

REPUBLIC BANCORP INC /KY/
Form 10-Q
August 09, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly
report
pursuant to
Section 13
or 15(d) of
the
Securities
Exchange
Act of
1934

For the quarterly period ended June 30, 2016

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-24649

REPUBLIC BANCORP, INC.

(Exact name of registrant as specified in its charter)

Kentucky
(State of other jurisdiction of incorporation or organization) 61-0862051
(I.R.S. Employer Identification No.)

601 West Market Street, Louisville, Kentucky 40202
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (502) 584-3600

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

The number of shares outstanding of the registrant's Class A Common Stock and Class B Common Stock, as of July 31, 2016, was 18,616,863 and 2,245,184.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)

	June 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	\$ 142,979	\$ 210,082
Securities available for sale	514,846	517,058
Securities held to maturity (fair value of \$36,336 in 2016 and \$39,196 in 2015)	36,181	38,727
Mortgage loans held for sale, at fair value	12,280	4,083
Mortgage loans held for sale, at lower of cost or fair value	74,430	—
Consumer loans held for sale, at fair value	6,826	—
Consumer loans held for sale, at the lower of cost or fair value	1,122	514
Loans	3,691,323	3,326,610
Allowance for loan and lease losses	(29,308)	(27,491)
Loans, net	3,662,015	3,299,119
Federal Home Loan Bank stock, at cost	28,208	28,208
Premises and equipment, net	42,956	31,106
Goodwill	16,313	10,168
Other real estate owned	1,503	1,220
Bank owned life insurance	60,986	52,817
Other assets and accrued interest receivable	46,277	37,187
TOTAL ASSETS	\$ 4,646,922	\$ 4,230,289
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 867,095	\$ 634,863
Interest-bearing	1,988,952	1,852,614
Total deposits	2,856,047	2,487,477
Securities sold under agreements to repurchase and other short-term borrowings	126,124	395,433
Federal Home Loan Bank advances	987,500	699,500
Subordinated note	45,364	41,240
Other liabilities and accrued interest payable	36,864	30,092

Total liabilities	4,051,899	3,653,742
Commitments and contingent liabilities (Footnote 9)	—	—
STOCKHOLDERS' EQUITY		
Preferred stock, no par value	—	—
Class A Common Stock and Class B Common Stock, no par value	4,906	4,915
Additional paid in capital	137,315	136,910
Retained earnings	449,487	432,673
Accumulated other comprehensive income	3,315	2,049
Total stockholders' equity	595,023	576,547
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 4,646,922	\$ 4,230,289

See accompanying footnotes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
INTEREST INCOME:				
Loans, including fees	\$ 37,746	\$ 33,616	\$ 79,175	\$ 65,207
Taxable investment securities	1,983	1,779	3,875	3,552
Federal Home Loan Bank stock and other	411	327	1,105	724
Total interest income	40,140	35,722	84,155	69,483
INTEREST EXPENSE:				
Deposits	1,347	1,021	2,739	2,165
Securities sold under agreements to repurchase and other short-term borrowings	15	17	40	55
Federal Home Loan Bank advances	2,973	2,997	5,926	5,925
Subordinated note	228	629	439	1,258
Total interest expense	4,563	4,664	9,144	9,403
NET INTEREST INCOME	35,577	31,058	75,011	60,080
Provision for loan and lease losses	1,814	904	7,000	1,089
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	33,763	30,154	68,011	58,991
NONINTEREST INCOME:				
Service charges on deposit accounts	3,282	3,247	6,422	6,286
Net refund transfer fees	1,909	1,907	18,987	17,242
Mortgage banking income	1,560	1,224	2,821	2,577
Interchange fee income	2,217	2,044	4,340	4,238
Republic Processing Group program fees	664	169	963	397
Gain on call of security available for sale	—	88	—	88
Net gains (losses) on other real estate owned	80	(155)	328	(274)
Increase in cash surrender value of bank owned life insurance	369	353	708	702
Other	721	608	1,154	1,215
Total noninterest income	10,802	9,485	35,723	32,471
NONINTEREST EXPENSES:				

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Salaries and employee benefits	17,814	14,323	34,897	29,600
Occupancy and equipment, net	5,109	5,142	10,528	10,343
Communication and transportation	872	771	1,945	1,817
Marketing and development	1,190	977	1,697	1,562
FDIC insurance expense	480	474	1,138	1,148
Bank franchise tax expense	647	847	3,098	3,248
Data processing	1,543	1,092	2,876	2,058
Interchange related expense	1,047	931	1,951	1,938
Supplies	240	219	689	580
Other real estate owned expense	116	120	196	339
Legal and professional fees	604	528	1,427	2,143
Other	2,204	1,741	3,965	3,463
Total noninterest expenses	31,866	27,165	64,407	58,239
INCOME BEFORE INCOME TAX EXPENSE	12,699	12,474	39,327	33,223
INCOME TAX EXPENSE	4,359	4,154	13,252	11,115
NET INCOME	\$ 8,340	\$ 8,320	\$ 26,075	\$ 22,108
BASIC EARNINGS PER SHARE:				
Class A Common Stock	\$ 0.40	\$ 0.40	\$ 1.26	\$ 1.07
Class B Common Stock	\$ 0.37	\$ 0.37	1.14	0.97
DILUTED EARNINGS PER SHARE:				
Class A Common Stock	\$ 0.40	\$ 0.40	\$ 1.26	\$ 1.07
Class B Common Stock	\$ 0.37	\$ 0.36	1.14	0.97
DIVIDENDS DECLARED PER COMMON SHARE:				
Class A Common Stock	\$ 0.209	\$ 0.198	\$ 0.407	\$ 0.385
Class B Common Stock	\$ 0.190	\$ 0.180	0.370	0.350

See accompanying footnotes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Net income	\$ 8,340	\$ 8,320	\$ 26,075	\$ 22,108
OTHER COMPREHENSIVE INCOME				
Change in fair value of derivatives used for cash flow hedges	(219)	175	(790)	(221)
Reclassification amount for derivative losses realized in income	86	103	173	204
Change in unrealized gain (loss) on securities available for sale	416	(1,056)	2,708	182
Reclassification adjustment for gain on security available for sale recognized in earnings	—	(88)	—	(88)
Change in unrealized gain on security available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings	1	(4)	(148)	(26)
Net unrealized gains (losses)	284	(870)	1,943	51
Tax effect	(97)	304	(677)	(18)
Total other comprehensive income, net of tax	187	(566)	1,266	33
COMPREHENSIVE INCOME	\$ 8,527	\$ 7,754	\$ 27,341	\$ 22,141

See accompanying footnotes to consolidated financial statements.

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CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

SIX MONTHS ENDED JUNE 30, 2016

(in thousands)	Common Stock		Amount	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Class A Shares Outstanding	Class B Shares Outstanding					
Balance, January 1, 2016	18,652	2,245	\$ 4,915	\$ 136,910	\$ 432,673	\$ 2,049	\$ 576,547
Net income	—	—	—	—	26,075	—	26,075
Net change in accumulated other comprehensive income	—	—	—	—	—	1,266	1,266
Dividends declared Common Stock:							
Class A Shares	—	—	—	—	(7,579)	—	(7,579)
Class B Shares	—	—	—	—	(831)	—	(831)
Stock options exercised, net of shares redeemed	4	—	—	80	—	—	80
Repurchase of Class A Common Stock	(41)	—	(9)	(274)	(851)	—	(1,134)
Net change in notes receivable on Class A Common Stock	—	—	—	2	—	—	2
Deferred director compensation expense -	4	—	—	100	—	—	100

Class A
Common Stock

Stock based compensation expense - performance stock units	—	—	—	254	—	—	254
Stock based compensation expense - restricted stock	(2)	—	—	117	—	—	117
Stock based compensation expense - stock options	—	—	—	126	—	—	126
Balance, June 30, 2016	18,617	2,245	\$ 4,906	\$ 137,315	\$ 449,487	\$ 3,315	\$ 595,023

