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Unadjusted Tangible Common Equity ratio increasing to a range of 7.25% to 7.50% by the end of 2014.

**Non-GAAP Measures**

When management assesses the Company's financial performance for purposes of making day-to-day and strategic decisions, it does so based upon the performance of its core banking business, which is primarily derived from the combination of net interest income and noninterest or fee income, reduced by operating expenses, the provision for loan losses, and the impact of income taxes. The Company's financial performance is determined in accordance with GAAP which sometimes includes gains or losses due to items that management believes are unrelated to its core banking business and will not have a material financial impact on operating results in future periods, such as gains or losses on the sales of securities, merger and acquisition expenses, and other items. Management, therefore, also computes the Company's non-GAAP operating earnings, which excludes these items, to measure the strength of the Company's core banking business and to identify trends that may to some extent be obscured by such gains or losses. Management's computation of the Company's non-GAAP operating earnings information is set forth because management believes it may be useful for investors to have access to the same analytical tool used by management to evaluate the Company's core operational performance so that investors may assess the Company's overall financial health and identify business and performance trends that may be more difficult to identify and evaluate when noncore items are included. Management also believes that the computation of non-GAAP operating earnings may facilitate the comparison of the Company to other companies in the financial services industry.

Non-GAAP operating earnings should not be considered a substitute for GAAP results. An item which management deems to be noncore and excludes when computing non-GAAP operating earnings can be of substantial importance to the Company's results for any particular quarter or year. The Company's non-GAAP operating earnings information set forth is not necessarily comparable to non-GAAP information which may be presented by other companies.

The following tables summarize the impact of noncore items recorded for the time periods indicated below and reconcile them in accordance with GAAP:

|                                                    | Three Months Ended March 31 |           |                            |        |
|----------------------------------------------------|-----------------------------|-----------|----------------------------|--------|
|                                                    | Net Income                  |           | Diluted Earnings Per Share |        |
|                                                    | 2014                        | 2013      | 2014                       | 2013   |
|                                                    | (Dollars in thousands)      |           |                            |        |
| As reported (GAAP)                                 |                             |           |                            |        |
| Net income available to common shareholders (GAAP) | \$ 13,383                   | \$ 12,252 | \$0.56                     | \$0.54 |
| Non-GAAP adjustments                               |                             |           |                            |        |
| Noninterest income components                      |                             |           |                            |        |
| Gain on life insurance benefits, tax exempt        | (1,627                      | ) —       | (0.06                      | ) —    |
| Noninterest expense components                     |                             |           |                            |        |
| Merger and acquisition expenses, net of tax        | 66                          | 856       | —                          | 0.04   |
| Impairment on acquired facilities, net of tax      | 298                         | —         | 0.01                       | —      |
| Severance, net of tax                              | —                           | 192       | —                          | —      |
| Total impact of noncore items                      | (1,263                      | ) 1,048   | (0.05                      | ) 0.04 |
| As adjusted (Non-GAAP)                             | \$ 12,120                   | \$ 13,300 | \$0.51                     | \$0.58 |

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The following table summarizes the impact of noncore items on the calculation of the Company's efficiency ratio for the periods indicated:

|                                                            | Quarter-to-Date        |                      |                       |                  |                   |             |  |
|------------------------------------------------------------|------------------------|----------------------|-----------------------|------------------|-------------------|-------------|--|
|                                                            | March 31,<br>2014      | December<br>31, 2013 | September<br>30, 2013 | June 30,<br>2013 | March 31,<br>2013 |             |  |
|                                                            | (Dollars in thousands) |                      |                       |                  |                   |             |  |
| Net interest income                                        | \$ 47,606              | \$ 46,905            | \$ 45,196             | \$ 45,615        | \$ 44,862         | (a)         |  |
| Noninterest income (GAAP)                                  | \$ 17,516              | \$ 17,464            | \$ 18,130             | \$ 16,692        | \$ 15,724         | (b)         |  |
| Net gain on sale of nonequity securities                   | —                      | (258 )               | —                     | —                | —                 |             |  |
| Gain on life insurance benefits                            | (1,627 )               | (227 )               | —                     | —                | —                 |             |  |
| Gain on extinguishment of debt                             | —                      | —                    | (763 )                | —                | —                 |             |  |
| Noninterest income on an operating basis                   | \$ 15,889              | \$ 16,979            | \$ 17,367             | \$ 16,692        | \$ 15,724         | (c)         |  |
| Noninterest expense (GAAP)                                 | \$ 41,887              | \$ 47,845            | \$ 40,722             | \$ 42,164        | \$ 42,920         | (d)         |  |
| Merger & acquisition                                       | (77 )                  | (6,219 )             | (366 )                | (754 )           | (1,345 )          |             |  |
| Severance                                                  | —                      | —                    | —                     | —                | (325 )            |             |  |
| Impairment on acquired facilities                          | (503 )                 | —                    | —                     | —                | —                 |             |  |
| Noninterest expense on an operating basis                  | \$ 41,307              | \$ 41,626            | \$ 40,356             | \$ 41,410        | \$ 41,250         | (e)         |  |
| Total revenue (GAAP)                                       | \$ 65,122              | \$ 64,369            | \$ 63,326             | \$ 62,307        | \$ 60,586         | (a+b)       |  |
| Total operating revenue                                    | \$ 63,495              | \$ 63,884            | \$ 62,563             | \$ 62,307        | \$ 60,586         | (a+c)       |  |
| Ratios                                                     |                        |                      |                       |                  |                   |             |  |
| Efficiency ratio (GAAP)                                    | 64.32                  | % 74.33              | % 64.31               | % 67.67          | % 70.84           | % (d/(a+b)) |  |
| Efficiency ratio on an operating basis                     | 65.06                  | % 65.16              | % 64.50               | % 66.46          | % 68.09           | % (e/(a+c)) |  |
| Noninterest income as a % of revenue                       | 26.90                  | % 27.13              | % 28.63               | % 26.79          | % 25.95           | % (b/(a+b)) |  |
| Noninterest income as a % of revenue on an operating basis | 25.02                  | % 26.58              | % 27.76               | % 26.79          | % 25.95           | % (c/(a+c)) |  |

**Critical Accounting Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. The Company believes that the most critical accounting policies are those which the Company's financial condition depends upon, and which involve the most complex or subjective decisions or assessments.

There have been no material changes in critical accounting policies during the first three months of 2014. Please refer to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013 for a complete listing of critical accounting policies.



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## FINANCIAL POSITION

**Securities Portfolio** The Company's securities portfolio consists of securities available for sale and securities which management intends to hold until maturity. Securities increased by \$16.3 million, or 2.3%, at March 31, 2014 as compared to December 31, 2013. Security purchases continue to be primarily comprised of agency mortgage-backed securities. The ratio of securities to total assets was 11.6% as of March 31, 2014 and December 31, 2013.

The Company continually reviews investment securities for the presence of other-than-temporary impairment ("OTTI"). Further analysis of the Company's OTTI can be found in Note 3 "Securities" within Notes to Consolidated Financial Statements included in Item 1 hereof.

**Residential Mortgage Loan Sales** The Company's primary loan sale activity arises from the sale of government sponsored enterprise eligible residential mortgage loans to other financial institutions. During the first quarter of 2014 and 2013, the Bank originated residential loans with the intention of selling them in the secondary market, and to a lesser extent, to hold in the Company's residential portfolio. The following table shows the total residential loans that were closed and whether the amounts were held in the portfolio or sold/held for sale in the secondary market during the period indicated:

Table 1 - Closed Residential Real Estate Loans

|                                        | Three Months Ended March 31 |          |
|----------------------------------------|-----------------------------|----------|
|                                        | 2014                        | 2013     |
|                                        | (Dollars in thousands)      |          |
| Held in portfolio                      | \$11,659                    | \$4,038  |
| Sold/held for sale in secondary market | 23,421                      | 94,083   |
| Total closed loans                     | \$35,080                    | \$98,121 |

The table below reflects the loans which were sold during the periods indicated:

Table 2 - Residential Mortgage Loan Sales

|                                     | Three Months Ended March 31 |           |
|-------------------------------------|-----------------------------|-----------|
|                                     | 2014                        | 2013      |
|                                     | (Dollars in thousands)      |           |
| Sold with servicing rights released | \$3,668                     | \$81,922  |
| Sold with servicing rights retained | 19,533                      | 21,914    |
| Total loans sold                    | \$23,201                    | \$103,836 |

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As noted in the table above, loans may be sold with servicing rights released or with servicing rights retained. Upon sale, the mortgage servicing asset is established, which represents the then current estimated fair value based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Servicing rights are recorded in other assets in the consolidated balance sheets, are amortized in proportion to and over the period of estimated net servicing income, and are assessed for impairment based on fair value at each reporting date.

Impairment is determined by stratifying the rights based on predominant characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance, to the extent that fair value is less than the capitalized amount. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance may be recorded as an increase to income. The principal balance of loans serviced by the Bank on behalf of investors amounted to \$341.9 million, \$331.4 million, and \$206.7 million at March 31, 2014, December 31, 2013, and March 31, 2013, respectively. The following table shows the adjusted cost of the servicing rights associated with these loans and the changes for the periods indicated:

Table 3 - Mortgage Servicing Asset

|                                | Three Months Ended March 31 |         |
|--------------------------------|-----------------------------|---------|
|                                | 2014                        | 2013    |
|                                | (Dollars in thousands)      |         |
| Balance at beginning of period | \$2,368                     | \$899   |
| Additions                      | 173                         | 177     |
| Amortization                   | (141)                       | (124)   |
| Change in valuation allowance  | (23)                        | 62      |
| Balance at end of period       | \$2,377                     | \$1,014 |

When a loan is sold, the Company enters into agreements that contain representations and warranties about the characteristics of the loans sold and their origination. The Company may be required to either repurchase mortgage loans or to indemnify the purchaser from losses if representations and warranties are breached. The Company incurred no material losses during the three months ended March 31, 2014 or 2013, and therefore at this time, has not established a reserve for loan repurchases because it believes the amount of probable losses is not reasonably estimable.

Forward sale contracts of mortgage loans and forward to-be-announced ("TBA") mortgage contracts, considered derivative instruments for accounting purposes, are utilized by the Company in its efforts to manage risk of loss associated with its mortgage loan commitments and mortgage loans held for sale. Prior to closing and funding certain one-to-four family residential mortgage loans, an interest rate lock commitment is generally extended to the borrower. During the period from commitment date to closing date, the Company is subject to the risk that market rates of interest may change. If market rates rise, investors generally will pay less to purchase such loans, resulting in a reduction in the gain on sale of the loans or, possibly, a loss. In an effort to mitigate such risk, forward delivery sales commitments are executed, under which the Company agrees to deliver whole mortgage loans to various investors, or forward TBA mortgage contracts are entered into with a counterparty, which hedges this market risk. See Note 7, "Derivative and Hedging Activities" within Notes to Consolidated Financial statements included in Item 1 hereof for more information on mortgage activity and mortgage related derivatives.

Loan Portfolio Management continues to focus on growth in the commercial and home equity lending categories, while placing less emphasis on the other lending categories. Management believes this emphasis is prudent, given the prevailing interest rate and economic environment, as well as strategic priorities. The Bank's loan portfolio increased \$89.0 million during the first quarter of 2014 to \$4.8 billion. The commercial loan portfolio continues to be the major driver increasing by \$88.6 million during the first quarter of 2014, accompanied by solid growth across all other categories.



