CNB FINANCIAL CORP/PA
Form 10-Q
May 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 - Q

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

For the quarterly period ended March 31, 2014

or

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

For the transition period from ______ to ______

Commission File Number 000-13396

CNB FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Pennsylvania	**25-1450605**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1 South Second Street

P.O. Box 42

Clearfield, Pennsylvania 16830

(Address of principal executive offices)

Registrant s telephone number, including area code, (814) 765-9621

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. x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x 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. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

The number of shares outstanding of the issuer s common stock as of May 5, 2014

COMMON STOCK NO PAR VALUE PER SHARE: 14,465,407 SHARES

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PART I.

FINANCIAL INFORMATION

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Forward-Looking Statements

The information below includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to the financial condition, liquidity, results of operations, future performance and our business. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that are not historical facts. Forward-looking statements include statements with respect to beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond our control). Forward-looking statements often include the words believes, expects, anticipates, estimates, forecasts, intends, plans, targe potentially, probably, projects, outlook or similar expressions or future conditional verbs such as may, will, should, would and cou known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements, include, but are not limited to, (i) changes in general business, industry or economic conditions or competition; (ii) changes in any applicable law, rule, regulation, policy, guideline or practice governing or affecting financial holding companies and their subsidiaries or with respect to tax or accounting principles or otherwise; (iii) adverse changes or conditions in capital and financial markets; (iv) changes in interest rates; (v) higher than expected costs or other difficulties related to integration of combined or merged businesses; (vi) the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions; (vii) changes in the quality or composition of our loan and investment portfolios; (viii) adequacy of loan loss reserves; (ix) increased competition; (x) loss of certain key officers; (xi) continued relationships with major customers; (xii) deposit attrition; (xiii) rapidly changing technology; (xiv) unanticipated regulatory or judicial proceedings and liabilities and other costs; (xv) changes in the cost of funds, demand for loan products or demand for financial services; and (xvi) other economic, competitive, governmental or technological factors affecting our operations, markets, products, services and prices. Some of these and other factors are discussed in our annual and quarterly reports filed with the Securities and Exchange Commission. Such factors could have an adverse impact on our financial position and our results of operations.

The forward-looking statements contained herein are based upon management s beliefs and assumptions. Any forward-looking statement made herein speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

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Part I Financial Information

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except share data

	(unaudited) March 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$ 30,780	$ 25,769
Interest bearing deposits with other banks	3,086	3,864
Total cash and cash equivalents	33,866	29,633
Interest bearing time deposits with other banks	225	275
Securities available for sale	687,862	685,991
Trading securities	4,073	4,127
Loans held for sale	329	487
Loans	1,297,874	1,299,259
Less: unearned discount	(3,778)	(3,896)
Less: allowance for loan losses	(16,674)	(16,234)
Net loans	1,277,422	1,279,129
FHLB and other equity interests	7,519	7,533
Premises and equipment, net	32,864	31,589
Bank owned life insurance	34,044	33,804
Mortgage servicing rights	906	904
Goodwill	27,194	27,194
Core deposit intangible	4,280	4,583
Accrued interest receivable and other assets	23,477	26,040
Total Assets	$ 2,134,061	$ 2,131,289
LIABILITIES AND SHAREHOLDERS EQUITY		
Non-interest bearing deposits	$ 221,831	$ 221,293
Interest bearing deposits	1,606,827	1,614,021
Total deposits	1,828,658	1,835,314
FHLB and other long-term borrowings	75,899	75,000
Other short-term borrowings	15,250	12,950
Subordinated debentures	20,620	20,620
Accrued interest payable and other liabilities	21,353	22,494
Total liabilities	1,961,780	1,966,378
Common stock, $0 par value; authorized 50,000,000 shares; issued 14,473,482 shares	0	0
Additional paid in capital	77,641	77,923
Retained earnings	99,845	97,066
Treasury stock, at cost (8,640 shares at March 31, 2014 and 45,702 shares at December 31, 2013)	(113)	(633)

Accumulated other comprehensive loss	(5,092)	(9,445)
Total shareholders equity	172,281	164,911
Total Liabilities and Shareholders Equity	$ 2,134,061	$ 2,131,289