See accompanying footnotes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Six Months Ended	
	June 30,	
	2016	2015
OPERATING ACTIVITIES:		
Net income	\$ 26,075	\$ 22,108
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization on investment securities, net	279	380
Accretion on loans, deposits and core deposit intangible, net	(1,301)	(1,649)
Depreciation of premises and equipment	3,465	3,251
Amortization of mortgage servicing rights	683	716
Provision for loan and lease losses	7,000	1,089
Net gain on sale of mortgage loans held for sale	(2,560)	(2,353)
Origination of mortgage loans held for sale	(95,787)	(96,008)
Proceeds from sale of mortgage loans held for sale	90,150	94,472
Net gain on sale of consumer loans held for sale	(839)	(246)
Origination of consumer loans held for sale	(129,027)	(24,410)
Proceeds from sale of consumer loans held for sale	122,432	23,114
Net realized gain on sales, calls and impairment of securities	—	(88)
Net gain realized on sale of other real estate owned	(328)	(430)
Writedowns of other real estate owned	—	704
Deferred director compensation expense - Company Stock	100	109
Stock based compensation expense	497	203
Increase in cash surrender value of bank owned life insurance	(708)	(702)
Net change in other assets and liabilities:		
Accrued interest receivable	(174)	(131)
Accrued interest payable	12	(55)
Other assets	211	(1,859)
Other liabilities	(2,731)	581
Net cash provided by operating activities	17,449	18,796
INVESTING ACTIVITIES:		
Net change in cash for acquisition of Cornerstone Bancorp, Inc.	(9,088)	—
Purchases of securities available for sale	(390,079)	(889,325)
Proceeds from calls, maturities and paydowns of securities available for sale	394,575	868,424
Proceeds from calls, maturities and paydowns of securities held to maturity	2,866	2,342
Net change in outstanding warehouse lines of credit	(199,348)	(169,474)
Purchase of non-business-acquisition loans, including premiums paid	(47,986)	(63,163)
Net change in other loans	(7,726)	(48,458)
Proceeds from redemption of Federal Home Loan Bank stock	224	—
Proceeds from sales of other real estate owned	1,727	7,009
Net purchases of premises and equipment	(3,088)	(2,507)
Net cash used in investing activities	(257,923)	(295,152)

FINANCING ACTIVITIES:

Net change in deposits	163,899	221,428
Net change in securities sold under agreements to repurchase and other short-term borrowings	(269,309)	(126,283)
Payments of Federal Home Loan Bank advances	(207,000)	(208,000)
Proceeds from Federal Home Loan Bank advances	495,000	417,000
Repurchase of Common Stock	(1,134)	(327)
Net proceeds from Common Stock options exercised	80	119
Cash dividends paid	(8,165)	(7,693)
Net cash provided by financing activities	173,371	296,244

NET CHANGE IN CASH AND CASH EQUIVALENTS	(67,103)	19,888
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	210,082	72,878
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 142,979	\$ 92,766

SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION:

Cash paid during the period for:

Interest	\$ 9,115	\$ 9,458
Income taxes	12,771	6,130

SUPPLEMENTAL NONCASH DISCLOSURES:

Transfers from loans to real estate acquired in settlement of loans	\$ 1,938	\$ 1,922
Transfers from loans held for investment to held for sale	74,430	—
Loans provided for sales of other real estate owned	256	2,962

See accompanying footnotes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – JUNE 30, 2016 and 2015 AND DECEMBER 31, 2015 (UNAUDITED)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The consolidated financial statements include the accounts of Republic Bancorp, Inc. (the “Parent Company”) and its wholly-owned subsidiaries, Republic Bank & Trust Company (“RB&T” or the “Bank”) and Republic Insurance Services, Inc. (the “Captive”). The Bank is a Kentucky-based, state chartered non-member financial institution. The Captive is a wholly-owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and the Bank as well as eight other third-party insurance captives for which insurance may not be available or economically feasible. Republic Bancorp Capital Trust (“RBCT”) is a Delaware statutory business trust that is a wholly-owned unconsolidated finance subsidiary of Republic Bancorp, Inc. As a result of the its acquisition of Cornerstone Bancorp, Inc. on May 17, 2016, Republic Bancorp, Inc. became the 100% successor owner of Cornerstone Capital Trust 1 (“CCT1”), an unconsolidated finance subsidiary.

All companies are collectively referred to as “Republic” or the “Company.” All significant intercompany balances and transactions are eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. For further information, refer to the consolidated financial statements and footnotes thereto included in Republic’s Form 10-K for the year ended December 31, 2015.

As of June 30, 2016, the Company was divided into four distinct business operating segments: Traditional Banking, Warehouse Lending (“Warehouse”), Mortgage Banking and Republic Processing Group (“RPG”). Management considers the first three segments to collectively constitute “Core Bank” or “Core Banking” activities. The RPG segment includes the following divisions: Tax Refund Solutions (“TRS”), Refund Payment Solutions (“RPS”) and Republic Credit Solutions (“RCS”). TRS generates the majority of RPG’s income, with the relatively smaller divisions of RPG, RPS and RCS, considered immaterial for separate and independent segment reporting. All divisions of the RPG segment operate through the Bank.

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Core Bank (includes Traditional Banking, Warehouse Lending and Mortgage Banking segments)

The Traditional Banking segment provides traditional banking products primarily to customers in the Company's market footprint. As of June 30, 2016, in addition to Internet Banking and Correspondent Lending delivery channels, Republic had 44 full-service banking centers with locations as follows:

- Kentucky — 32
- Metropolitan Louisville — 19
- Central Kentucky — 8
- Elizabethtown — 1
- Frankfort — 1
- Georgetown — 1
- Lexington — 4
- Shelbyville — 1
- Western Kentucky — 2
- Owensboro — 2
- Northern Kentucky — 3
- Covington — 1
- Florence — 1
- Independence — 1
- Southern Indiana — 3
- Floyds Knobs — 1
- Jeffersonville — 1
- New Albany — 1
- Metropolitan Tampa, Florida — 6
- Metropolitan Cincinnati, Ohio — 1
- Metropolitan Nashville, Tennessee — 2

Republic's headquarters are located in Louisville, which is the largest city in Kentucky, based on population.

Core Banking results of operations are primarily dependent upon net interest income, which represents the difference between the interest income and fees on interest-earning assets and the interest expense on interest-bearing liabilities. Principal interest-earning Core Banking assets represent investment securities and commercial and consumer loans primarily secured by real estate and/or personal property. Interest-bearing liabilities primarily consist of interest-bearing deposit accounts, securities sold under agreements to repurchase, as well as short-term and long-term borrowing sources. Federal Home Loan Bank ("FHLB") advances have traditionally been a significant borrowing source for the Bank.

Other sources of Core Banking income include service charges on deposit accounts, debit and credit card interchange fee income, title insurance commissions, fees charged to clients for trust services, increases in the cash surrender value

of Bank Owned Life Insurance (“BOLI”) and revenue generated from Mortgage Banking activities. Mortgage Banking activities represent both the origination and sale of loans in the secondary market and the servicing of loans for others, primarily the Federal Home Loan Mortgage Corporation (“Freddie Mac” or “FHLMC”).

Core Banking operating expenses consist primarily of salaries and employee benefits, occupancy and equipment expenses, communication and transportation costs, data processing, interchange related expenses, marketing and development expenses, Federal Deposit Insurance Corporation (“FDIC”) insurance expense, franchise tax expense and various other general and administrative costs. Core Banking results of operations are significantly impacted by general economic and competitive conditions, particularly changes in market interest rates, government laws and policies and actions of regulatory agencies.

The Core Bank provides short-term, revolving credit facilities to mortgage bankers across the Nation through its Warehouse segment in the form of warehouse lines of credit. These credit facilities are secured by single family, first lien residential real estate loans. Outstanding balances on these credit facilities may be subject to significant fluctuations consistent with the overall market demand for mortgage loans.

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Primarily from its Warehouse clients, the Core Bank acquires single family, first lien mortgage loans that meet the Core Bank's specifications through its Correspondent Lending channel. Substantially all loans purchased through the Correspondent Lending channel are purchased at a premium.

Republic Processing Group

Tax Refund Solutions division — Republic, through its TRS division, is one of a limited number of financial institutions that facilitates the receipt and payment of federal and state tax refund products through third-party tax preparers located throughout the Nation, as well as tax-preparation software providers. Substantially all of the business generated by the TRS division occurs in the first half of the year. The TRS division traditionally operates at a loss during the second half of the year, during which time the division incurs costs preparing for the upcoming year's first quarter tax season.