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The Bank's commercial and industrial portfolio grew 4.9% in the three months ended March 31, 2014. This portfolio is well-diversified with loans to various types of industries. The following pie chart shows the diversification of the commercial and industrial portfolio as of March 31, 2014:

|                                                                               |                        |   |
|-------------------------------------------------------------------------------|------------------------|---|
|                                                                               | (Dollars in thousands) |   |
| Average loan size                                                             | \$229                  |   |
| Largest individual commercial and industrial loan exposure                    | \$16,000               |   |
| Commercial and industrial nonperforming loans/commercial and industrial loans | 0.40                   | % |

The Bank's commercial real estate portfolio, inclusive of commercial construction, is the Bank's largest loan type concentration and has grown by 2.0% for the three months ended March 31, 2014. This portfolio is also well-diversified with loans secured by a variety of property types, such as owner-occupied and nonowner-occupied commercial, retail, office, industrial, warehouse, industrial development bonds, and other special purpose properties, such as hotels, motels, nursing homes, restaurants, churches, recreational facilities, marinas, and golf courses. Commercial real estate also includes loans secured by certain residential-related property types including multi-family apartment buildings, residential development tracts and condominiums. The following pie chart shows the diversification of the commercial real estate portfolio as of March 31, 2014:

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|                                                                          | (Dollars in thousands) |   |
|--------------------------------------------------------------------------|------------------------|---|
| Average loan size                                                        | \$736                  |   |
| Largest individual commercial real estate mortgage exposure              | \$24,108               |   |
| Commercial real estate nonperforming loans/commercial real estate loans  | 0.58                   | % |
| Owner occupied commercial real estate loans/commercial real estate loans | 17.0                   | % |

In addition to the commercial portfolios, the Bank also originates both fixed-rate and adjustable-rate residential real estate loans as well as residential construction lending related to single-home residential development within the Bank's market area. The Bank also provides home equity loans and lines that may be made as a fixed rate term loan or under a variable rate revolving line of credit secured by a first or second mortgage on the borrower's residence or second home. Additionally, the Bank makes loans for a wide variety of other personal needs. Consumer loans primarily consist of installment loans and overdraft protections. The residential, home equity and other consumer portfolios have increased by \$392,000 for the three months ended March 31, 2014 to \$1.4 billion.

**Asset Quality** The Company continually monitors the asset quality of the loan portfolio using all available information. Based on this assessment, loans demonstrating certain payment issues or other weaknesses may be categorized as delinquent, impaired, nonperforming and/or put on nonaccrual status. Additionally, in the course of resolving such loans, the Company may choose to restructure the contractual terms of certain loans to match the borrower's ability to repay the loan based on their current financial condition. If a restructured loan meets certain criteria, it may be categorized as a troubled debt restructuring (TDR).

**Delinquency** The Bank's philosophy toward managing its loan portfolios is predicated upon careful monitoring, which stresses early detection and response to delinquent and default situations. The Bank seeks to make arrangements to resolve any delinquent or default situation over the shortest possible time frame. Generally, the Bank requires that a delinquency notice be mailed to a borrower upon expiration of a grace period (typically no longer than 15 days beyond the due date). Reminder notices may be sent and telephone calls may be made prior to the expiration of the grace period. If the delinquent status is not resolved within a reasonable time frame following the mailing of a delinquency notice, the Bank's personnel charged with managing its loan portfolios contact the borrower to ascertain the reasons for delinquency and the prospects for payment. Any subsequent actions taken to resolve the delinquency will depend upon the nature of the loan and the length of time that the loan has been delinquent. The borrower's needs are considered as much as reasonably possible without jeopardizing the Bank's position. A late charge is usually assessed on loans upon expiration of the grace period.

**Nonaccrual Loans** As a general rule, within commercial real estate or home equity categories, loans more than 90 days past due with respect to principal or interest are classified as nonaccrual loans. As permitted by banking regulations, certain consumer loans past due 90 days or more continue to accrue interest. In addition, certain commercial and real estate loans that are more than 90 days past due may be kept on an accruing status if the loans are well secured and in the process of collection. The Company may also put a junior lien mortgage on nonaccrual status as a result of delinquency with respect to the first position, which is held by another financial institution, while the junior lien is currently performing. Income accruals are suspended on all nonaccrual loans and all previously accrued and uncollected interest is reversed against current income. A loan remains on nonaccrual status until it becomes current with respect to principal and interest (and in certain instances remains current for up to six months), when the loan is liquidated, or when the loan is determined to be uncollectible and is charged-off against the allowance for loan losses.

**Troubled Debt Restructurings** In the course of resolving problem loans, the Bank may choose to restructure the contractual terms of certain loans. The Bank attempts to work out an alternative payment schedule with the borrower in order to avoid or cure a default. Any loans that are modified are reviewed by the Bank to identify if a TDR has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status and the restructuring of the loan may include adjustments to interest rates, extensions of maturity, consumer loans where the borrower's obligations have been effectively discharged through Chapter 7 Bankruptcy and the borrower has not reaffirmed the debt to the Bank, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. If such efforts by the Bank do not result in satisfactory performance, the loan is referred to legal counsel, at which time foreclosure proceedings are initiated. At any time prior to a sale of the property at foreclosure, the Bank may terminate foreclosure proceedings if the borrower is able to work-out a satisfactory payment plan.

It is the Bank's policy to have any restructured loans which are on nonaccrual status prior to being modified remain on nonaccrual status for six months, subsequent to being modified, before management considers its return to accrual status. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. Loans that are considered TDRs are classified as performing, unless they are on nonaccrual status or greater than 90 days delinquent. Loans classified as TDRs remain classified as such for the life of the loan, except in limited circumstances, when it may be determined that the borrower is performing under modified terms and the restructuring agreement specified an interest rate greater than or equal to an acceptable market rate for a comparable new loan at the time of the restructuring.

**Purchased Credit Impaired Loans** Purchased Credit Impaired ("PCI") loans are acquired loans which had evidence of deterioration in credit quality at the purchase date and for which it is probable that all contractually required payments will not be collected. The PCI loans are recorded at fair value without any carryover of the allowance for loan losses. The excess cash flows expected to be collected over the carrying amount of the loans, referred to as the "accretable yield," is accreted into interest income over the life of the loans using the effective yield method. Accordingly, PCI loans are not subject to classification as nonaccrual in the same manner as originated loans, rather they are generally considered to be accruing loans because their interest income recognized relates to the accretable yield and not to contractual interest payments. The carrying amount of these purchased credit impaired loans was \$29.1 million as of March 31, 2014, as compared to \$29.5 million as of December 31, 2013. See Note 4, "Loans, Allowance for Loan Losses and Credit Quality" within Notes to Consolidated Financial Statements included in Item 1 hereof for more information.

**Nonperforming Assets** Nonperforming assets are comprised of nonperforming loans, nonperforming securities, other real estate owned ("OREO"), and other assets in possession. Nonperforming loans consist of nonaccrual loans and loans that are more than 90 days past due but still accruing interest.

Nonperforming securities consist of securities that are on nonaccrual status. The Company holds five collateralized debt obligation securities ("CDOs") comprised of pools of trust preferred securities issued by banks and insurance companies, which are currently deferring interest payments on certain tranches within the bonds' structures including the tranches held by the Company. The bonds are anticipated to continue to defer interest until cash flows are sufficient to satisfy certain collateralization levels designed to protect more senior tranches. As a result the Company

has placed the five securities on nonaccrual status and has reversed any previously accrued but unpaid income related to these securities.

OREO consists of real estate properties, which have served as collateral to secure loans, that are controlled or owned by the Bank. These properties are recorded at fair value less estimated costs to sell at the date control is established, resulting in a new cost basis. The amount by which the recorded investment in the loan exceeds the fair value (net of estimated costs to sell) of the foreclosed asset is charged to the allowance for loan losses. Subsequent declines in the fair value of the foreclosed asset below the new cost basis are recorded through the use of a valuation allowance. Subsequent increases in the fair value are recorded as reductions in the valuation allowance, but not below zero. All costs incurred thereafter in maintaining the property are generally

charged to noninterest expense. In the event the real estate is utilized as a rental property, rental income and expenses are recorded as incurred.

Other assets in possession typically consist of foreclosed non-real estate assets deemed to be in control of the Company.

The following table sets forth information regarding nonperforming assets held by the Bank at the dates indicated:

Table 4 - Nonperforming Assets

|                                                   | March 31,<br>2014      | December 31,<br>2013 | March 31,<br>2013 |   |
|---------------------------------------------------|------------------------|----------------------|-------------------|---|
|                                                   | (Dollars in thousands) |                      |                   |   |
| Loans Accounted for on a nonaccrual basis         |                        |                      |                   |   |
| Commercial and industrial                         | \$3,299                | \$4,178              | \$3,188           |   |
| Commercial real estate                            | 13,970                 | 11,834               | 9,355             |   |
| Small business                                    | 788                    | 633                  | 680               |   |
| Residential real estate                           | 10,632                 | 10,329               | 11,950            |   |
| Home equity                                       | 7,062                  | 7,068                | 7,687             |   |
| Other consumer                                    | 28                     | 92                   | 201               |   |
| Total (1)                                         | \$35,779               | \$34,134             | \$33,061          |   |
| Loans past due 90 days or more but still accruing |                        |                      |                   |   |
| Residential real estate (2)                       | 368                    | 462                  | —                 |   |
| Other consumer                                    | 24                     | 63                   | 30                |   |
| Total                                             | \$392                  | \$525                | \$30              |   |
| Total nonperforming loans                         | \$36,171               | \$34,659             | \$33,091          |   |
| Nonaccrual securities (3)                         | 2,353                  | 1,541                | 1,903             |   |
| Other real estate owned                           | 7,830                  | 7,466                | 11,645            |   |
| Other assets in possession                        | 167                    | 167                  | 176               |   |
| Total nonperforming assets                        | \$46,521               | \$43,833             | \$46,815          |   |
| Nonperforming loans as a percent of gross loans   | 0.75                   | % 0.73               | % 0.74            | % |
| Nonperforming assets as a percent of total assets | 0.75                   | % 0.72               | % 0.82            | % |

(1) Inclusive of TDRs on nonaccrual of \$7.0 million, \$7.5 million, and \$8.7 million, at March 31, 2014, December 31, 2013, and March 31, 2013, respectively.

(2) Represents purchased credit impaired loans that are accruing interest due to expectations of future cash collections.

(3) Amounts represent the fair value of five nonaccrual securities at March 31, 2014 and December 31, 2013 and six nonaccrual securities at March 31, 2013.