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

	Three months ended March 31, 2014	Three months ended March 31, 2013
INTEREST AND DIVIDEND INCOME:		
Loans including fees	$ 17,085	$ 12,302
Securities:		
Taxable	3,396	3,409
Tax-exempt	909	957
Dividends	47	36
Total interest and dividend income	21,437	16,704
INTEREST EXPENSE:		
Deposits	2,072	2,234
Borrowed funds	898	829
Subordinated debentures (includes $97 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in both 2014 and 2013)	187	190
Total interest expense	3,157	3,253
NET INTEREST INCOME	18,280	13,451
PROVISION FOR LOAN LOSSES	1,019	930
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	17,261	12,521
NON-INTEREST INCOME:		
Wealth and asset management fees	672	574
Service charges on deposit accounts	1,041	942
Other service charges and fees	568	430
Net realized gains on available-for-sale securities (includes $66 and $76 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2014 and 2013, respectively)	66	76
Net realized and unrealized gains (losses) on trading securities	(25)	303
Mortgage banking	175	255
Bank owned life insurance	240	262
Other	468	229
Total non-interest income	3,205	3,071
NON-INTEREST EXPENSES:		
Salaries and benefits	6,835	5,197
Net occupancy expense	1,761	1,317
Amortization of core deposit intangible	303	
Data processing	1,103	767
State and local taxes	562	439
Legal, professional, and examination fees	442	311
Advertising	311	246
FDIC insurance premiums	340	279

Merger costs		103
Other	1,604	1,023
Total non-interest expenses	13,261	9,682
INCOME BEFORE INCOME TAXES	7,205	5,910
INCOME TAX EXPENSE (includes ($11) and ($7) income tax expense from reclassification items in 2014 and 2013, respectively)	2,039	1,613
NET INCOME	$ 5,166	$ 4,297
EARNINGS PER SHARE:		
Basic	$ 0.36	$ 0.34
Diluted	$ 0.36	$ 0.34
DIVIDENDS PER SHARE:		
Cash dividends per share	$ 0.165	$ 0.165

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

Dollars in thousands

	Three months ended March 31, 2014	Three months ended March 31, 2013
NET INCOME	$ 5,166	$ 4,297
Other comprehensive income (loss), net of tax:		
Net change in fair value of interest rate swap agreements designated as cash flow hedges:		
Unrealized gain (loss) on interest rate swaps, net of tax of $21 and ($6), respectively	(39)	12
Reclassification adjustment for losses recognized in earnings, net of tax of ($34) and ($34), respectively	63	63
	24	75
Net change in unrealized gains (losses) on securities available for sale:		
Unrealized gains (losses) on other-than-temporarily impaired securities available for sale:		
Unrealized gains (losses) arising during the period, net of tax of ($48) and $15, respectively	89	(27)
Unrealized gains (losses) on other securities available for sale:		
Unrealized gains (losses) arising during the period, net of tax of $2,306 and $865, respectively	4,283	(1,606)
Reclassification adjustment for realized gains included in net income, net of tax of $23 and $27, respectively	(43)	(49)
	4,240	(1,655)
Other comprehensive income (loss)	4,353	(1,607)
COMPREHENSIVE INCOME	$ 9,519	$ 2,690

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Dollars in thousands

	Three months ended March 31, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 5,166	$ 4,297
Adjustments to reconcile net income to net cash provided by operations:		
Provision for loan losses	1,019	930
Depreciation and amortization of premises and equipment, core deposit intangible, and mortgage servicing rights	1,011	554
Amortization and accretion of securities premiums and discounts, deferred loan fees and costs, net yield and credit mark on acquired loans, and unearned income	157	1,126
Net realized gains on sales of available-for-sale securities	(66)	(76)
Net realized and unrealized (gains) losses on trading securities	25	(303)
Proceeds from sale of trading securities	0	1,567
Purchase of trading securities	0	(1,980)
Gain on sale of loans	(119)	(243)
Net gains on dispositions of premises and equipment and foreclosed assets	(105)	(2)
Proceeds from sale of loans	2,223	11,072
Origination of loans held for sale	(2,021)	(9,417)
Income on bank owned life insurance	(240)	(262)
Stock-based compensation expense	208	83
Contribution of treasury stock	30	30
Changes in:		
Accrued interest receivable and other assets	2,620	(876)
Accrued interest payable and other liabilities	(3,436)	(1,646)
NET CASH PROVIDED BY OPERATING ACTIVITIES	6,472	4,854
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net increase (decrease) in interest bearing time deposits with other banks	50	(50)
Proceeds from maturities, prepayments and calls of available-for-sale securities	20,162	29,276
Proceeds from sales of available-for-sale securities	12,951	1,324
Purchase of available-for-sale securities	(29,027)	(57,812)
Loan origination and payments, net	1,201	(5,967)
Redemption of FHLB and other equity interests	14	87
Purchase of premises and equipment	(1,910)	(828)
Proceeds from the sale of premises and equipment and foreclosed assets	164	0
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	3,605	(33,970)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in:		
Checking, money market and savings accounts	38,520	62,167
Certificates of deposit	(45,176)	(1,725)
Proceeds from sale of treasury stock	0	2
Cash dividends paid	(2,387)	(2,064)
Repayment of long-term borrowings	(51)	(44)
Proceeds from long-term borrowings	950	900
Net change in short-term borrowings	2,300	(23,510)

NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(5,844)	35,726
NET INCREASE IN CASH AND CASH EQUIVALENTS	4,233	6,610
CASH AND CASH EQUIVALENTS, Beginning	29,633	31,881
CASH AND CASH EQUIVALENTS, Ending	$ 33,866	$ 38,491
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 3,201	$ 3,257
Income taxes	$ 542	$ 32
SUPPLEMENTAL NONCASH DISCLOSURES:		
Transfers to other real estate owned	$ 129	$ 51
Grant of restricted stock awards from treasury stock	$ 609	$ 539

See Notes to Consolidated Financial Statements

CNB FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (SEC) and in compliance with accounting principles generally accepted in the United States of America (GAAP). Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

In the opinion of management of the registrant, the accompanying consolidated financial statements as of March 31, 2014 and for the three month periods ended March 31, 2014 and 2013 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods presented. The financial performance reported for CNB Financial Corporation (the Corporation) for the three month period ended March 31, 2014 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation s Annual Report on Form 10-K for the period ended December 31, 2013 (the 2013 Form 10-K). All dollar amounts are stated in thousands, except share and per share data and other amounts as indicated. Certain prior period amounts have been reclassified to conform to the current period presentation.

2. STOCK COMPENSATION

The Corporation has a stock incentive plan for key employees and independent directors. The stock incentive plan, which is administered by a committee of the Board of Directors, provides for aggregate grants of up to 500,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the fourth anniversary of the grant. For independent directors, the vesting schedule is one-third of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the third anniversary of the grant.

At March 31, 2014, there was no unrecognized compensation cost related to nonvested stock options granted under this plan and no stock options were granted during the three month periods ended March 31, 2014 and 2013. At March 31, 2014 and December 31, 2013, the Corporation had 35,500 stock options that were fully vested and exercisable.

Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Nonvested restricted stock awards are recorded as a reduction of additional paid-in-capital in shareholders equity until earned. Compensation expense resulting from these restricted stock awards was $208 and $83 for the three months ended March 31, 2014 and 2013, respectively. As of March 31, 2014, there was $1,111 of total unrecognized compensation cost related to unvested restricted stock awards.

A summary of changes in nonvested restricted stock awards for the three months ended March 31, 2014 follows:

	Shares	Per Share Weighted Average Grant Date Fair Value
Nonvested at beginning of period	62,076	$ 16.25
Granted	35,400	17.19

Vested	(27,415)		16.05
Nonvested at end of period	70,061	$	16.80

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3. FAIR VALUE
Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities relationship to other benchmark quoted securities (Level 2 inputs). The fair value of one corporate bond held by the Corporation has been determined by using Level 3 inputs. The Corporation has engaged a valuation expert to price this security using a proprietary model which incorporates assumptions about certain factors that market participants would use in pricing the security, including bid/ask spreads and liquidity and credit premiums.

The Corporation s structured pooled trust preferred security is priced using Level 3 inputs. The decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely, and the once-active market has become comparatively inactive. The Corporation engaged a third party consultant who has developed a model for pricing this security. Information such as historical and current performance of the underlying collateral, deferral and default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions and insurance companies are utilized in determining the security valuation. Due to the current market conditions as well as the limited trading activity of these types of securities, the market value of the Corporation s structured pooled trust preferred security is highly sensitive to assumption changes and market volatility.