Refund Transfers ("RTs") are products whereby a tax refund is issued to the taxpayer after the Bank has received the refund from the federal or state government. There is no credit risk or borrowing cost associated with these products because they are only delivered to the taxpayer upon receipt of the tax refund directly from the governmental paying authority. Fees earned on RTs, net of rebates, are reported as noninterest income under the line item "Net refund transfer fees."

TRS offered its new Easy Advance ("EA") tax credit product during the first quarter of 2016. The EA product had the following features during the period it was offered through February 29, 2016:

- An advance amount of \$750 per taxpayer customer;
- No EA fee charged to the taxpayer customer;
- All fees for the product were paid by the tax preparer or tax software company (collectively, the "Tax Providers") with a restriction prohibiting the Tax Providers from passing along the fees to the taxpayer customer;
- No requirement that the taxpayer customer pay for another bank product, such as an RT;
- Multiple funds disbursement methods, including direct deposit, prepaid card, check or the Walmart Direct2Cash® product, based on the taxpayer customer's election;
- Repayment of the EA to the Bank was deducted from the taxpayer customer's tax refund proceeds; and
- If an insufficient refund to repay the EA occurred:
 - o there was no recourse to the taxpayer customer,
 - o no negative credit reporting on the taxpayer customer, and
 - o no collection efforts against the taxpayer customer.

Fees paid by the Tax Providers to the Company for the EA product are reported as interest income on loans under the line item "Loans, including fees." During 2016, EAs were generally repaid within three weeks after the taxpayer customer's tax return was submitted to the applicable tax authority. Provisions for loss on EAs were estimated when advances were made, with all loss provisions made in the first quarter of 2016. Unpaid EAs were charged-off within 81 days after the taxpayer customer's tax return was submitted to the applicable tax authority, with the majority of charge-offs recorded during the second quarter of 2016.

Republic Payment Solutions division — The RPS division is an issuing bank offering general-purpose reloadable prepaid cards through third-party program managers.

The Company reports fees related to RPS programs under “Republic Processing Group program fees.” Additionally, the Company’s portion of interchange revenue generated by prepaid card transactions is reported as noninterest income under “Interchange fee income.”

Republic Credit Solutions division — The RCS division offers short-term consumer credit products. In general, the credit products are unsecured, small dollar consumer loans with maturities of 30-days-or-more, and are dependent on various factors including the consumer’s ability to repay.

The Company reports RCS loans originated for investment under “Loans,” while loans originated for sale are reported under “Consumer loans held for sale.” The Company reports interest income and loan origination fees earned on RCS loans under “Loans, including fees,” while any gains or losses on sale reported as noninterest income under “Republic Processing Group program fees.”

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Accounting Standards Update (“ASU”) ASU No. 2016-4, Liabilities – Extinguishments of Liabilities (Topic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products

Prepaid stored-value products are products in physical and digital forms with stored monetary values that are issued for the purpose of being commonly accepted as payment for goods or services. In some cases, a prepaid stored-value product may be unused wholly or partially for an indefinite time period. This unused value is commonly referred to as “breakage.” Although Subtopic 405-20, Liabilities—Extinguishments of Liabilities, includes derecognition guidance for both financial liabilities and nonfinancial liabilities, there currently is diversity in the methodology used to recognize breakage.

ASU 2016-4 provides that liabilities related to the sale of prepaid stored-value products are financial liabilities and provide a narrow scope exception to the guidance in Subtopic 405-20 to require that breakage for those liabilities be accounted for consistent with the breakage guidance in Topic 606, Revenue from Contracts with Customers.

The guidance in ASU 2016-4 is effective for the Company for fiscal years beginning after December 15, 2017. The Company does not project this guidance to have a material impact on its financial statements.

ASU No. 2016-5, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships

ASU 2016-5 clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18 of the Accounting Standards Codification) continue to be met.

The guidance in ASU 2016-5 is effective for the Company for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. The Company does not project this guidance to have a material impact on its financial statements.

ASU No. 2016-9, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

ASU 2016-9 provides simplification in areas of accounting for share-based payments, including: the income tax consequences; classification of awards as either equity or liabilities; and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities.

The guidance in this ASU is effective for the Company for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. The Company does not project this guidance to have a material impact on its financial statements.

ASU No. 2016-11, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

ASU 2016-11 amends guidance on reporting credit losses for assets held at amortized-cost basis and available-for-sale debt securities.

For assets held at amortized cost basis, this ASU eliminates the probable initial recognition threshold in current GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses. The allowance for credit losses is a valuation account that is deducted from the amortized-cost basis of the financial assets to present the net amount expected to be collected.

For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP; however, Topic 326 will require that credit losses be presented as an allowance rather than as a write-down.

This ASU affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash.

The guidance in this ASU is effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within those annual periods. The Company expects a substantial, but yet undetermined, increase in its allowance for loan and lease losses upon implementation of this ASU.

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2. ACQUISITION OF CORNERSTONE BANCORP, INC.

OVERVIEW

On May 17, 2016, the Company completed its acquisition of Cornerstone Bancorp, Inc. (“Cornerstone”), and its wholly-owned bank subsidiary Cornerstone Community Bank (“CCB”), for approximately \$32 million in cash. The primary reason for the acquisition of Cornerstone was to expand the Company’s footprint in the Tampa, Florida metropolitan statistical area.

ACQUISITION SUMMARY

The following table provides a summary of the assets acquired and liabilities assumed as recorded by Cornerstone, the preliminary fair value adjustments necessary to adjust those acquired assets and assumed liabilities to fair value, and the preliminary fair values of those assets and liabilities as recorded by the Company. As provided for under GAAP, management has up to 12 months following the date of acquisition to finalize the fair values of the acquired assets and assumed liabilities. The preliminary fair value adjustments and the preliminary resultant fair values shown in the following table continue to be evaluated by management and may be subject to further adjustment.

Acquisition of Cornerstone Bancorp, Inc. - Summary of Assets Acquired and Liabilities Assumed

(in thousands)	May 17, 2016 As Recorded by Cornerstone	Fair Value Adjustments (1)	As Recorded by Republic (1)
Assets acquired:			
Cash and cash equivalents	\$ 22,707	\$ —	\$ 22,707
Investment securities	329	—	329
Loans	195,136	(5,525)	a 189,611
Allowance for loan and lease losses	(1,955)	1,955	a —
Loans, net	193,181	(3,570)	189,611
Federal Home Loan Bank stock, at cost	224	—	224
Premises and equipment, net	7,770	4,457	b 12,227
Core deposit intangible	—	1,205	c 1,205
Deferred income taxes	3,714	(74)	d 3,640
Bank owned life insurance	7,461	—	7,461
Other assets and accrued interest receivable	658	—	658

Total assets acquired	\$ 236,044	\$ 2,018	\$ 238,062
Liabilities assumed:			
Deposits			
Noninterest-bearing	\$ 52,908	\$ —	\$ 52,908
Interest-bearing	152,257	92	e 152,349
Total deposits	205,165	92	205,257
Subordinated note	4,124	—	4,124
Other liabilities and accrued interest payable	2,244	787	f 3,031
Total liabilities assumed	211,533	879	212,412
Net assets acquired	\$ 24,511	\$ 1,139	25,650
Cash consideration paid			(31,795)
Goodwill			\$ 6,145

(1) The Company's acquisition of Cornerstone closed on May 17, 2016. Accordingly, the fair value adjustments shown are preliminary estimates of the purchase accounting adjustments. Management is continuing to evaluate each of these fair value adjustments and may revise one or more of such fair value adjustments in future periods based on this continuing evaluation. To the extent that any of these preliminary fair value adjustments are revised in future periods, the resultant fair values and the amount of goodwill recorded by the Company will change.

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Explanation of preliminary fair value adjustments:

- a. Adjustment reflects the fair value adjustment based on the Company's evaluation of the acquired loan portfolio and to eliminate the recorded allowance for loan losses.
- b. Adjustment reflects the fair value adjustment based on the Company's evaluation of the premises and equipment acquired.
- c. Adjustment reflects the fair value adjustment for the core deposit intangible asset recorded as a result of the acquisition.
- d. This adjustment reflects the differences in the carrying values of acquired assets and assumed liabilities for financial reporting purposes and their basis for federal income tax purposes.
- e. Adjustment reflects the fair value adjustment based on the Company's evaluation of the assumed time deposits.
- f. Adjustment reflects the amount needed to adjust other liabilities to estimated fair value and to record certain liabilities directly attributable to the acquisition of Cornerstone.