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The following table summarized the changes in nonperforming assets for the periods indicated:

Table 5 - Activity in Nonperforming Assets

|                                                                    | Three Months Ended     |                |
|--------------------------------------------------------------------|------------------------|----------------|
|                                                                    | March 31, 2014         | March 31, 2013 |
|                                                                    | (Dollars in thousands) |                |
| Nonperforming assets beginning balance                             | \$43,833               | \$42,427       |
| New to nonperforming                                               | 10,369                 | 10,243         |
| Loans charged-off                                                  | (4,566 )               | (1,574 )       |
| Loans paid-off                                                     | (1,367 )               | (2,402 )       |
| Loans transferred to other real estate owned and foreclosed assets | (746 )                 | (771 )         |
| Loans restored to performing status                                | (2,062 )               | (1,096 )       |
| Change to other real estate owned                                  |                        |                |
| New to other real estate owned                                     | \$746                  | \$771          |
| Valuation write down                                               | (236 )                 | (486 )         |
| Sale of Other Real Estate Owned                                    | (590 )                 | (918 )         |
| Capital improvements to other real estate owned                    | 444                    | 304            |
| Total change to other real estate owned                            | 364                    | (329 )         |
| Change in nonaccrual securities                                    | 812                    | 392            |
| Other                                                              | (116 )                 | (75 )          |
| Nonperforming assets ending balance                                | \$46,521               | \$46,815       |

The following table sets forth information regarding troubled debt restructured loans as of the dates indicated:

Table 6 - Troubled Debt Restructurings

|                                                               | March 31,<br>2014      | December 31,<br>2013 |   |
|---------------------------------------------------------------|------------------------|----------------------|---|
|                                                               | (Dollars in thousands) |                      |   |
| Performing troubled debt restructurings                       | \$40,329               | \$38,410             |   |
| Nonaccrual troubled debt restructurings                       | 6,998                  | 7,454                |   |
| Total                                                         | \$47,327               | \$45,864             |   |
| Performing troubled debt restructurings as a % of total loans | 0.84                   | % 0.81               | % |
| Nonaccrual troubled debt restructurings as a % of total loans | 0.15                   | % 0.16               | % |
| Total troubled debt restructurings as a % of total loans      | 0.99                   | % 0.97               | % |

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The following table summarizes changes in TDRs for the periods indicated:

Table 7 - Activity in Troubled Debt Restructurings

|                        | Three Months<br>Ended March 31,<br>2014 | Three Months<br>Ended March 31,<br>2013 |
|------------------------|-----------------------------------------|-----------------------------------------|
|                        | (Dollars in thousands)                  |                                         |
| TDRs beginning balance | \$ 45,864                               | \$53,318                                |
| New to TDR status      | 2,851                                   | 1,485                                   |
| Paydowns               | (684)                                   | (4,084)                                 |
| Charge-offs            | (704)                                   | (289)                                   |
| TDRs ending balance    | \$ 47,327                               | \$50,430                                |

Income accruals are suspended on all nonaccrual loans and all previously accrued and uncollected interest is reversed against current income. The table below shows interest income that was recognized or collected on all nonaccrual loans and TDRs as of the dates indicated:

Table 8 - Interest Income Recognized/Collected on Nonaccrual Loans and Troubled Debt Restructurings

|                                                                                                                                                            | Three Months Ended<br>March 31 |       |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-------|
|                                                                                                                                                            | 2014                           | 2013  |
|                                                                                                                                                            | (Dollars in thousands)         |       |
| The amount of incremental gross interest income that would have been recorded if nonaccrual loans had been current in accordance with their original terms | \$447                          | \$388 |
| The amount of interest income on nonaccrual loans and performing TDRs that was included in net income                                                      | 498                            | 652   |

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and industrial, commercial real estate, commercial construction, and small business categories and for all loans identified as a troubled debt restructuring by comparing the loan's value to either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. For impaired loans deemed collateral dependent, where impairment is measured using the fair value of the collateral, the Bank will either order a new appraisal or use another available source of collateral assessment such as a broker's opinion of value to determine a reasonable estimate of the fair value of the collateral.

At March 31, 2014, impaired loans included all commercial and industrial loans, commercial real estate loans, commercial construction, and small business loans that are on nonaccrual status, TDRs, and other loans that have been categorized as impaired. Total impaired loans at March 31, 2014 and December 31, 2013 were \$70.5 million and \$72.1 million, respectively. For additional information regarding the Bank's asset quality, including delinquent loans, nonaccruals, TDRs, and impaired loans, see Note 4, "Loans, Allowance for Loan Losses and Credit Quality" within Notes to Consolidated Financial Statements included in Item 1 hereof.



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Potential problem loans are any loans which are not included in nonaccrual or nonperforming loans, where known information about possible credit problems of the borrowers causes management to have concerns as to the ability of such borrowers to comply with present loan repayment terms. At March 31, 2014, there were 69 relationships, with an aggregate balance of \$71.0 million, deemed to be potential problem loans. These potential problem loans continued to perform with respect to payments. Management actively monitors these loans and strives to minimize any possible adverse impact to the Bank.

**Allowance for Loan Losses** The allowance for loan losses is maintained at a level that management considers adequate to provide for probable loan losses based upon evaluation of known and inherent risks in the loan portfolio. The allowance is increased by providing for loan losses through a charge to expense and by recoveries of loans previously charged-off and is reduced by loans being charged-off.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on increases in nonperforming loans, changes in economic conditions, or for other reasons.

Additionally, various regulatory agencies, as an integral part of the Bank's examination process, periodically assess the adequacy of the allowance for loan losses and may require it to increase its provision for loan losses or recognize further loan charge-offs, in accordance with U.S GAAP.

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The following table summarizes changes in the allowance for loan losses and other selected statistics for the periods presented:

Table 9 - Summary of Changes in the Allowance for Loan Losses

|                                                                              | Three Months Ended     |   |                      |   |                       |   |                  |   |                   |   |  |
|------------------------------------------------------------------------------|------------------------|---|----------------------|---|-----------------------|---|------------------|---|-------------------|---|--|
|                                                                              | March 31,<br>2014      |   | December 31,<br>2013 |   | September 30,<br>2013 |   | June 30,<br>2013 |   | March 31,<br>2013 |   |  |
|                                                                              | (Dollars in thousands) |   |                      |   |                       |   |                  |   |                   |   |  |
| Average total loans                                                          | \$4,788,064            |   | \$4,651,524          |   | \$4,535,596           |   | \$4,540,997      |   | \$4,495,804       |   |  |
| Allowance for loan losses,<br>beginning of period                            | \$53,239               |   | \$53,562             |   | \$52,976              |   | \$51,906         |   | \$51,834          |   |  |
| Charged-off loans                                                            |                        |   |                      |   |                       |   |                  |   |                   |   |  |
| Commercial and industrial                                                    | 783                    |   | 92                   |   | 866                   |   | 1,302            |   | 423               |   |  |
| Commercial real estate                                                       | 2,922                  |   | 2,776                |   | 209                   |   | 196              |   | 407               |   |  |
| Commercial construction                                                      | —                      |   | —                    |   | 308                   |   | —                |   | —                 |   |  |
| Small business                                                               | 268                    |   | 268                  |   | 84                    |   | 276              |   | 145               |   |  |
| Residential real estate                                                      | 128                    |   | 165                  |   | 210                   |   | 186              |   | 61                |   |  |
| Home equity                                                                  | 94                     |   | 416                  |   | 420                   |   | 257              |   | 277               |   |  |
| Other consumer                                                               | 371                    |   | 381                  |   | 273                   |   | 260              |   | 261               |   |  |
| Total charged-off loans                                                      | 4,566                  |   | 4,098                |   | 2,370                 |   | 2,477            |   | 1,574             |   |  |
| Recoveries on loans previously<br>charged-off                                |                        |   |                      |   |                       |   |                  |   |                   |   |  |
| Commercial and industrial                                                    | 79                     |   | 9                    |   | 24                    |   | 103              |   | 136               |   |  |
| Commercial real estate                                                       | 68                     |   | 109                  |   | 89                    |   | 8                |   | —                 |   |  |
| Commercial construction                                                      | —                      |   | 100                  |   | —                     |   | —                |   | —                 |   |  |
| Small business                                                               | 47                     |   | 156                  |   | 47                    |   | 37               |   | 39                |   |  |
| Residential real estate                                                      | —                      |   | 52                   |   | 5                     |   | 86               |   | —                 |   |  |
| Home equity                                                                  | 93                     |   | 62                   |   | 22                    |   | 30               |   | 21                |   |  |
| Other consumer                                                               | 167                    |   | 137                  |   | 119                   |   | 183              |   | 150               |   |  |
| Total recoveries                                                             | 454                    |   | 625                  |   | 306                   |   | 447              |   | 346               |   |  |
| Net loans Charged-off<br>(Recovered)                                         |                        |   |                      |   |                       |   |                  |   |                   |   |  |
| Commercial and industrial                                                    | 704                    |   | 83                   |   | 842                   |   | 1,199            |   | 287               |   |  |
| Commercial real estate                                                       | 2,854                  |   | 2,667                |   | 120                   |   | 188              |   | 407               |   |  |
| Commercial construction                                                      | —                      |   | (100                 |   | ) 308                 |   | —                |   | —                 |   |  |
| Small business                                                               | 221                    |   | 112                  |   | 37                    |   | 239              |   | 106               |   |  |
| Residential real estate                                                      | 128                    |   | 113                  |   | 205                   |   | 100              |   | 61                |   |  |
| Home equity                                                                  | 1                      |   | 354                  |   | 398                   |   | 227              |   | 256               |   |  |
| Other consumer                                                               | 204                    |   | 244                  |   | 154                   |   | 77               |   | 111               |   |  |
| Total net loans charged-off                                                  | 4,112                  |   | 3,473                |   | 2,064                 |   | 2,030            |   | 1,228             |   |  |
| Provision for loan losses                                                    | 4,502                  |   | 3,150                |   | 2,650                 |   | 3,100            |   | 1,300             |   |  |
| Total allowances for loan losses,<br>end of period                           | \$53,629               |   | \$53,239             |   | \$53,562              |   | \$52,976         |   | \$51,906          |   |  |
| Net loans charged-off as a<br>percent of average total loans<br>(annualized) | 0.35                   | % | 0.30                 | % | 0.18                  | % | 0.18             | % | 0.11              | % |  |
| Allowance for loan losses as a<br>percent of total loans                     | 1.12                   | % | 1.13                 | % | 1.18                  | % | 1.17             | % | 1.16              | % |  |

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|                                                                              |        |   |        |   |        |   |        |   |        |   |
|------------------------------------------------------------------------------|--------|---|--------|---|--------|---|--------|---|--------|---|
| Allowance for loan losses as a percent of nonperforming loans                | 148.27 | % | 153.61 | % | 141.37 | % | 144.95 | % | 156.86 | % |
| Net loans charged-off as a percent of allowance for loan losses (annualized) | 31.10  | % | 25.88  | % | 15.29  | % | 15.37  | % | 9.59   | % |
| Recoveries as a percent of charge-offs                                       | 9.94   | % | 15.25  | % | 12.91  | % | 18.05  | % | 21.98  | % |

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For purposes of the allowance for loan losses, management segregates the loan portfolio into the portfolio segments detailed in the table below. The allocation of the allowance for loan losses is made to each loan category using the analytical techniques and estimation methods described herein. While these amounts represent management's best estimate of the distribution of probable losses at the evaluation dates, they are not necessarily indicative of either the categories in which actual losses may occur or the extent of such actual losses that may be recognized within each category. Each of these loan categories possess unique risk characteristics that are considered when determining the appropriate level of allowance for each segment. The total allowance is available to absorb losses from any segment of the loan portfolio.

The following table sets forth the allocation of the allowance for loan losses by loan category at the dates indicated:  
Table 10 - Summary of Allocation of Allowance for Loan Losses

|                                 | March 31,<br>2014      | Percent of<br>Allowance<br>Amount | December 31,<br>2013 | Percent of<br>Allowance<br>Amount |   |
|---------------------------------|------------------------|-----------------------------------|----------------------|-----------------------------------|---|
|                                 |                        | In Category<br>To Total Loans     |                      | In Category<br>To Total Loans     |   |
|                                 | (Dollars in thousands) |                                   |                      |                                   |   |
| Commercial and industrial       | \$15,601               | 17.1                              | % \$15,622           | 16.6                              | % |
| Commercial real estate          | 24,917                 | 47.5                              | % 24,541             | 47.7                              | % |
| Commercial construction         | 3,570                  | 5.0                               | % 3,371              | 4.7                               | % |
| Small business                  | 1,207                  | 1.6                               | % 1,215              | 1.6                               | % |
| Residential real estate         | 2,829                  | 11.2                              | % 2,760              | 11.5                              | % |
| Home equity                     | 4,758                  | 17.2                              | % 5,036              | 17.5                              | % |
| Other consumer                  | 747                    | 0.4                               | % 694                | 0.4                               | % |
| Total allowance for loan losses | \$53,629               | 100.0                             | % \$53,239           | 100.0                             | % |

To determine if a loan should be charged-off, all possible sources of repayment are analyzed. Possible sources of repayment include the potential for future cash flows, the value of the Bank's collateral, and the strength of co-makers or guarantors. When available information confirms that specific loans or portions thereof are uncollectible, these amounts are promptly charged-off against the allowance for loan losses and any recoveries of such previously charged-off amounts are credited to the allowance.