Goodwill of approximately \$6 million, which is the excess of the merger consideration over the fair value of net assets acquired, is expected to be recorded in the Cornerstone acquisition and is the result of expected operational synergies and other factors. This goodwill is all attributable to the Company's Traditional Banking segment and is not expected to be deductible for tax purposes. To the extent that management revises any of the above fair value adjustments as a result of its continuing evaluation, the amount of goodwill recorded in the Cornerstone acquisition will change.

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CORNERSTONE CONTRIBUTION FOR THE REPORTING PERIOD

The Company's consolidated statements of income include the impact of the Company's Cornerstone acquisition for the three and six months ended June 30, 2016. The results of operations of the assets acquired and liabilities assumed in the Company's Cornerstone acquisition, inclusive of any pre-acquisition related costs, are summarized in the following table:

(in thousands)	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
	Non-Acquisition Related	Acquisition-Related	Total	Non-Acquisition Related	Acquisition-Related	Total
INTEREST INCOME:						
Loans, including fees	\$ 1,055	\$ —	\$ 1,055	\$ 1,055	\$ —	\$ 1,055
Taxable investment securities	203	—	203	203	—	203
Total interest income	1,258	—	1,258	1,258	—	1,258
INTEREST EXPENSE:						
Deposits	67	—	67	67	—	67
Interbank borrowings	251	—	251	251	—	251
Subordinated note	12	—	12	12	—	12
Total interest expense	330	—	330	330	—	330
NET INTEREST INCOME	928	—	928	928	—	928
Provision for loan and lease losses	86	—	86	86	—	86
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	842	—	842	842	—	842
NONINTEREST INCOME:						
Service charges on deposit accounts	37	—	37	37	—	37
Interchange fee income	19	—	19	19	—	19
Other	36	—	36	36	—	36
Total noninterest income	92	—	92	92	—	92
NONINTEREST EXPENSES:						
Salaries and employee benefits	419	274	a 693	419	274	a 693

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Occupancy and equipment, net	96	—		96	100	—		100
Communication and transportation	29	10	b	39	30	10	b	40
Marketing and development	27	—		27	27	—		27
FDIC insurance expense	19	—		19	19	—		19
Data processing	14	289	c	303	31	417	c	448
Supplies	6	12	d	18	7	20	d	27
Legal and professional fees	28	88	e	116	29	150	e	179
Other	65	31	f	96	68	31	f	99
Total noninterest expenses	703	704		1,407	730	902		1,632
INCOME (LOSS) BEFORE								
INCOME TAX EXPENSE	231	(704)		(473)	204	(902)		(698)
INCOME TAX EXPENSE								
(BENEFIT)	68	(211)		(143)	60	(271)		(211)
NET INCOME (LOSS)	\$ 163	\$ (493)		\$ (330)	\$ 144	\$ (631)		\$ (487)

Explanation of acquisition-related items:

- a. Severance payouts and signing bonuses for former Cornerstone employees.
- b. Notices to former Cornerstone stakeholders of change in ownership and merger-related travel.
- c. Core system conversion-related costs.
- d. Costs to update forms and supplies to RBT brand.
- e. Includes legal, audit, tax and other acquisition related consulting costs.
- f. Includes amortization of core deposit intangible asset.

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3. INVESTMENT SECURITIES

Securities Available for Sale

The gross amortized cost and fair value of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (“AOCI”) were as follows:

June 30, 2016 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 296,407	\$ 1,943	\$ (10)	\$ 298,340
Private label mortgage backed security	3,999	947	—	4,946
Mortgage backed securities - residential	85,544	3,026	(9)	88,561
Collateralized mortgage obligations	101,655	674	(261)	102,068
Freddie Mac preferred stock	—	254	—	254
Community Reinvestment Act mutual fund	2,500	53	—	2,553
Corporate bonds	15,006	20	(52)	14,974
Trust preferred security	3,427	—	(277)	3,150
Total securities available for sale	\$ 508,538	\$ 6,917	\$ (609)	\$ 514,846

December 31, 2015 (in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 286,914	\$ 59	\$ (494)	\$ 286,479
Private label mortgage backed security	4,037	1,095	—	5,132
Mortgage backed securities - residential	88,968	3,395	(95)	92,268
Collateralized mortgage obligations	113,972	748	(1,052)	113,668
Freddie Mac preferred stock	—	173	—	173
Community Reinvestment Act mutual fund	1,000	11	—	1,011
Corporate bonds	15,009	16	(103)	14,922
Trust preferred security	3,405	—	—	3,405
Total securities available for sale	\$ 513,305	\$ 5,497	\$ (1,744)	\$ 517,058

Securities Held to Maturity

The carrying value, gross unrecognized gains and losses, and fair value of securities held to maturity were as follows:

June 30, 2016 (in thousands)	Carrying Value	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 511	\$ 5	\$ —	\$ 516
Mortgage backed securities - residential	162	13	—	175
Collateralized mortgage obligations	30,433	288	(69)	30,652
Corporate bonds	5,075	—	(82)	4,993
Total securities held to maturity	\$ 36,181	\$ 306	\$ (151)	\$ 36,336

December 31, 2015 (in thousands)	Carrying Value	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
U.S. Treasury securities and U.S. Government agencies	\$ 515	\$ 1	\$ —	\$ 516
Mortgage backed securities - residential	53	6	—	59
Collateralized mortgage obligations	33,159	464	—	33,623
Corporate bonds	5,000	—	(2)	4,998
Total securities held to maturity	\$ 38,727	\$ 471	\$ (2)	\$ 39,196

At June 30, 2016 and December 31, 2015, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of stockholders' equity.

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Sales of Securities Available for Sale

During the three and six months ended June 30, 2016 there were no gains or losses on sales or calls of securities available for sale.

During the three and six months ended June 30, 2015 there was a gain of \$88,000 on the call of one security available for sale.

Investment Securities by Contractual Maturity

The amortized cost and fair value of the investment securities portfolio by contractual maturity at June 30, 2016 follows. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are detailed separately.

June 30, 2016 (in thousands)	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Carrying Value	Fair Value
Due in one year or less	\$ 60,393	\$ 60,626	\$ —	\$ —
Due from one year to five years	241,020	242,740	5,586	5,509
Due from five years to ten years	10,000	9,948	—	—
Due beyond ten years	3,427	3,150	—	—
Private label mortgage backed security	3,999	4,946	—	—
Mortgage backed securities - residential	85,544	88,561	162	175
Collateralized mortgage obligations	101,655	102,068	30,433	30,652
Freddie Mac preferred stock	—	254	—	—
Community Reinvestment Act mutual fund	2,500	2,553	—	—
Total securities	\$ 508,538	\$ 514,846	\$ 36,181	\$ 36,336

Freddie Mac Preferred Stock

During 2008, the U.S. Treasury, the Federal Reserve Board and the Federal Housing Finance Agency (“FHFA”) announced that the FHFA was placing Freddie Mac under conservatorship and giving management control to the

FHFA. The Bank contemporaneously determined that its 40,000 shares of Freddie Mac preferred stock were fully impaired and recorded an other-than-temporary impairment (“OTTI”) charge of \$2.1 million in 2008. The OTTI charge brought the carrying value of the stock to \$0. In 2014, based on active trading volume of Freddie Mac preferred stock, the Company determined it appropriate to record an unrealized gain to AOCI related to its Freddie Mac preferred stock holdings. Based on the stock’s market closing price as of June 30, 2016, the Company’s unrealized gain for its Freddie Mac preferred stock totaled \$254,000.

Corporate Bonds

The Bank maintains a portfolio of corporate bonds, \$75,000 of which were obtained on May 17, 2016 in connection with the Bank’s acquisition of CCB. The remaining corporate bonds were rated “investment grade” by accredited rating agencies as of their respective purchase dates. The total fair value of the Bank’s corporate bonds represented 4% of the Bank’s investment portfolio as of June 30, 2016 and December 31, 2015.