Regardless of whether a loan is unsecured or collateralized, the Company charges off the amount of any confirmed loan loss in the period when the loans, or portions of loans, are deemed uncollectible. For troubled, collateral-dependent loans, loss-confirming events may include an appraisal or other valuation that reflects a shortfall between the value of the collateral and the carrying value of the loan or receivable, or a deficiency balance following the sale of the collateral.

For additional information regarding the Bank's allowance for loan losses, see Note 4, "Loans, Allowance for Loan Losses and Credit Quality" within Notes to Consolidated Financial Statements included in Item 1 hereof.

**Federal Home Loan Bank Stock** The Bank held an investment in Federal Home Loan Bank ("FHLB") of Boston of \$39.9 million at both March 31, 2014 and December 31, 2013. The FHLB is a cooperative that provides services to its member banking institutions. The primary reason for the FHLB of Boston membership is to gain access to a reliable source of wholesale funding, particularly term funding, as a tool to manage interest rate risk. The purchase of stock in the FHLB is a requirement for a member to gain access to funding. The Company purchases FHLB stock proportional to the volume of funding received and views the purchases as a necessary long-term investment for the purposes of balance sheet liquidity and not for investment return.

**Goodwill and Identifiable Intangible Assets** Goodwill and identifiable intangible assets were \$182.1 million and \$182.6 million at March 31, 2014 and December 31, 2013, respectively.

The Company typically performs its annual goodwill impairment testing during the third quarter of the year, unless certain indicators suggest earlier testing to be warranted. The Company performed its annual goodwill impairment testing during the third quarter of 2013 and determined that the Company's goodwill was not impaired. Identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. There were no events or changes that indicated impairment of identifiable intangible assets.

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**Cash Surrender Value of Life Insurance Policies** The Bank holds life insurance policies for the purpose of offsetting its future obligations to its employees under its retirement and benefits plans. The cash surrender value of life insurance policies was \$97.8 million and \$100.4 million at March 31, 2014 and December 31, 2013, respectively. The Bank recorded tax exempt income from the life insurance policies of \$722,000 and \$746,000 for the three months ended March 31, 2014 and March 31, 2013, respectively. Also during the first quarter of 2014, the Company recognized tax exempt gains on life insurance benefits in the amount of \$1.6 million.

**Deposits** As of March 31, 2014, deposits increased by 2.6% to \$5.1 billion when compared to \$5.0 billion at December 31, 2013. Strong deposit growth was heavily led by the core deposit categories, which increased by \$146.2 million from December 31, 2013 to March 31, 2014 and now represent 85.62% of total deposits. Total cost of deposits was 0.22% for the quarter, reflecting management's continued emphasis on core deposits.

The Bank also participates in the Certificate of Deposit Registry Service ("CDARS") program, allowing the Bank to provide easy access to multi-million dollar FDIC deposit insurance protection on certificate of deposits investments for consumers, businesses and public entities. The economic downturn has made the CDARS an attractive product for customers. In addition, the Bank may occasionally raise funds through brokered certificates of deposit. This channel allows the Bank to seek additional funding in potentially large quantities by attracting deposits from outside the Bank's core market. At March 31, 2014 and December 31, 2013, the Company had \$79.5 million and \$77.5 million, respectively, of brokered deposits of which \$58.4 million and \$53.7 million, respectively, were part of the CDARS program.

**Borrowings** The Company's borrowings consist of both short-term and long-term borrowings and provide the Bank with one of its primary sources of funding. Maintaining available borrowing capacity, provides the Bank with a contingent source of liquidity.

The Company's borrowings consisted of the following as of the periods indicated:

Table 11 - Borrowings

|                                                                | March 31,<br>2014      | December 31,<br>2013 |
|----------------------------------------------------------------|------------------------|----------------------|
|                                                                | (Dollars in thousands) |                      |
| Federal Home Loan Bank borrowings                              | \$ 140,228             | \$ 140,294           |
| Short-term borrowings - one year and under (1)                 |                        |                      |
| Customer repurchase agreements and other short-term borrowings | 128,485                | 154,288              |
| Long-term borrowings - over one year (1)                       |                        |                      |
| Wholesale repurchase agreements                                | 50,000                 | 50,000               |
| Junior subordinated debentures:                                |                        |                      |
| Capital Trust V                                                | 51,547                 | 51,547               |
| Slades Ferry Trust I                                           | 10,310                 | 10,310               |
| Central Trust I                                                | 5,258                  | 5,258                |
| Central Trust II                                               | 6,737                  | 6,791                |
| Subordinated debentures                                        | 30,000                 | 30,000               |
| Total long-term borrowings                                     | \$ 153,852             | \$ 153,906           |
| Total borrowings                                               | \$ 422,565             | \$ 448,488           |

(1) Classification is based upon duration at origination and not predicated upon remaining time to maturity.

As of March 31, 2014 and December 31, 2013, the Bank had \$2.8 billion and \$2.9 billion, respectively, of assets pledged as collateral against borrowings. These assets are primarily pledged to the FHLB of Boston, the Federal Reserve Bank of Boston, and serve as collateral for customer repurchase agreements.

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**Capital Resources** On March 20, 2014, the Company's Board of Directors declared a cash dividend of \$0.24 per share to stockholders of record as of the close of business on March 31, 2014. This dividend was paid on April 11, 2014. The Federal Reserve, the FDIC, and other regulatory agencies have established capital guidelines for banks and bank holding companies. Risk-based capital guidelines issued by the federal regulatory agencies require banks to meet a minimum Tier 1 risk-based capital ratio of 4.0% and a total risk-based capital ratio of 8.0%. A minimum requirement of 4.0% Tier 1 leverage capital is also mandated. At March 31, 2014 and December 31, 2013, the Company and the Bank exceeded the minimum requirements for Tier 1 risk-based, total risk-based capital, and Tier 1 leverage capital.

The Company's and the Bank's actual capital amounts and ratios are also presented in the following table:

Table 12 - Company and Bank's Capital Amounts and Ratios

|                                          | Actual                 |       | For Capital Adequacy Purposes |           |   |      | To Be Well Capitalized Under Prompt Corrective Action Provisions |           |     |       |   |
|------------------------------------------|------------------------|-------|-------------------------------|-----------|---|------|------------------------------------------------------------------|-----------|-----|-------|---|
|                                          | Amount                 | Ratio | Amount                        | Ratio     |   |      | Amount                                                           | Ratio     |     |       |   |
|                                          | March 31, 2014         |       |                               |           |   |      |                                                                  |           |     |       |   |
|                                          | (Dollars in thousands) |       |                               |           |   |      |                                                                  |           |     |       |   |
| Company (consolidated)                   |                        |       |                               |           |   |      |                                                                  |           |     |       |   |
| Total capital (to risk weighted assets)  | \$599,447              | 12.52 | %                             | 382,892   | ≥ | 8.00 | %                                                                | N/A       | N/A |       |   |
| Tier 1 capital (to risk weighted assets) | 514,938                | 10.76 | %                             | 191,446   | ≥ | 4.00 | %                                                                | N/A       | N/A |       |   |
| Tier 1 capital (to average assets)       | 514,938                | 8.60  | %                             | 239,645   | ≥ | 4.00 | %                                                                | N/A       | N/A |       |   |
| Bank                                     |                        |       |                               |           |   |      |                                                                  |           |     |       |   |
| Total capital (to risk weighted assets)  | \$590,708              | 12.35 | %                             | \$382,749 | ≥ | 8.00 | %                                                                | \$478,436 | ≥   | 10.00 | % |
| Tier 1 capital (to risk weighted assets) | 506,199                | 10.58 | %                             | 191,375   | ≥ | 4.00 | %                                                                | 287,062   | ≥   | 6.00  | % |
| Tier 1 capital (to average assets)       | 506,199                | 8.45  | %                             | 239,649   | ≥ | 4.00 | %                                                                | 299,561   | ≥   | 5.00  | % |
|                                          | December 31, 2013      |       |                               |           |   |      |                                                                  |           |     |       |   |
|                                          | (Dollars in thousands) |       |                               |           |   |      |                                                                  |           |     |       |   |
| Company (consolidated)                   |                        |       |                               |           |   |      |                                                                  |           |     |       |   |
| Total capital (to risk weighted assets)  | \$589,811              | 12.58 | %                             | \$375,117 | ≥ | 8.00 | %                                                                | N/A       | N/A |       |   |
| Tier 1 capital (to risk weighted assets) | 505,646                | 10.78 | %                             | 187,558   | ≥ | 4.00 | %                                                                | N/A       | N/A |       |   |
| Tier 1 capital (to average assets)       | 505,646                | 8.64  | %                             | 234,153   | ≥ | 4.00 | %                                                                | N/A       | N/A |       |   |
| Bank                                     |                        |       |                               |           |   |      |                                                                  |           |     |       |   |
| Total capital (to risk weighted assets)  | \$582,599              | 12.42 | %                             | \$375,205 | ≥ | 8.00 | %                                                                | \$496,006 | ≥   | 10.00 | % |
| Tier 1 capital (to risk weighted assets) | 498,434                | 10.63 | %                             | 187,603   | ≥ | 4.00 | %                                                                | 281,404   | ≥   | 6.00  | % |
| Tier 1 capital (to average assets)       | 498,434                | 8.51  | %                             | 234,154   | ≥ | 4.00 | %                                                                | 292,692   | ≥   | 5.00  | % |

In July 2013, the Federal Reserve Board, or Federal Reserve, published final rules establishing a new comprehensive capital framework for U.S. banking organizations, referred to herein as the Rules. The FDIC has adopted substantially identical rules (as interim final rules). The Rules implement the Basel Committee's December 2010 framework, commonly referred to as Basel III, for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Rules, among other things: (i) introduce a new capital measure called "Common Equity Tier 1," or CET1; (ii) specify that Tier 1 capital consist of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements; (iii) apply most deductions/adjustments to regulatory capital measures to CET1 and not to the other components of capital, thus potentially requiring higher levels of CET1 in order to meet minimum ratios; and (iv) expand the scope of the reductions/adjustments from capital as compared to existing regulations. Based upon

preliminary assessments of the proposed framework, management believes that the Company will continue to exceed all estimated well-capitalized regulatory requirements over the course of the proposed phase-in period.

**Dividend Restrictions** In the ordinary course of business, the Company is dependent upon dividends from the Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels.

Approval is also required if dividends declared

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exceed the net profits for that year combined with the retained net profits for the preceding two years. Under the foregoing dividend restrictions and while maintaining regulatory capital in excess of "well capitalized" minimum levels, dividends paid by the Bank to the Company for the periods ended March 31, 2014 and 2013 totaled \$8.3 million and \$7.2 million, respectively.

Trust Preferred Securities In accordance with the applicable accounting standard related to variable interest entities, the common stock of trusts which have issued trust preferred securities have not been included in the consolidated financial statements. At both March 31, 2014 and March 31, 2013, \$71.0 million, in trust preferred securities have been included in the Tier 1 capital of the Company for regulatory reporting purposes pursuant to the Federal Reserve's capital adequacy guidelines. Certain provisions of the Basel III capital standards proposal will require trust preferred securities to be excluded from Tier 1 capital, however, the Company qualifies under certain grandfathering provisions which allows the trust preferred securities to continue to be treated as Tier 1 capital under the Basel III capital standards.

Investment Management As of March 31, 2014, the Rockland Trust Investment Management Group had assets under administration of \$2.3 billion, representing approximately 4,505 trust, fiduciary, and agency accounts. At December 31, 2013, assets under administration were also \$2.3 billion, representing approximately 4,401 trust, fiduciary, and agency accounts. Included in these amounts as of March 31, 2014 and December 31, 2013 are assets under administration of \$198.2 million and \$195.9 million, respectively, relating to the Company's registered investment advisor, Bright Rock Capital Management, LLC, which provides institutional quality investment management services to institutional and high net worth clients. Revenue from the Investment Management Group amounted to \$4.1 million and \$3.5 million for the three months ended March 31, 2014 and March 31, 2013, respectively.

Additionally, for the three months ended March 31, 2014 and March 31, 2013, retail investments and insurance revenue was \$533,000 and \$348,000, respectively. Retail investments and insurance includes commission revenue from LPL Financial and its affiliates, LPL Insurance Associates, Inc., Savings Bank Life Insurance of Massachusetts, and Smith Companies LTD, a division of Capitas Financial, LLC.

**RESULTS OF OPERATIONS**

The following table provides a summary of results of operations:

Table 13 - Summary of Results of Operations

|                            | Three Months Ended March 31 |   |          |   |
|----------------------------|-----------------------------|---|----------|---|
|                            | 2014                        |   | 2013     |   |
|                            | (Dollars in thousands)      |   |          |   |
| Net Income                 | \$13,383                    |   | \$12,252 |   |
| Diluted earnings per share | \$0.56                      |   | \$0.54   |   |
| Return on average assets   | 0.88                        | % | 0.88     | % |
| Return on average equity   | 9.02                        | % | 9.25     | % |
| Net interest margin        | 3.49                        | % | 3.58     | % |

Net Interest Income The amount of net interest income is affected by changes in interest rates and by the volume and mix of interest earning assets and interest bearing liabilities.

On a fully tax equivalent basis, net interest income for the first quarter of 2014 increased \$2.8 million, or 6.2%, to \$47.9 million, when compared to the first quarter of 2013. The decline in the net interest margin is primarily the result of assets re-pricing in a lower rate environment without the ability to fully offset this impact through further reductions in funding costs.

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The following tables present the Company's average balances, net interest income, interest rate spread, and net interest margin for the three months ending March 31, 2014 and 2013. Nontaxable income from loans and securities is presented on a fully tax-equivalent basis by adjusting tax-exempt income upward by an amount equivalent to the prevailing income taxes that would have been paid if the income had been fully taxable.

Table 14 - Average Balance, Interest Earned/Paid &amp; Average Yields

|                                                                                            | Three Months Ended March 31<br>2014 |                             |                  |   | 2013               |                             |                  |   |
|--------------------------------------------------------------------------------------------|-------------------------------------|-----------------------------|------------------|---|--------------------|-----------------------------|------------------|---|
|                                                                                            | Average<br>Balance                  | Interest<br>Earned/<br>Paid | Average<br>Yield |   | Average<br>Balance | Interest<br>Earned/<br>Paid | Average<br>Yield |   |
| (Dollars in thousands)                                                                     |                                     |                             |                  |   |                    |                             |                  |   |
| Interest-earning assets                                                                    |                                     |                             |                  |   |                    |                             |                  |   |
| Interest-earning deposits with banks,<br>federal funds sold, and short term<br>investments | \$61,356                            | \$38                        | 0.25             | % | \$53,149           | \$34                        | 0.26             | % |
| Securities                                                                                 |                                     |                             |                  |   |                    |                             |                  |   |
| Taxable investment securities                                                              | 706,355                             | 4,650                       | 2.67             | % | 523,550            | 3,529                       | 2.73             | % |
| Nontaxable investment securities (1)                                                       | 6,143                               | 63                          | 4.16             | % | 916                | 18                          | 7.97             | % |
| Total securities                                                                           | 712,498                             | 4,713                       | 2.68             | % | 524,466            | 3,547                       | 2.74             | % |
| Loans held for sale                                                                        | 6,041                               | 51                          | 3.42             | % | 41,890             | 268                         | 2.59             | % |
| Loans (2)                                                                                  |                                     |                             |                  |   |                    |                             |                  |   |
| Commercial and industrial                                                                  | 816,467                             | 7,941                       | 3.94             | % | 693,284            | 6,838                       | 4.00             | % |
| Commercial real estate (1)                                                                 | 2,281,778                           | 24,205                      | 4.30             | % | 2,121,824          | 23,729                      | 4.54             | % |
| Commercial construction                                                                    | 228,818                             | 2,346                       | 4.16             | % | 199,303            | 2,016                       | 4.10             | % |
| Small business                                                                             | 77,503                              | 1,069                       | 5.59             | % | 77,688             | 1,060                       | 5.53             | % |
| Total commercial                                                                           | 3,404,566                           | 35,561                      | 4.24             | % | 3,092,099          | 33,643                      | 4.41             | % |
| Residential real estate                                                                    | 540,382                             | 5,166                       | 3.88             | % | 580,617            | 5,918                       | 4.13             | % |
| Home equity                                                                                | 823,890                             | 7,258                       | 3.57             | % | 797,204            | 7,094                       | 3.61             | % |
| Total consumer real estate                                                                 | 1,364,272                           | 12,424                      | 3.69             | % | 1,377,821          | 13,012                      | 3.83             | % |
| Other consumer                                                                             | 19,226                              | 485                         | 10.23            | % | 25,884             | 561                         | 8.79             | % |
| Total loans                                                                                | 4,788,064                           | 48,470                      | 4.11             | % | 4,495,804          | 47,216                      | 4.26             | % |
| Total interest-earning assets                                                              | \$5,567,959                         | \$53,272                    | 3.88             | % | \$5,115,309        | \$51,065                    | 4.05             | % |
| Cash and due from banks                                                                    | 140,788                             |                             |                  |   | 68,653             |                             |                  |   |
| Federal Home Loan Bank stock                                                               | 39,926                              |                             |                  |   | 41,045             |                             |                  |   |
| Other assets                                                                               | 405,367                             |                             |                  |   | 420,470            |                             |                  |   |
| Total assets                                                                               | \$6,154,040                         |                             |                  |   | \$5,645,477        |                             |                  |   |
| Interest-bearing liabilities                                                               |                                     |                             |                  |   |                    |                             |                  |   |
| Deposits                                                                                   |                                     |                             |                  |   |                    |                             |                  |   |
| Savings and interest checking accounts                                                     | \$1,962,983                         | \$889                       | 0.18             | % | \$1,612,395        | \$707                       | 0.18             | % |
| Money market                                                                               | 997,817                             | 619                         | 0.25             | % | 868,405            | 578                         | 0.27             | % |
| Time deposits                                                                              | 733,018                             | 1,281                       | 0.71             | % | 758,504            | 1,380                       | 0.74             | % |
| Total interest-bearing deposits                                                            | \$3,693,818                         | \$2,789                     | 0.31             | % | \$3,239,304        | \$2,665                     | 0.33             | % |
| Borrowings                                                                                 |                                     |                             |                  |   |                    |                             |                  |   |
| Federal Home Loan Bank                                                                     | \$151,273                           | \$1,002                     | 2.69             | % | \$271,558          | \$1,378                     | 2.06             | % |
| Customer repurchase agreements and<br>other short-term borrowings                          | 138,536                             | 55                          | 0.16             | % | 155,666            | 91                          | 0.24             | % |
| Wholesale repurchase agreements                                                            | 50,000                              | 286                         | 2.32             | % | 50,000             | 286                         | 2.32             | % |
| Junior subordinated debentures                                                             | 73,884                              | 992                         | 5.45             | % | 74,104             | 999                         | 5.47             | % |

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|                         |        |     |      |   |        |     |      |   |
|-------------------------|--------|-----|------|---|--------|-----|------|---|
| Subordinated debentures | 30,000 | 248 | 3.35 | % | 30,000 | 539 | 7.29 | % |
|-------------------------|--------|-----|------|---|--------|-----|------|---|

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|                                                      |             |          |      |   |             |          |      |   |
|------------------------------------------------------|-------------|----------|------|---|-------------|----------|------|---|
| Total borrowings                                     | \$443,693   | \$2,583  | 2.36 | % | \$581,328   | \$3,293  | 2.30 | % |
| Total interest-bearing liabilities                   | \$4,137,511 | \$5,372  | 0.53 | % | \$3,820,632 | \$5,958  | 0.63 | % |
| Demand deposits                                      | 1,347,559   |          |      |   | 1,200,810   |          |      |   |
| Other liabilities                                    | 67,259      |          |      |   | 86,769      |          |      |   |
| Total liabilities                                    | \$5,552,329 |          |      |   | \$5,108,211 |          |      |   |
| Stockholders' equity                                 | 601,711     |          |      |   | 537,266     |          |      |   |
| Total liabilities and stockholders' equity           | \$6,154,040 |          |      |   | \$5,645,477 |          |      |   |
| Net interest income (1)                              |             | \$47,900 |      |   |             | \$45,107 |      |   |
| Interest rate spread (3)                             |             |          | 3.35 | % |             |          | 3.42 | % |
| Net interest margin (4)                              |             |          | 3.49 | % |             |          | 3.58 | % |
| Supplemental information                             |             |          |      |   |             |          |      |   |
| Total deposits, including demand deposits            | \$5,041,377 | \$2,789  |      |   | \$4,440,114 | \$2,665  |      |   |
| Cost of total deposits                               |             |          | 0.22 | % |             |          | 0.24 | % |
| Total funding liabilities, including demand deposits | \$5,485,070 | \$5,372  |      |   | \$5,021,442 | \$5,958  |      |   |
| Cost of total funding liabilities                    |             |          | 0.40 | % |             |          | 0.48 | % |

- The total amount of adjustment to present interest income and yield on a FTE basis is \$291,000 and \$245,000 for the three months ended March 31, 2014 and 2013, respectively. The FTE adjustment relates to nontaxable
- (1) investment securities with average balance of \$6.1 million and \$915,000 and nontaxable industrial development bonds recorded within commercial real estate with average balances of \$45.0 million and \$35.4 million, for the three months ended March 31, 2014 and 2013, respectively.
- (2) Average nonaccruing loans are included in loans.
- (3) Interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.
- (4) Net interest margin represents annualized net interest income as a percentage of average interest-earning assets.