Mortgage Backed Securities and Collateralized Mortgage Obligations

At June 30, 2016, with the exception of the \$4.9 million private label mortgage backed security, all other mortgage backed securities and collateralized mortgage obligations (“CMOs”) held by the Bank were issued by U.S. government-sponsored entities and agencies, primarily Freddie Mac and the Federal National Mortgage Association (“Fannie Mae” or “FNMA”), institutions that the government has affirmed its commitment to support. At June 30, 2016 and December 31, 2015, there were gross unrealized losses of \$270,000 and \$1.1 million related to available for sale mortgage backed securities and CMOs. Because these unrealized losses are attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank does not have the intent to sell these securities, and it is likely that it will not be required to sell the securities before their anticipated recovery, management does not consider these securities to be OTTI.

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Trust Preferred Security

During the fourth quarter of 2015, the Parent Company purchased a \$3 million floating rate trust preferred security (“TRUP”) at a price of 68% of par. The coupon on this security is based on the 3-month LIBOR rate plus 159 basis points, giving the Parent Company an expected yield to maturity of 4.27% when considering the discount. The Company performed an initial analysis prior to acquisition and performs ongoing analysis of the credit risk of the underlying borrower in relation to this security.

Unrealized-Loss Analysis

Securities with unrealized losses at June 30, 2016 and December 31, 2015, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

June 30, 2016 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Treasury securities and U.S. Government agencies	\$ 9,989	\$ (10)	\$ —	\$ —	\$ 9,989	\$ (10)
Mortgage backed securities - residential	—	—	5,004	(9)	5,004	(9)
Collateralized mortgage obligations	23,015	(133)	14,070	(128)	37,085	(261)
Corporate bonds	9,948	(52)	—	—	9,948	(52)
Trust preferred security	3,150	(277)	—	—	3,150	(277)
Total securities available for sale	\$ 46,102	\$ (472)	\$ 19,074	\$ (137)	\$ 65,176	\$ (609)

December 31, 2015 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Treasury securities and U.S. Government agencies	\$ 191,584	\$ (433)	\$ 9,914	\$ (61)	\$ 201,498	\$ (494)
Mortgage backed securities - residential	5,727	(95)	—	—	5,727	(95)

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Collateralized mortgage obligations	6,831	(212)	35,869	(840)	42,700	(1,052)
Corporate bonds	9,896	(103)	—	—	9,896	(103)
Total securities available for sale	\$ 214,038	\$ (843)	\$ 45,783	\$ (901)	\$ 259,821	\$ (1,744)

June 30, 2016 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities held to maturity:						
Collateralized mortgage obligations	\$ 7,725	\$ (69)	\$ —	\$ —	\$ 7,725	\$ (69)
Corporate bonds	—	—	4,993	(82)	4,993	(82)
Total securities held to maturity	\$ 7,725	\$ (69)	\$ 4,993	\$ (82)	\$ 12,718	\$ (151)

December 31, 2015 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities held to maturity:						
Corporate bonds	\$ 4,998	\$ (2)	\$ —	—	\$ 4,998	\$ (2)
Total securities held to maturity	\$ 4,998	\$ (2)	\$ —	\$ —	\$ 4,998	\$ (2)

At June 30, 2016, the Bank's security portfolio consisted of 174 securities, 20 of which were in an unrealized loss position.

At December 31, 2015, the Bank's security portfolio consisted of 162 securities, 34 of which were in an unrealized loss position.

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Other-than-temporary impairment (“OTTI”)

Unrealized losses for all investment securities are reviewed to determine whether the losses are “other-than-temporary.” Investment securities are evaluated for OTTI on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in value below amortized cost is other-than-temporary. In conducting this assessment, the Bank evaluates a number of factors including, but not limited to the following:

- The length of time and the extent to which fair value has been less than the amortized cost basis;
- The Bank’s intent to hold until maturity or sell the debt security prior to maturity;
- An analysis of whether it is more-likely-than-not that the Bank will be required to sell the debt security before its anticipated recovery;
- Adverse conditions specifically related to the security, an industry, or a geographic area;
 - The historical and implied volatility of the fair value of the security;
- The payment structure of the security and the likelihood of the issuer being able to make payments;
- Failure of the issuer to make scheduled interest or principal payments;
- Any rating changes by a rating agency; and
- Recoveries or additional decline in fair value subsequent to the balance sheet date.

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 are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for the anticipated credit losses.

The Bank owns one private label mortgage backed security with a total carrying value of \$4.9 million at June 30, 2016. This security, with an average remaining life currently estimated at five years, is mostly backed by “Alternative A” first lien mortgage loans, but also has an insurance “wrap” or guarantee as an added layer of protection to the security holder. This asset is illiquid, and as such, the Bank determined it to be a Level 3 security in accordance with Accounting Standards Codification (“ASC”) Topic 820, Fair Value Measurements and Disclosures. Based on this determination, the Bank utilized an income valuation model (“present value model”) approach, in determining the fair value of the security. This approach is beneficial for positions that are not traded in active markets or are subject to transfer restrictions, and/or where valuations are adjusted to reflect illiquidity and/or non-transferability. Such adjustments are generally based on available market evidence. In the absence of such evidence, management’s best estimate is used. Management’s best estimate consists of both internal and external support for this investment.

See additional discussion regarding the Bank’s private label mortgage backed security under Footnote 10 “Fair Value” in this section of the filing.

Pledged Investment Securities

Investment securities pledged to secure public deposits, securities sold under agreements to repurchase and securities held for other purposes, as required or permitted by law are as follows:

(in thousands)	June 30, 2016	December 31, 2015
Carrying amount	\$ 204,614	\$ 489,598
Fair value	204,885	490,074

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4. LOANS HELD FOR SALE

In the ordinary course of business, the Bank originates for sale mortgage loans and short-term consumer loans. Mortgage loans originated for sale are primarily originated and sold into the secondary market through the Bank's Mortgage Banking operations, while short-term consumer loans originated for sale are originated and sold through the RCS division of the Company's RPG segment.

Mortgage Loans Held for Sale, at Fair Value

See additional detail regarding mortgage loans originated for sale, at fair value under Footnote 11 "Mortgage Banking Activities" of this section of the filing.

Mortgage Loans Held for Sale, at Lower of Cost or Fair Value

In addition to loans originated by Republic with the intent to sell, the Company may, from time to time, reclassify loans from held for investment to the held-for-sale class. In June 2016, management decided to sell \$74 million of mortgage loans originated through the Bank's Correspondent Lending channel in order to further enhance its overall liquidity position. The final cash settlement for this sale occurred in late July 2016.

Consumer Loans Held for Sale, at Fair Value

During the first quarter of 2016, RCS initiated a short-term installment loan program, in which the Company sells 100% of the receivables approximately 21 days after origination. The Company carries these loans at fair value, with the loans marked to market on a monthly basis, and any changes in their fair value reported as a component of "Republic Processing Group program fees."

Activity for consumer loans held for sale and carried at fair value was as follows:

(in thousands)	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016
Balance, beginning of period	\$ 415	\$ —
Origination of consumer loans held for sale	13,242	13,657
Proceeds from the sale of consumer loans held for sale	(6,958)	(6,958)
Net gain on sale of consumer loans held for sale	127	127
Balance, end of period	\$ 6,826	\$ 6,826

Consumer Loans Held for Sale, at Lower of Cost or Fair Value

RCS originates for sale its short-term, line-of-credit product and its credit-card product. The Bank sells 90% of the balances maintained through these products within two days of loan origination and retains a 10% interest. The short-term, line-of-credit product represents the substantial majority of activity in consumer loans held for sale and carried at the lower of cost or fair value, as RCS moved beyond the pilot phase for this product in June 2015. In December 2015, RCS began piloting its credit-card product. Any gains or losses on sale of such products are reported as a component of “Republic Processing Group program fees.”