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The following table presents certain information on a fully tax-equivalent basis regarding changes in the Company's interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to: (1) changes in rate (change in rate multiplied by old volume), (2) changes in volume (change in volume multiplied by old rate), and (3) changes in volume/rate (change in volume multiplied by change in rate) which is allocated to the change due to rate column:

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Table 15 - Volume Rate Analysis

|                                                                         | Three Months Ended March 31<br>2014 Compared To 2013 |                            |                 | Three Months Ended March 31<br>2013 Compared To 2012 |                            |                 |
|-------------------------------------------------------------------------|------------------------------------------------------|----------------------------|-----------------|------------------------------------------------------|----------------------------|-----------------|
|                                                                         | Change<br>Due to<br>Rate                             | Change<br>Due to<br>Volume | Total<br>Change | Change<br>Due to<br>Rate                             | Change<br>Due to<br>Volume | Total<br>Change |
| (Dollars in thousands)                                                  |                                                      |                            |                 |                                                      |                            |                 |
| Income on interest-earning assets                                       |                                                      |                            |                 |                                                      |                            |                 |
| Interest earning deposit, federal funds sold and short term investments | \$(1 )                                               | \$5                        | \$4             | \$1                                                  | \$—                        | \$1             |
| Securities                                                              |                                                      |                            |                 |                                                      |                            |                 |
| Trading assets                                                          | —                                                    | —                          | —               | —                                                    | (38 )                      | (38 )           |
| Taxable securities                                                      | (111 )                                               | 1,232                      | 1,121           | (903 )                                               | (57 )                      | (960 )          |
| Nontaxable securities (1)                                               | (58 )                                                | 103                        | 45              | —                                                    | (31 )                      | (31 )           |
| Total securities                                                        |                                                      |                            | 1,166           |                                                      |                            | (1,029 )        |
| Loans held for sale                                                     | 12                                                   | (229 )                     | (217 )          | (49 )                                                | 187                        | 138             |
| Loans                                                                   |                                                      |                            |                 |                                                      |                            |                 |
| Commercial and industrial                                               | (112 )                                               | 1,215                      | 1,103           | (227 )                                               | 1,164                      | 937             |
| Commercial real estate (1)                                              | (1,313 )                                             | 1,789                      | 476             | (2,372 )                                             | 3,367                      | 995             |
| Commercial construction                                                 | 31                                                   | 299                        | 330             | (139 )                                               | 612                        | 473             |
| Small business                                                          | 12                                                   | (3 )                       | 9               | (62 )                                                | (15 )                      | (77 )           |
| Total commercial                                                        |                                                      |                            | 1,918           |                                                      |                            | 2,328           |
| Residential real estate                                                 | (342 )                                               | (410 )                     | (752 )          | (399 )                                               | 1,721                      | 1,322           |
| Home equity                                                             | (73 )                                                | 237                        | 164             | (305 )                                               | 739                        | 434             |
| Total consumer real estate                                              |                                                      |                            | (588 )          |                                                      |                            | 1,756           |
| Other consumer                                                          | 68                                                   | (144 )                     | (76 )           | 45                                                   | (255 )                     | (210 )          |
| Total loans (1)(2)                                                      |                                                      |                            | 1,254           |                                                      |                            | 3,874           |
| Total income of interest-earning assets                                 |                                                      |                            | 2,207           |                                                      |                            | 2,984           |
| Expense of interest-bearing liabilities                                 |                                                      |                            |                 |                                                      |                            |                 |
| Deposits                                                                |                                                      |                            |                 |                                                      |                            |                 |
| Savings and interest checking accounts                                  | \$28                                                 | \$154                      | \$182           | \$(82 )                                              | \$92                       | \$10            |
| Money market                                                            | (45 )                                                | 86                         | 41              | (143 )                                               | 82                         | (61 )           |
| Time certificates of deposits                                           | (53 )                                                | (46 )                      | (99 )           | (319 )                                               | 296                        | (23 )           |
| Total interest bearing deposits                                         |                                                      |                            | 124             |                                                      |                            | (74 )           |
| Borrowings                                                              |                                                      |                            |                 |                                                      |                            |                 |
| Federal Home Loan Bank borrowings                                       | 235                                                  | (611 )                     | (376 )          | (234 )                                               | 268                        | 34              |
| Customer repurchase agreements and other short-term borrowings          | (26 )                                                | (10 )                      | (36 )           | (17 )                                                | (2 )                       | (19 )           |
| Wholesale repurchase agreements                                         | —                                                    | —                          | —               | (3 )                                                 | —                          | (3 )            |
| Junior subordinated debentures                                          | (4 )                                                 | (3 )                       | (7 )            | (103 )                                               | 182                        | 79              |
| Subordinated debt                                                       | (291 )                                               | —                          | (291 )          | (2 )                                                 | —                          | (2 )            |
| Total borrowings                                                        |                                                      |                            | (710 )          |                                                      |                            | 89              |
| Total expense of interest-bearing liabilities                           |                                                      |                            | (586 )          |                                                      |                            | 15              |
| Change in net interest income                                           |                                                      |                            | \$2,793         |                                                      |                            | \$2,969         |

(1)The total amount of adjustment to present interest income and yield on a FTE basis is \$291,000 and \$245,000 for the three months ended March 31, 2014 and 2013, respectively. The FTE adjustment relates to nontaxable investment securities with an average balance of \$6.1 million and \$915,000 and nontaxable industrial development

bonds recorded within commercial real estate with an average balance of \$45.0 million and \$35.4 million for the three months ended March 31, 2014 and 2013, respectively.

- (2) Loans include portfolio loans and nonaccrual loans; however, unpaid interest on nonaccrual loans has not been included for purposes of determining interest income.

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**Provision For Loan Losses** The provision for loan losses represents the charge to expense that is required to maintain an adequate level of allowance for loan losses. The provision for loan losses totaled \$4.5 million and \$1.3 million for the three months ended March 31, 2014 and March 31, 2013, respectively. The increase in the provision was driven mainly by the charge-off of one relatively large commercial real estate credit. The Company's allowance for loan losses, as a percentage of total loans, was 1.12% at March 31, 2014, as compared to 1.13% at December 31, 2013 and 1.16% at March 31, 2013. For the three months ended March 31, 2014 and 2013, net loan charge-offs totaled \$4.1 million and \$1.2 million, respectively.

Regional and local general economic conditions continued to improve during the first quarter of 2014, as measured by employment levels, consumer confidence, economic activity, and other regional economic indicators. Local residential real estate market fundamentals were mixed during the first quarter of 2014, characterized by a lower level of home sales, lower inventory levels, and increased sales prices compared to the same period in 2013. Foreclosures are down for the 16th consecutive month. Regional commercial real estate market conditions were mixed, with some markets experiencing positive trends, while others exhibit higher vacancy rates and flat to negative absorption. Leading economic indicators suggest continued economic improvement through the first half of 2014.

Management's periodic evaluation of the adequacy of the allowance for loan losses considers past loan loss experience, known and inherent risks in the loan portfolio, adverse situations which may affect the borrowers' ability to repay, the estimated value of the underlying collateral, if any, and current economic conditions. Substantial portions of the Bank's loans are secured by real estate in Massachusetts and Rhode Island. Accordingly, the ultimate collectability of a substantial portion of the Bank's loan portfolio is susceptible to changes in property values within those states.

**Noninterest Income** The following table sets forth information regarding noninterest income for the periods shown:

Table 16 - Noninterest Income

|                                                             | Three Months Ended     |          | Change  |         |    |
|-------------------------------------------------------------|------------------------|----------|---------|---------|----|
|                                                             | March 31               |          | Amount  | %       |    |
|                                                             | 2014                   | 2013     |         |         |    |
|                                                             | (Dollars in thousands) |          |         |         |    |
| Deposit account fees                                        | \$4,359                | \$4,217  | \$142   | 3.37    | %  |
| Interchange and ATM fees                                    | 2,975                  | 2,328    | 647     | 27.79   | %  |
| Investment management                                       | 4,603                  | 3,884    | 719     | 18.51   | %  |
| Mortgage banking                                            | 487                    | 2,281    | (1,794) | (78.65) | )% |
| Loan level derivative income                                | 746                    | 532      | 214     | 40.23   | %  |
| Increase in cash surrender value of life insurance policies | 722                    | 746      | (24)    | (3.22)  | )% |
| Net gain on sale of equity securities                       | 91                     | —        | 91      | 100.00  | %  |
| Gain on life insurance benefits                             | 1,627                  | —        | 1,627   | 100.00  | %  |
| Other noninterest income                                    | 1,906                  | 1,736    | 170     | 9.79    | %  |
| Total                                                       | \$17,516               | \$15,724 | \$1,792 | 11.40   | %  |

Noninterest income amounted to \$17.5 million during the three months ended March 31, 2014, a \$1.8 million, or 11.4%, increase from the same period in the prior year. The primary reasons for the significant variances in the noninterest income category shown in the preceding table are noted below:

Interchange and ATM fees increased due to the Company's focus on core checking accounts and increased debit card usage.

Investment management income was led by strong sales, particularly in the retail channel. Additionally, assets under administration were \$2.3 billion at March 31, 2014, an increase of \$52.3 million, or 2.3%, as compared to the same period in the prior year.

Mortgage banking income decreased for the three months ended March 31, 2014 as compared to the year ago period, reflective of a decrease in overall mortgage production.

Loan level derivative income increase reflects a higher level of commercial loan closings where a derivative was employed.



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The Company recorded gains on life insurance benefits in the amount of \$1.6 million for the quarter ended March 31, 2014, which represented tax-exempt income to the Company. There were no such benefits recorded during the quarter ended March 31, 2013.

Other noninterest income's increase was led by an increase of \$111,000 in Federal Home Loan Bank dividend income as the dividend rate was increased during the first quarter.

Noninterest Expense The following table sets forth information regarding non-interest expense for the periods shown:

Table 17 - Noninterest Expense

|                                         | Three Months Ended     |          | Change    |         |   |
|-----------------------------------------|------------------------|----------|-----------|---------|---|
|                                         | March 31<br>2014       | 2013     |           |         |   |
|                                         | (Dollars in thousands) |          | Amount    | %       |   |
| Salaries and employee benefits          | \$23,080               | \$22,715 | \$365     | 1.61    | % |
| Occupancy and equipment expense         | 6,146                  | 5,249    | 897       | 17.09   | % |
| Data processing & facilities management | 1,253                  | 1,184    | 69        | 5.83    | % |
| Consulting expense                      | 559                    | 710      | (151)     | (21.27) | % |
| FDIC Assessment                         | 905                    | 821      | 84        | 10.23   | % |
| Debit card expense                      | 614                    | 670      | (56)      | (8.36)  | % |
| Advertising expense                     | 824                    | 1,172    | (348)     | (29.69) | % |
| Software maintenance                    | 662                    | 681      | (19)      | (2.79)  | % |
| Telecommunication expense               | 548                    | 655      | (107)     | (16.34) | % |
| Merger and acquisition expense          | 77                     | 1,345    | (1,268)   | (94.28) | % |
| Other noninterest expenses              | 7,219                  | 7,718    | (499)     | (6.47)  | % |
| Total                                   | \$41,887               | \$42,920 | \$(1,033) | (2.41)  | % |

Noninterest expense decreased by \$1.0 million, or 2.4%, during the three months ended March 31, 2014, as compared to the same period in the prior year. The primary reasons for the significant variances in the noninterest expense category shown in the preceding table are noted below:

Occupancy and equipment expense increases were attributable to impairment on acquired facilities of \$503,000 and increased snow removal costs of \$150,000 as compared to the first quarter of the prior year.

Consulting expense was lower in the first quarter of 2014 due to the timing of certain initiatives.

Advertising expense decreased as compared to the year ago period due to the timing of marketing campaigns.

Telecommunication expense decreased from the prior year as the prior year included increased costs associated with certain system conversions.

Merger and acquisition expense in 2014 relates to the Mayflower acquisition which closed in November of 2013 and in 2013 relates to the Central Bancorp, Inc. acquisition which closed in November of 2012.

Other noninterest expense decreased by \$499,000, or 6.5%, for the three months ended March 31, 2014 compared to the prior year period. The decreases were driven by a decrease in loan workout costs of \$324,000 and a decrease in contract labor of \$298,000, offset by a slight increase in internet banking expense.

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**Income Taxes** The tax effect of all income and expense transactions is recognized by the Company in each year's consolidated statements of income, regardless of the year in which the transactions are reported for income tax purposes. The following table sets forth information regarding the Company's tax provision and applicable tax rates for the periods indicated:

Table 18 - Tax Provision and Applicable Tax Rates

|                                                  | Three Months Ended<br>March 31 |           |
|--------------------------------------------------|--------------------------------|-----------|
|                                                  | 2014                           | 2013      |
|                                                  | (Dollars in thousands)         |           |
| Combined federal and state income tax provisions | \$5,350                        | \$4,114   |
| Effective income tax rates                       | 28.56                          | % 25.14 % |

The effective income tax rates are lower than the blended statutory tax rate of 40.85% for the three months ended March 31, 2014 and 2013, due to certain tax preference assets such as life insurance policies and tax exempt bonds, as well as federal tax credits recognized primarily in connection with the New Markets Tax Credit program and investments in Low Income Housing Project Investments. The increase in the tax rate for 2014 was primarily due to a reduction in the benefits recognized from New Markets Tax Credits.

The Company's subsidiaries have received several awards of tax credit allocation authority under the federal New Markets Tax Credit Program which enable the Company to recognize federal tax credits over a seven year period totaling 39.0% of the total award. The Company recognizes federal tax credits as capital investments are made into its subsidiaries to fund below market interest rate loans to qualifying businesses in low income communities. The following table details the remaining tax credit recognition by year associated with this program:

Table 19—New Markets Tax Credit Recognition Schedule

| Investment |         | 2014                   | 2015    | 2016    | 2017    | 2018    | 2019    | Total<br>Remaining<br>Credits |
|------------|---------|------------------------|---------|---------|---------|---------|---------|-------------------------------|
|            |         | (Dollars in thousands) |         |         |         |         |         |                               |
| 2008       | \$6.8   | M 408                  | —       | —       | —       | —       | —       | 408                           |
| 2009       | 10.0    | M 600                  | 600     | —       | —       | —       | —       | 1,200                         |
| 2010       | 40.0    | M 2,400                | 2,400   | 2,400   | —       | —       | —       | 7,200                         |
| 2012       | 21.4    | M 1,071                | 1,285   | 1,285   | 1,285   | 1,285   | —       | 6,211                         |
| 2013       | 44.6    | M 2,229                | 2,229   | 2,675   | 2,675   | 2,675   | 2,675   | 15,158                        |
| Total      | \$122.8 | M \$6,708              | \$6,514 | \$6,360 | \$3,960 | \$3,960 | \$2,675 | \$30,177                      |

The Company invests in various Low Income Housing Projects which are real estate limited partnerships that acquire, develop, own and operate low and moderate-income housing. As a limited partner in these operating partnerships, the Company will receive tax credits and tax deductions for losses incurred by the underlying properties. The investments are accounted for using the proportional amortization method and will be amortized over various periods through 2030, which represents the period that the tax benefits will be utilized. It is expected that the limited partnership investments will generate a net tax benefit of approximately \$12.2 million over the remaining life of the investments from the combination of the tax credits and operating losses.

Deferred tax assets generally represent items that can be used as a tax deduction or credit in future income tax returns, for which a financial statement tax benefit has already been recognized. The realization of the net deferred tax asset generally depends upon future levels of taxable income and the existence of prior years' taxable income to which "carry-back" refund claims could be made. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or

settled. The effect of a change in enacted tax rates on the deferred tax assets is recognized in income in the period that includes the enactment date. The Company had no recorded tax valuation allowance as of March 31, 2014 and 2013.

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### Risk Management

The Company's Board of Directors and Executive Management have identified significant risk categories which affect the Company. The risk categories include: credit risk, operations risk, compliance risk, reputation risk, strategic risk, market risk and liquidity risk. The Board of Directors has approved a Risk Management Policy that addresses each category of risk. The Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Information Officer, Director of Residential Lending and Compliance Officer, Executive Vice President of Commercial Lending and other members of management provide regular reports to the Board of Directors, identifying key risk issues and plans to address these issues. The Board of Directors will ensure the level of risk is within limits established by both the Risk Management Policy and other previously approved policies.

**Credit Risk** Credit risk represents the possibility that the Company's borrowing customers or other counterparties may not repay loans or other contractual obligations according to their terms due to changes in the financial capacity and ability of such borrowing customers or counterparties to meet their obligations. In some cases, the collateral securing the payment of the loans may be sufficient to assure repayment, but in other cases the Company may experience significant credit losses which could have an adverse effect on its operating results. The Company makes various assumptions and judgments about the collectability of its loan portfolio, including the creditworthiness of its borrowers and counterparties and the value of the real estate and other assets serving as collateral for the repayment of loans. For further discussion regarding the credit risk and the credit quality of the Company's loan portfolio, see Note 4, "Loans, Allowance for Loan Losses and Credit Quality" within Notes to Consolidated Financial Statements included in Item 1 hereof.

**Operations Risk** Operations risk is the risk of loss due to human behavior, inadequate or failed internal systems and controls, and external influences such as market conditions, fraudulent activities, disasters and security risks. The Company continuously strives to strengthen its system of internal controls, operating processes and employee awareness. The Bank has an Operations Risk Management Committee that meets monthly and reports to the Board quarterly or more frequently if warranted. The Committee is chaired by the Director of Compliance and members of the Committee include representatives from Audit, Finance, Technology, Information Security and periodic attendance from business units throughout the organization. An operations risk management dashboard is updated quarterly and reviewed with the Board.

**Compliance Risk** Compliance risk represents the risk of regulatory sanctions or financial loss resulting from the Company's failure to comply with rules and regulations issued by the various banking agencies, the U.S. Securities and Exchange Commission, and the NASDAQ Stock Market, and standards of good banking practice. Activities which may expose the Company to compliance risk include, but are not limited to, those dealing with the prevention of money laundering, privacy and data protection, adherence to all applicable laws and regulations, community reinvestment initiatives and employment and tax matters. Compliance risk is mitigated through the use of written policies and procedures, training of staff, and monitoring of activities for adherence to those procedures.

**Strategic and Reputation Risk** Strategic and reputation risk represent the risk of loss due to impairment of reputation, failure to fully develop and execute business plans, and failure to assess current and new opportunities in business, markets and products. Mitigation of strategic and/or reputational risk is achieved through robust annual strategic planning and frequent executive strategic reviews, ongoing competitive and technological observation, rigorous assessment processes of new product, new branch, and new business initiatives, adherence to ethical standards and a philosophy of customer advocacy, a structured process of customer complaint resolution, and ongoing reputational monitoring and management tools.

**Market Risk** Market risk is the sensitivity of income to changes in interest rates, foreign exchange rates, commodity prices and other market-driven rates or prices. Interest rate sensitivity is the most significant market risk to which the Company is exposed.

Interest rate risk is the sensitivity of income to changes in interest rates. Changes in interest rates, as well as fluctuations in the level and duration of assets and liabilities, affect net interest income, the Company's primary source of revenue. Interest rate risk arises directly from the Company's core banking activities. In addition to directly impacting net interest income, changes in the level of interest rates can also affect the amount of loans originated, the timing of cash flows on loans and securities, and the fair value of securities and derivatives, as well as other effects.

The primary goal of interest rate risk management is to control this risk within limits approved by the Board of Directors. These limits reflect the Company's tolerance for interest rate risk over both short-term and long-term horizons. The Company attempts to control interest rate risk by identifying, quantifying, and where appropriate, hedging its exposure. If assets and liabilities do not re-price simultaneously and in equal volume, the potential for interest rate exposure exists. It is management's objective to maintain stability in the growth of net interest income through the maintenance of an appropriate mix of interest-earning assets and interest-bearing liabilities and, when necessary, within prudent limits, through the use of off-balance sheet hedging instruments such as interest rate swaps, floors and caps.

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The Company quantifies its interest rate exposures using net interest income simulation models, as well as simpler gap analysis, and Economic Value of Equity analysis. Key assumptions in these simulation analyses relate to behavior of interest rates and behavior of the Company's deposit and loan customers. The most material assumptions relate to the prepayment of mortgage assets (including mortgage loans and mortgage-backed securities) and the life and sensitivity of nonmaturity deposits (e.g. DDA, NOW, savings and money market). In the case of prepayment of mortgage assets, assumptions are derived from published dealer median prepayment estimates for comparable mortgage loans. The risk of prepayment tends to increase when interest rates fall. Since future prepayment behavior of loan customers is uncertain, the resultant interest rate sensitivity of loans cannot be determined exactly.

The Company's policy on interest-rate risk simulation specifies that for all "core" interest rate scenarios, estimated net interest income for the subsequent one-year period should not decline by more than 10%. The Company's core scenarios for March 31, 2014 included five instantaneous parallel shifts ("shocks") to market interest rates and four gradual (12 to 24 months) shifts in interest. Additionally, the Company also analyzed a separate alternative scenario labeled "Yield Curve Twist," in which the yield curve steepened over the first 18 months of the simulation, raising long term rates, and then flattened over months 19-36, as the short term rates increased, targeting fed fund rate at 4.00%. The results of all scenarios are outlined in the table below:

Table 20 - Interest Rate Sensitivity

|                                     | Impact on Net Interest Income |        |    |     |        |        |    |  |
|-------------------------------------|-------------------------------|--------|----|-----|--------|--------|----|--|
|                                     | Three Months Ended March 31   |        |    |     |        |        |    |  |
|                                     | 2014                          |        |    |     | 2013   |        |    |  |
|                                     | Year 1                        | Year 2 |    |     | Year 1 | Year 2 |    |  |
| Parallel rate shocks (basis points) |                               |        |    |     |        |        |    |  |
| -100                                | 0.1                           | % (3.4 | )% |     | 0.2    | % (4.8 | )% |  |
| +100                                | 3.9                           | % 5.8  | %  |     | 4.2    | % 3.8  | %  |  |
| +200                                | 8.0                           | % 12.0 | %  |     | 8.2    | % 9.9  | %  |  |
| +300                                | 12.1                          | % 18.3 | %  |     | 12.2   | % 15.8 | %  |  |
| +400                                | 16.1                          | % 24.5 | %  |     | 16.0   | % 21.6 | %  |  |
| Gradual rate shifts (basis points)  |                               |        |    |     |        |        |    |  |
| -100 over 12 months                 | 0.4                           | % (2.1 | )% |     | 0.6    | % (3.4 | )% |  |
| +200 over 12 months                 | 3.4                           | % 10.2 | %  |     | 3.5    | % 7.8  | %  |  |
| +400 over 24 months                 | 3.4                           | % 14.1 | %  |     | 3.5    | % 11.4 | %  |  |
| Flat +500 over 12 months            | 4.2                           | % 16.4 | %  |     | 4.4    | % 14.4 | %  |  |
| Alternative scenarios               |                               |        |    |     |        |        |    |  |
| Yield curve twist                   | 0.6                           | % 4.1  | %  | n/a |        | n/a    |    |  |

The Company's policy on interest rate risk simulation also specifies that estimated net interest income for the second year of all "core scenarios" should decline by less than 15.0%. The Company was within policy limits at March 31, 2014 and 2013. It should be emphasized, however, that the results are dependent on material assumptions such as those discussed above. For instance, asymmetrical rate behavior can have a material impact on the simulation results. If competition for deposits forced the Company to raise rates on those liabilities quicker than is assumed in the simulation analysis without a corresponding increase in asset yields, net interest income may be negatively impacted. Alternatively, if the Company is able to lag increases in deposit rates as loans re-price upward, net interest income would be positively impacted.