Activity for consumer loans held for sale and carried at the lower of cost or market value was as follows:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	\$ 566	\$ —	\$ 514	\$ —
Origination of consumer loans held for sale	71,717	19,898	115,370	21,969
Proceeds from the sale of consumer loans held for sale	(71,441)	(18,456)	(115,474)	(20,673)
Net gain on sale of consumer loans held for sale	280	100	712	246
Balance, end of period	\$ 1,122	\$ 1,542	\$ 1,122	\$ 1,542

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5. LOANS AND ALLOWANCE FOR LOAN AND LEASE LOSSES

The composition of the loan portfolio at period end follows:

(in thousands)	June 30, 2016	December 31, 2015
Residential real estate:		
Owner occupied	\$ 1,052,357	\$ 1,081,934
Owner occupied - correspondent*	162,269	249,344
Non owner occupied	145,803	116,294
Commercial real estate	973,061	824,887
Commercial real estate - purchased whole loans*	36,085	35,674
Construction & land development	80,398	66,500
Commercial & industrial	248,286	229,721
Lease financing receivables	10,976	8,905
Warehouse lines of credit	586,077	386,729
Home equity	324,437	289,194
Consumer:		
RPG loans*	12,198	7,204
Credit cards	11,884	11,068
Overdrafts	1,458	685
Purchased whole loans*	8,145	5,892
Other consumer	37,889	12,579
Total loans**	3,691,323	3,326,610
Allowance for loan and lease losses	(29,308)	(27,491)
Total loans, net	\$ 3,662,015	\$ 3,299,119

*Identifies loans to borrowers located primarily outside of the Bank's market footprint.

**Total loans are presented inclusive of premiums, discounts and net loan origination fees and costs. See table directly below for expanded detail.

The following table reconciles the contractually receivable and carrying amounts of loans at June 30, 2016 and December 31, 2015:

(in thousands)	June 30, 2016	December 31, 2015
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Contractual receivable	\$ 3,697,531	\$ 3,329,741
Unearned income(1)	(926)	(741)
Unamortized premiums(2)	3,210	3,792
Unaccreted discounts(3)	(11,500)	(7,860)
Net unamortized deferred origination fees and costs	3,008	1,678
Carrying value of loans	\$ 3,691,323	\$ 3,326,610

- (1) Unearned income relates to lease financing receivables.
- (2) Premiums predominately relate to loans acquired through the Bank's Correspondent Lending channel.
- (3) Unaccreted discounts include accretable and non-accretable discounts and predominately relate to loans acquired in the Bank's 2016 Cornerstone acquisition and 2012 FDIC-assisted transactions.

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Loan Purchases

The Core Bank acquires for investment single family, first lien mortgage loans that meet the Core Bank's specifications through its Correspondent Lending channel. The loans acquired through the Correspondent Lending channel are primarily purchased from the Core Bank's Warehouse clients, with substantially all loans purchased at a premium. Loans acquired through the Correspondent Lending channel generally reflect borrowers outside of the Bank's market footprint, with 75% of such loans as of June 30, 2016 secured by collateral in the state of California.

In addition to mortgage loans acquired through its Correspondent Lending channel, the Bank also acquires unsecured consumer installment loans for investment from a third-party originator. Such consumer loans are purchased at par and are selected by the Bank based on certain underwriting specifications.

The following table reflects the purchased activity of single family, first lien mortgage loans and unsecured consumer loans, by class, during the three and six months ended June 30, 2016 and 2015.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Residential real estate:				
Owner occupied - correspondent*	\$ 23,043	\$ 43,632	\$ 43,564	\$ 62,802
Consumer:				
Purchased whole loans*	1,756	—	4,422	361
Total purchased loans	\$ 24,799	\$ 43,632	\$ 47,986	\$ 63,163

* Represents origination amount, inclusive of applicable purchase premiums.

Loans Acquired in Cornerstone Acquisition

The following table summarizes loans acquired in the Company's May 17, 2016 Cornerstone acquisition:

(in thousands)	May 17, 2016			Acquisition-Day Fair Value
	Contractual Receivable	Non-accretable Amount	Accretable Amount	

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Residential real estate:				
Owner occupied	17,934	—	(430)	17,504
Non owner occupied	11,392	—	(124)	11,268
Commercial real estate	107,213	—	(1,549)	105,664
Construction & land development	18,277	—	(504)	17,773
Commercial & industrial	11,462	—	(208)	11,254
Home equity	20,652	—	(362)	20,290
Consumer and other	2,347	—	(203)	2,144
Total loans - ASC 310-20	189,277	—	(3,380)	185,897
Residential real estate:				
Owner occupied	516	(209)	(7)	300
Non owner occupied	1,525	(297)	(153)	1,075
Commercial real estate	3,191	(1,099)	(190)	1,902
Construction & land development	175	—	—	175
Commercial & industrial	66	(49)	1	18
Home equity	382	(128)	(11)	243
Consumer and other	4	(3)	—	1
Total loans - ASC 310-30 - purchased-credit-impaired loans	5,859	(1,785)	(360)	3,714
Total loans	\$ 195,136	\$ (1,785)	\$ (3,740)	\$ 189,611

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Purchased-Credit-Impaired (“PCI”) Loans

The Bank acquired PCI loans on May 17, 2016 in its Cornerstone acquisition and during the year ended December 31, 2012 in two FDIC-assisted transactions. PCI loans are accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality.

Management utilized the following criteria in determining which loans were classified as PCI loans for its May 17, 2016 Cornerstone acquisition:

- Loans for which the Bank assigned a non-accretable discount
- Loans classified as nonaccrual when acquired
- Loans past due 90+ days when acquired

The following table reconciles the contractually required and carrying amounts of all PCI loans at June 30, 2016 and December 31, 2015:

(in thousands)	June 30, 2016	December 31, 2015
Contractually-required principal	\$ 21,074	\$ 18,250
Non-accretable amount	(2,416)	(1,582)
Accretable amount	(4,087)	(4,125)
Carrying value of loans	\$ 14,571	\$ 12,543

The following table presents a rollforward of the accretable amount on all PCI loans for the three and six months ended June 30, 2016 and 2015:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	\$ (3,853)	\$ (2,170)	\$ (4,125)	\$ (2,297)
Transfers between non-accretable and accretable	(44)	(3,378)	(499)	(3,354)
Net accretion into interest income on loans, including loan fees	170	1,225	897	1,328
Generated from acquisition of Cornerstone Bancorp, Inc.	(360)	—	(360)	—
Balance, end of period	\$ (4,087)	\$ (4,323)	\$ (4,087)	\$ (4,323)

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Credit Quality Indicators

Based on the Bank's internal analyses performed as of June 30, 2016 and December 31, 2015, the following tables reflect loans by risk category. Risk categories are defined in the Company's Annual Report on Form 10-K for the year ended December 31, 2015:

June 30, 2016 (in thousands)	Pass	Special Mention*	Substandard*	Doubtful Loss	Purchased Credit Impaired /Loans - Group 1	Purchased Credit Impaired Loans - Substandard	Total Rated Loans**
Residential real estate:							
Owner occupied	\$ —	\$ 27,371	\$ 14,449	\$ —	\$ 1,108	\$ —	\$ 42,928
Owner occupied - correspondent	—	—	—	—	—	—	—
Non owner occupied	—	721	858	—	1,348	—	2,927
Commercial real estate	948,545	6,952	5,750	—	11,814	—	973,061
Commercial real estate - purchased whole loans	36,085	—	—	—	—	—	36,085
Construction & land development	79,124	465	809	—	—	—	80,398
Commercial & industrial	246,968	869	394	—	55	—	248,286
Lease financing receivables	10,976	—	—	—	—	—	10,976
Warehouse lines of credit	586,077	—	—	—	—	—	586,077
Home equity	—	110	1,709	—	244	—	2,063
Consumer:							
RPG loans	—	—	—	—	—	—	—
Credit cards	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Purchased whole loans	—	—	—	—	—	—	—
Other consumer	—	26	62	—	2	—	90
Total rated loans	\$ 1,907,775	\$ 36,514	\$ 24,031	\$ —	\$ 14,571	\$ —	\$ 1,982,891

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*Special Mention and Substandard loans included \$177,000 and \$719,000 that were removed from PCI accounting in accordance with ASC 310-30-35-13 due to a post-acquisition troubled debt restructuring.