The most significant factors affecting market risk exposure of the Company's net interest income during the three months ended March 31, 2014 were the shape of the U.S. Government securities and interest rate swap yield curve, the level of U.S. prime interest rate and LIBOR rates, and the level of interest rates being offered on long-term fixed rate loans.

The Company manages the interest rate risk inherent in both its loan and borrowing portfolios by utilizing interest rate swap agreements and interest rate caps and floors. An interest rate swap is an agreement whereby one party agrees to pay a floating rate of interest on a notional principal amount in exchange for receiving a fixed rate of interest on the same notional amount for a predetermined period of time from a second party. Interest rate caps and floors are agreements whereby one party agrees to pay a floating rate of interest on a notional principal amount for a predetermined period of time to a second party if certain market

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interest rate thresholds are realized. The amounts relating to the notional principal amount are not actually exchanged. Additionally, the Company manages the interest rate risk inherent in its mortgage banking operations by entering into forward sales contracts and forward TBA mortgage contracts. An increase in market interest rates between the time the Company commits to terms on a loan and the time the Company ultimately sells the loan in the secondary market will have the effect of reducing the gain (or increasing the loss) the Company records on the sale. The Company attempts to mitigate this risk by entering into forward sales commitments and forward TBA mortgage contracts in amounts sufficient to cover loans anticipated to close and interest rate-locked loan commitments. See Note 7, “Derivative and Hedging Activities” within Notes to Consolidated Financial Statements included in Item 1 hereof for additional information regarding the Company’s derivative financial instruments.

The Company’s earnings are not directly or materially impacted by movements in foreign currency rates or commodity prices. Movements in equity prices may have a modest impact on earnings by affecting the volume of activity or the amount of fees from investment-related business lines.

**Liquidity Risk** Liquidity risk is the risk that the Company will not have the ability to generate adequate amounts of cash in the most economical way for the institution to meet its ongoing obligations to pay deposit withdrawals, service borrowings, and to fund loan commitments. The Company’s primary sources of funds are deposits, borrowings, and the amortization, prepayment and maturities of loans and securities. The Bank utilizes its extensive branch network to access retail customers who provide a stable base of in-market core deposits. These funds are principally comprised of demand deposits, interest checking accounts, savings accounts, and money market accounts. Deposit levels are greatly influenced by interest rates, economic conditions, and competitive factors.

The Company actively manages its liquidity position under the direction of the Asset/ Liability Committee (ALCO). The Company’s primary measure of short-term liquidity is the Basic Surplus/Deficit as a percentage of assets. This ratio, which is an analysis of the relationship between liquid assets and short-term liabilities relative to total assets, was within policy limits at March 31, 2014. The Basic Surplus measure is affected primarily by changes in deposits, securities and short-term investments, loans and borrowings. An increase in deposits, without a corresponding increase in nonliquid assets, will improve the Basic Surplus measure, whereas, an increase in loans, with no increase in deposits, will decrease the measure. Other factors affecting the Basic Surplus measure include collateral requirements at the FHLB, changes in the securities portfolio, and the mix of deposits.

The Bank is careful to increase deposits without adversely impacting the weighted average cost of those funds. As part of a prudent liquidity risk management practice, the Company maintains various liquidity sources, some of which are only accessed on a contingency basis. Accordingly, management has implemented funding strategies that include FHLB advances, Federal Reserve Bank borrowing capacity and repurchase agreement lines. These nondeposit funds are also viewed as a contingent source of liquidity and, when profitable lending and investment opportunities exist, access to such funds provides a means to grow the balance sheet.

Borrowing capacity at the FHLB and the Federal Reserve is impacted by the amount and type of assets available to be pledged. For example, a prime, one-to-four family, residential loan, may provide 75 cents of borrowing capacity for every \$1.00 pledged, whereas, a commercial loan may provide a lower amount. As a result, the Company’s strategic lending decisions can also affect its liquidity position.

The Company can raise additional liquidity through the issuance of equity or unsecured debt privately or publicly. Additionally, the Company is able to enter into additional repurchase agreements or acquire brokered deposits at its discretion. The availability and cost of equity or debt on an unsecured basis is dependent on many factors. Some factors that will impact this source of liquidity are the Company’s financial position, the market environment, and the Company’s credit rating. As such, the Company is careful to monitor the various factors that could impact its ability to raise liquidity through these channels.

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The table below shows current and unused liquidity capacity from various sources as of the dated indicated:

Table 21—Sources of Liquidity

|                                      | March 31, 2014         |                                     | December 31, 2013 |                                     |
|--------------------------------------|------------------------|-------------------------------------|-------------------|-------------------------------------|
|                                      | Outstanding            | Additional<br>Borrowing<br>Capacity | Outstanding       | Additional<br>Borrowing<br>Capacity |
|                                      | (Dollars in thousands) |                                     |                   |                                     |
| Federal Home Loan Bank of Boston (3) | \$ 140,228             | \$ 696,220                          | \$ 140,294        | \$ 668,143                          |
| Federal Reserve Bank of Boston       | —                      | 843,843                             | —                 | 856,013                             |
| Unpledged Securities                 | —                      | 322,546                             | —                 | 272,121                             |
| Customer repurchase agreements       | 128,485                | —                                   | (1) 149,288       | — (1)                               |
| Wholesale repurchase agreements      | 50,000                 | —                                   | (1) 50,000        | — (1)                               |
| Junior subordinated debentures (3)   | 73,852                 | —                                   | (1) 73,906        | — (1)                               |
| Subordinated debt                    | 30,000                 | —                                   | (1) 30,000        | — (1)                               |
| Parent Company line of credit        | —                      | 10,000                              | 5,000             | 5,000                               |
| Brokered deposits (2)                | 79,458                 | —                                   | (1) 77,501        | — (1)                               |
|                                      | \$ 502,023             | 1,872,609                           | \$ 525,989        | \$ 1,801,277                        |

(1) The additional borrowing capacity has not been assessed for these categories.

(2) Inclusive of \$58.4 million and \$53.7 million of brokered deposits acquired through participation in the Certificate of Deposit Account Registry Service program as of March 31, 2014 and December 31, 2013, respectively.

(3) Amounts shown are inclusive of fair value marks.

In addition to policies used for managing operational liquidity, the Board of Directors and the Asset/Liability Committee ("ALCO") of the Bank recognize the need to establish reasonable guidelines for managing through an environment of heightened liquidity risk. Catalysts for elevated liquidity risk can be Bank-specific issues and/or systemic industry-wide events. It is therefore, the responsibility of the Board and ALCO to institute systems and controls to provide advanced detection of potentially significant funding shortages, establish methods for assessing and monitoring risk levels, and institute prompt responses that may alleviate/circumvent a potential liquidity crisis. As such, the Board of Directors and the ALCO have put a Liquidity Contingency Plan in place. The overall goal of this plan is to provide a framework for the Bank to help detect liquidity problems promptly and appropriately address potential liquidity problems in a timely manner. In a period of perceived heightened liquidity risk, the Liquidity Contingency Plan provides for the establishment of a Liquidity Crisis Task Force. The Liquidity Crisis Task Force is responsible for monitoring the potential for a liquidity crisis and for establishing and executing an appropriate response.

**Off-Balance Sheet Arrangements** There have been no material changes in off-balance sheet financial instruments during the three months ended March 31, 2014. See Note 7, "Derivative and Hedging Activities" and Note 11, "Commitments and Contingencies" within Notes to Consolidated Financial Statements included in Item 1 hereof for more information relating to the Company's off-balance sheet financial instruments.

**Contractual Obligations, Commitments, and Contingencies** There have been no material changes in contractual obligations, commitments, or contingencies during the three months ended March 31, 2014. Please refer to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013 for a complete table of contractual obligations, commitments and contingencies.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information required by this Item 3 is included in Item 2 of Part I of this Form 10-Q, entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations."

### Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures. The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer along with the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Exchange Act. Based upon that evaluation, the Company's Chief Executive Officer along with the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

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Changes in Internal Controls over Financial Reporting. There were no changes in our internal control over financial reporting that occurred through the first quarter of 2014 that have materially affected or are reasonably likely to materially affect the Company's internal controls over financial reporting.

## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

The Company is not involved in any legal proceedings other than routine legal proceedings occurring in the ordinary course of business or other matters not considered to be material. Management believes that those legal proceedings involve, in the aggregate, amounts that are immaterial to the Company's financial condition and results of operations.

## Item 1A. Risk Factors

As of the date of this report, there have been no material changes with regard to the Risk Factors disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, which are incorporated herein by reference.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable.

(b) Not applicable.

(c) The following table sets forth information regarding the Company's repurchases of its common stock during the three months ended March 31, 2014:

| Period                          | Issuer Purchases of Equity Securities      |                                    |                                                                                                |                                                                                       |
|---------------------------------|--------------------------------------------|------------------------------------|------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|
|                                 | Total Number of<br>Shares Purchased<br>(1) | Average<br>Price Paid Per<br>Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plan or<br>Program (2) | Maximum Number of Shares<br>That May Yet Be<br>Purchased Under the Plan<br>or Program |
| January 1 to January 31, 2014   | —                                          | \$—                                | —                                                                                              | —                                                                                     |
| February 1 to February 28, 2014 | 13,189                                     | \$35.71                            | —                                                                                              | —                                                                                     |
| March 1 to March 31, 2014       | 10,745                                     | \$38.70                            | —                                                                                              | —                                                                                     |
| Total                           | 23,934                                     |                                    | —                                                                                              |                                                                                       |

(1) Shares repurchased relate to the surrendering of mature shares for the exercise of stock options and/or the surrendering of shares upon vesting of restricted stock awards to cover tax implications to the individual.

(2) The Company does not currently have a stock repurchase program or plan in place.

## Item 3. Defaults Upon Senior Securities—None

## Item 4. Mine Safety Disclosures - Not Applicable

## Item 5. Other Information—None

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Item 6. Exhibits

Exhibits Index

| No.  | Exhibit                                                                                                                                                                                                                                                             |
|------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Independent Bank Corp. and Rockland Trust Company Executive Officer Performance Incentive Plan is incorporated by reference to Exhibit 99.1 to Form 8-K filed on March 26, 2014.                                                                                    |
| 10.2 | Independent Bank Corp. Forms of Performance Based Restricted Stock Award Agreement for chief Executive Officer and Executive Officers and related performance goals, incorporated by reference to Exhibits 99.1, 99.2 and 99.3 to Form 8-K filed on March 26, 2014. |
| 31.1 | Section 302 Certification of Sarbanes-Oxley Act of 2002 is attached hereto.*                                                                                                                                                                                        |
| 31.2 | Section 302 Certification of Sarbanes-Oxley Act of 2002 is attached hereto.*                                                                                                                                                                                        |
| 32.1 | Section 906 Certification of Sarbanes-Oxley Act of 2002 is attached hereto.+                                                                                                                                                                                        |
| 32.2 | Section 906 Certification of Sarbanes-Oxley Act of 2002 is attached hereto.+                                                                                                                                                                                        |
| 101  | Interactive Data File +                                                                                                                                                                                                                                             |

\* Filed herewith

+ Furnished herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INDEPENDENT BANK CORP.

(registrant)

Date: May 8, 2014

/s/ Christopher Oddleifson  
Christopher Oddleifson  
President and  
Chief Executive Officer  
(Principal Executive Officer)

Date: May 8, 2014

/s/ Robert Cozzone  
Robert Cozzone  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

INDEPENDENT BANK CORP.

(registrant)