** The above table excludes all non-classified residential real estate, home equity and consumer loans.

December 31, 2015 (in thousands)	Pass	Special Mention*	Substandard*	Doubtful Loss	Purchased Credit Impaired Loans - Group 1	Purchased Credit Impaired Loans - Substandard**	Total Rated Loans**
Residential real estate:							
Owner occupied	\$ —	\$ 24,301	\$ 14,577	\$ —	\$ 560	\$ —	\$ 39,438
Owner occupied - correspondent	—	—	—	—	—	—	—
Non owner occupied	—	860	1,557	—	785	—	3,202
Commercial real estate	803,369	5,070	6,530	—	9,918	—	824,887
Commercial real estate - Purchased whole loans	35,674	—	—	—	—	—	35,674
Construction & land development	63,750	96	2,621	—	33	—	66,500
Commercial & industrial	227,344	936	194	—	1,247	—	229,721
Lease financing receivables	8,905	—	—	—	—	—	8,905
Warehouse lines of credit	386,729	—	—	—	—	—	386,729
Home equity	—	21	2,296	—	—	—	2,317
Consumer:							
RPG loans	—	—	—	—	—	—	—
Credit cards	—	—	—	—	—	—	—
Overdrafts	—	—	—	—	—	—	—
Purchased whole loans	—	—	—	—	—	—	—
Other consumer	—	28	58	—	—	—	86
Total rated loans	\$ 1,525,771	\$ 31,312	\$ 27,833	\$ —	\$ 12,543	\$ —	\$ 1,597,459

*Special Mention and Substandard loans included \$180,000 and \$1 million that were removed from PCI accounting in accordance with ASC 310-30-35-13 due to a post-acquisition troubled debt restructuring.

** The above table excludes all non-classified residential real estate, home equity and consumer loans.

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Allowance for Loan and Lease Losses

Activity in the allowance for loan and lease losses (“Allowance”) follows:

(in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
Allowance, beginning of period	\$ 31,475	\$ 24,631	\$ 27,491	\$ 24,410
Charge-offs - Core Banking	(804)	(685)	(1,416)	(1,177)
Charge-offs - RPG	(3,943)	(21)	(5,194)	(26)
Total charge-offs	(4,747)	(706)	(6,610)	(1,203)
Recoveries - Core Banking	377	377	705	715
Recoveries - RPG	389	42	722	237
Total recoveries	766	419	1,427	952
Net (charge-offs) recoveries - Core Banking	(427)	(308)	(711)	(462)
Net (charge-offs) recoveries - RPG	(3,554)	21	(4,472)	211
Net (charge-offs) recoveries	(3,981)	(287)	(5,183)	(251)
Provision - Core Banking	1,278	717	1,776	1,092
Provision - RPG	536	187	5,224	(3)
Total provision	1,814	904	7,000	1,089
Allowance, end of period	\$ 29,308	\$ 25,248	\$ 29,308	\$ 25,248

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The following tables present the activity in the Allowance by portfolio class for the three months ended June 30, 2016 and 2015:

Three Months Ended June 30, 2016 (in thousands)	Residential Real Estate			Commercial				Lease & Financing Receivables
	Owner	Occupied	Non Owner	Commercial	Purchased	Construction	Commercial	
	Occupied	Correspondent	Occupied	Real Estate	Whole Loans	Land Development	Industrial	
Beginning balance	\$ 8,049	\$ 607	\$ 1,095	\$ 7,642	\$ 36	\$ 1,348	\$ 1,384	\$ 97
Provision	(160)	(15)	(51)	48	—	(16)	387	18
Charge-offs	(73)	—	—	—	—	—	(330)	—
Recoveries	77	—	8	79	—	—	—	—
Ending balance	\$ 7,893	\$ 592	\$ 1,052	\$ 7,769	\$ 36	\$ 1,332	\$ 1,441	\$ 115

(continued)	Warehouse	Home	Consumer	Credit	Overdrafts	Purchased	Other	Total
	Lines of Credit		RPG			Loans	Whole Loans	
Beginning balance	\$ 985	\$ 3,054	\$ 5,469	\$ 466	\$ 450	\$ 565	\$ 228	\$ 31,475
Provision	480	(67)	536	37	489	28	100	1,814
Charge-offs	—	(49)	(3,943)	(50)	(171)	(64)	(67)	(4,747)
Recoveries	—	78	389	3	56	6	70	766
Ending balance	\$ 1,465	\$ 3,016	\$ 2,451	\$ 456	\$ 824	\$ 535	\$ 331	\$ 29,308

	Residential Real Estate			Commercial				Lease & Financing
	Owner	Occupied	Non Owner	Commercial	Purchased	Construction	Commercial	
	Owner	Occupied	Non Owner	Commercial	Purchased	Construction	Commercial	

Three Months
Ended
June 30, 2015
(in thousands)

	Occupied	Correspondent	Occupied	Real Estate	Whole Loans	Land Development	Industrial	Receivables
Beginning balance	\$ 8,629	\$ 579	\$ 920	\$ 7,553	\$ 35	\$ 958	\$ 1,157	\$ 40
Provision	(313)	29	10	353	—	142	52	36
Charge-offs	(178)	—	(29)	(147)	—	—	(27)	—
Recoveries	64	—	3	81	—	—	9	—
Ending balance	\$ 8,202	\$ 608	\$ 904	\$ 7,840	\$ 35	\$ 1,100	\$ 1,191	\$ 76

(continued)	Warehouse Lines of Credit	Home Equity	Consumer RPG Loans	Credit Cards	Overdrafts	Purchased Whole Loans	Other Consumer	Total
Beginning balance	\$ 1,058	\$ 2,708	\$ 44	\$ 362	\$ 245	\$ 184	\$ 159	\$ 24,631
Provision	164	56	187	40	57	83	8	904
Charge-offs	—	(21)	(21)	(31)	(103)	(60)	(89)	(706)
Recoveries	—	22	42	28	87	—	83	419
Ending balance	\$ 1,222	\$ 2,765	\$ 252	\$ 399	\$ 286	\$ 207	\$ 161	\$ 25,248

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The following tables present the activity in the Allowance by portfolio class for the six months ended June 30, 2016 and 2015:

Six Months Ended June 30, 2016 (in thousands)	Residential Real Estate			Commercial				Lease Financing Receivables
	Owner	Occupied	Non Owner	Commercial Real Estate	Purchased Whole Loans	Construction & Land Development	Commercial & Industrial	
	Occupied	Correspondent	Occupied	Real Estate	Whole Loans	Land Development	Industrial	
Beginning balance	\$ 8,301	\$ 623	\$ 1,052	\$ 7,636	\$ 36	\$ 1,303	\$ 1,455	\$ 89
Provision	(298)	(31)	(8)	68	—	53	312	26
Charge-offs	(261)	—	—	(41)	—	(44)	(330)	—
Recoveries	151	—	8	106	—	20	4	—
Ending balance	\$ 7,893	\$ 592	\$ 1,052	\$ 7,769	\$ 36	\$ 1,332	\$ 1,441	\$ 115

(continued)	Warehouse Lines of Credit	Home Equity	Consumer RPG Loans	Credit Cards	Overdrafts	Purchased Whole Loans	Other Consumer	Total
Beginning balance	\$ 967	\$ 2,996	\$ 1,699	\$ 448	\$ 351	\$ 392	\$ 143	\$ 27,491
Provision	498	—	5,224	58	673	260	165	7,000
Charge-offs	—	(84)	(5,194)	(62)	(332)	(123)	(139)	(6,610)
Recoveries	—	104	722	12	132	6	162	1,427
Ending balance	\$ 1,465	\$ 3,016	\$ 2,451	\$ 456	\$ 824	\$ 535	\$ 331	\$ 29,308

Residential Real Estate	Commercial	Lease
Owner	Real Estate -	Financing
Owner	Purchased	Commercial & Industrial
Occupied	Construction & Land Development	Receivables
Non Owner	Commercial Real Estate	Lease Financing

Six Months
Ended
June 30, 2015
(in thousands)

	Occupied	Correspondent	Occupied	Real Estate	Whole Loans	Land Development	Industrial	Receivables
Beginning balance	\$ 8,565	\$ 567	\$ 837	\$ 7,740	\$ 34	\$ 926	\$ 1,167	\$ 25
Provision	(173)	41	90	164	1	174	42	51
Charge-offs	(314)	—	(29)	(154)	—	—	(56)	—
Recoveries	124	—	6	90	—	—	38	—
Ending balance	\$ 8,202	\$ 608	\$ 904	\$ 7,840	\$ 35	\$ 1,100	\$ 1,191	\$ 76

(continued)	Warehouse Lines of Credit	Home Equity	Consumer RPG Loans	Credit Cards	Overdrafts	Purchased Whole Loans	Other Consumer	Total
Beginning balance	\$ 799	\$ 2,730	\$ 44	\$ 285	\$ 382	\$ 185	\$ 124	\$ 24,410
Provision	423	48	(3)	144	(22)	94	15	1,089
Charge-offs	—	(72)	(26)	(71)	(249)	(72)	(160)	(1,203)
Recoveries	—	59	237	41	175	—	182	952
Ending balance	\$ 1,222	\$ 2,765	\$ 252	\$ 399	\$ 286	\$ 207	\$ 161	\$ 25,248

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Nonperforming Loans and Nonperforming Assets

Detail of nonperforming loans and nonperforming assets follows:

(dollars in thousands)	June 30, 2016	December 31, 2015
Loans on nonaccrual status*	\$ 18,778	\$ 21,712
Loans past due 90-days-or-more and still on accrual**	1,178	224
Total nonperforming loans	19,956	21,936
Other real estate owned	1,503	1,220
Total nonperforming assets	\$ 21,459	\$ 23,156

Credit Quality Ratios:

Nonperforming loans to total loans	0.54	%	0.66	%
Nonperforming assets to total loans (including OREO)	0.58		0.70	
Nonperforming assets to total assets	0.46		0.55	

*Loans on nonaccrual status include impaired loans.

**For all periods presented, loans past due 90-days-or-more and still accruing consist entirely of PCI loans.

The following table presents the recorded investment in nonaccrual loans and loans past due 90-days-or-more and still on accrual by class of loans:

(in thousands)	Nonaccrual		Past Due 90-Days-or-More and Still Accruing Interest*	
	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
Residential real estate:				
Owner occupied	\$ 12,600	\$ 13,197	\$ —	\$ —
Owner occupied - correspondent	—	—	—	—
Non owner occupied	851	935	972	—
Commercial real estate	3,529	3,941	206	224
Commercial real estate - purchased whole loans	—	—	—	—
Construction & land development	83	1,589	—	—
Commercial & industrial	394	194	—	—

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Lease financing receivables	—	—	—	—
Warehouse lines of credit	—	—	—	—
Home equity	1,258	1,793	—	—
Consumer:				
RPG loans	—	—	—	—
Credit cards	—	—	—	—
Overdrafts	—	—	—	—
Purchased whole loans	—	—	—	—
Other consumer	63	63	—	—
Total	\$ 18,778	\$ 21,712	\$ 1,178	\$ 224

*For all periods presented, loans past due 90-days-or-more and still on accrual consist entirely of PCI loans.

Nonaccrual loans and loans past due 90-days-or-more and still on accrual include both smaller balance, primarily retail, homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Nonaccrual loans are typically returned to accrual status when all the principal and interest amounts contractually due are brought current and held current for six consecutive months and future contractual payments are reasonably assured. Troubled Debt Restructurings (“TDRs”) on nonaccrual status are reviewed for return to accrual status on an individual basis, with additional consideration given to performance under the modified terms.

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Delinquent Loans

The following tables present the aging of the recorded investment in loans by class of loans:

June 30, 2016 (dollars in thousands)	30 - 59 Days Delinquent	60 - 89 Days Delinquent	90 or More Days Delinquent*	Total Delinquent**	Total Current	Total
Residential real estate:						
Owner occupied	\$ 1,709	\$ 1,588	\$ 2,808	\$ 6,105	\$ 1,046,252	\$ 1,052,357
Owner occupied - correspondent	—	—	—	—	162,269	162,269
Non owner occupied	9	—	972	981	144,822	145,803
Commercial real estate	720	—	665	1,385	971,676	973,061
Commercial real estate - purchased whole loans	—	—	—	—	36,085	36,085
Construction & land development	—	—	—	—	80,398	80,398
Commercial & industrial	381	—	—	381	247,905	248,286
Lease financing receivables	—	—	—	—	10,976	10,976
Warehouse lines of credit	—	—	—	—	586,077	586,077
Home equity	235	44	629	908	323,529	324,437
Consumer:						
RPG loans	382	23	14	419	11,779	12,198
Credit cards	19	23	—	42	11,842	11,884
Overdrafts	199	1	—	200	1,258	1,458
Purchased whole loans	74	54	20	148	7,997	8,145
Other consumer	23	15	—	38	37,851	37,889
Total	\$ 3,751	\$ 1,748	\$ 5,108	\$ 10,607	\$ 3,680,716	\$ 3,691,323
Delinquency ratio***	0.10 %	0.05 %	0.14 %	0.29 %		

December 31, 2015 (dollars in thousands)	30 - 59 Days Delinquent	60 - 89 Days Delinquent	90 or More Days Delinquent*	Total Delinquent**	Total Current	Total
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Residential real estate:

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Owner occupied	\$ 1,960	\$ 1,044	\$ 3,878	\$ 6,882	\$ 1,075,052	\$ 1,081,934
Owner occupied - correspondent	—	—	—	—	249,344	249,344
Non owner occupied	14	—	39	53	116,241	116,294
Commercial real estate	178	—	933	1,111	823,776	824,887
Commercial real estate - purchased whole loans	—	—	—	—	35,674	35,674
Construction & land development	—	—	1,500	1,500	65,000	66,500
Commercial & industrial	299	—	—	299	229,422	229,721
Lease financing receivables	—	—	—	—	8,905	8,905
Warehouse lines of credit	—	—	—	—	386,729	386,729
Home equity	206	1	1,186	1,393	287,801	289,194
Consumer:						
RPG loans	246	—	—	246	6,958	7,204
Credit cards	10	2	—	12	11,056	11,068
Overdrafts	133	—	—	133	552	685
Purchased whole loans	5	42	—	47	5,845	5,892
Other consumer	37	18	—	55	12,524	12,579
Total	\$ 3,088	\$ 1,107	\$ 7,536	\$ 11,731	\$ 3,314,879	\$ 3,326,610
Delinquency ratio***	0.09 %	0.03 %	0.23 %	0.35 %		

*All loans past due 90-days-or-more, excluding PCI loans, were on nonaccrual status.

**Delinquent status may be determined by either the number of days past due or number of payments past due.

***Represents total loans 30-days-or-more past due by aging category divided by total loans.

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Impaired Loans

Information regarding the Bank's impaired loans follows:

(in thousands)	June 30, 2016	December 31, 2015
Loans with no allocated Allowance	\$ 24,237	\$ 26,143
Loans with allocated Allowance	34,610	39,980
Total impaired loans	\$ 58,847	\$ 66,123
Amount of the Allowance	\$ 4,937	\$ 5,427

Approximately \$6 million and \$7 million of impaired loans at June 30, 2016 and December 31, 2015 were PCI loans. Approximately \$896,000 and \$1 million of impaired loans at June 30, 2016 and December 31, 2015 were formerly PCI loans that became classified as "Impaired" through a post-acquisition troubled debt restructuring.

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The following tables present the balance in the Allowance and the recorded investment in loans by portfolio class based on impairment method as of June 30, 2016 and December 31, 2015:

June 30, 2016 (in thousands)	Residential Real Estate			Commercial Real Estate - Purchased	Commercial Construction & Development		Commercial & Industrial	Lease & Financing Receivables
	Owner Occupied	Owner Occupied - Correspondent	Non Owner Occupied		Real Estate	Whole Loans		
Allowance: Ending Allowance balance: Individually evaluated for impairment, excluding PCI loans	\$ 3,599	\$ —	\$ 70	\$ 288	\$ —	\$ 131	\$ 182	\$ —
Collectively evaluated for impairment PCI loans with post acquisition impairment	4,218	592	975	6,965	36	1,201	1,259	115
PCI loans without post acquisition impairment	76	—	7	516	—	—	—	—
Total ending Allowance:	\$ 7,893	\$ 592	\$ 1,052	\$ 7,769	\$ 36	\$ 1,332	\$ 1,441	\$ 115
Loans: Impaired loans individually evaluated, excluding PCI loans	\$ 36,722	\$ —	\$ 1,305	\$ 11,524	\$ —	\$ 902	\$ 487	\$ —
Loans collectively evaluated for impairment	1,014,527	162,269	143,150	949,723	36,085	79,496	247,744	10,976

PCI loans
with post
acquisition
impairment

724

—

273

5,092

—

—

—