The Corporation s derivative instrument is an interest rate swap that is similar to those that trade in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals prepared by third-parties. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also adjusts appraised values based on the length of time that has passed since the appraisal date and other factors. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

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Assets and liabilities measured at fair value on a recurring basis are as follows at March 31, 2014 and December 31, 2013:

		Fair Value Measurements at March 31, 2014 Using		
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities Available For Sale:				
U.S. Treasury	$ 0	$ 0	$ 0	$ 0
U.S. Government sponsored entities	182,727	0	182,727	0
States and political subdivisions	176,268	0	176,268	0
Residential and multi-family mortgage	245,828	0	245,828	0
Commercial mortgage	225	0	225	0
Corporate notes and bonds	14,202	0	14,202	0
Pooled trust preferred	798	0	0	798
Pooled SBA	66,824	0	66,824	0
Other securities	990	990	0	0
Total Securities Available For Sale	$ 687,862	$ 990	$ 686,074	$ 798
Trading Securities:				
Corporate equity securities	$ 2,680	$ 2,680	$ 0	$ 0
Mutual funds	933	933	0	0
Certificates of deposit	254	254	0	0
Corporate notes and bonds	152	0	152	0
U.S. Government sponsored entities	54	0	54	0
Total Trading Securities	$ 4,073	$ 3,867	$ 206	$ 0
Liabilities,				
Interest rate swaps	$ (1,079)	$ 0	$ (1,079)	$ 0

		Fair Value Measurements at December 31, 2013 Using		
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities Available For Sale:				
U.S. Treasury	$ 0	$ 0	$ 0	$ 0
U.S. Government sponsored entities	181,625	0	181,625	0
States and political subdivisions	177,943	0	177,943	0
Residential and multi-family mortgage	242,607	0	242,607	0
Commercial mortgage	374	0	374	0
Corporate notes and bonds	14,075	0	14,075	0
Pooled trust preferred	661	0	0	661
Pooled SBA	67,721	0	67,721	0
Other securities	985	985	0	0

Total Securities Available For Sale	$ 685,991	$ 985	$ 684,345	$ 661
Trading Securities:				
Corporate equity securities	$ 2,705	$ 2,705	$ 0	$ 0
Mutual funds	965	965	0	0
Certificates of deposit	253	253	0	0
Corporate notes and bonds	152	0	152	0
U.S. Government sponsored entities	52	0	52	0
Total Trading Securities	$ 4,127	$ 3,923	$ 204	$ 0
Liabilities,				
Interest rate swaps	$ (1,116)	$ 0	$ (1,116)	$ 0

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The table below presents a reconciliation of the fair value of securities available for sale measured on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2014:

	Pooled trust preferred
Balance, January 1, 2014	$ 661
Total gains or (losses):	
Included in other comprehensive income (unrealized)	137
Balance, March 31, 2014	$ 798

The table below presents a reconciliation of the fair value of securities available for sale measured on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2013:

	Corporate notes and bonds	Pooled trust preferred
Balance, January 1, 2013	$ 1,980	$ 600
Total gains or (losses):		
Included in other comprehensive income (unrealized)	87	(42)
Balance, March 31, 2013	$ 2,067	$ 558

The following table presents quantitative information about Level 3 fair value measurements at March 31, 2014:

	Fair value	Valuation Technique	Unobservable Inputs	Input Utilized
Pooled trust preferred	$ 798	Discounted cash flow	Collateral default rate	1.5% in 2014; 1.0% in 2015; 0.5% in 2016 and thereafter
			Yield	13%
			Prepayment speed	2.0% constant prepayment rate in 2014 and thereafter

The following table presents quantitative information about Level 3 fair value measurements at December 31, 2013:

	Fair value	Valuation Technique	Unobservable Inputs	Input Utilized
Pooled trust preferred	$ 661	Discounted cash flow	Collateral default rate	2% in 2014; 1.5% in 2015; 1.0% in 2016; 0.5% in 2017 and thereafter
			Yield	15%

	Prepayment speed	2.0% constant prepayment rate in 2014 and thereafter

At March 31, 2014 and December 31, 2013, the significant unobservable inputs used in the fair value measurement of the Corporation s pooled trust preferred security are collateral default rate, yield, and prepayment speed. Significant increases in specific-issuer default assumptions or decreases in specific-issuer recovery assumptions would result in a significantly lower fair value measurement. Conversely, decreases in specific-issuer default assumptions or increases in specific-issuer recovery assumptions would result in a higher fair value measurement.

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Assets and liabilities measured at fair value on a non-recurring basis are as follows at March 31, 2014 and December 31, 2013:

		Fair Value Measurements at March 31, 2014 Using		
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans:				
Commercial mortgages	$ 2,994	0	0	$ 2,994
Commercial, industrial, and agricultural	3,204	0	0	3,204

		Fair Value Measurements at December 31, 2013 Using		
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans:				
Commercial mortgages	$ 3,000	0	0	$ 3,000
Commercial, industrial, and agricultural	3,706	0	0	3,706

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a recorded investment of $8,059 with a valuation allowance of $1,861 as of March 31, 2014, resulting in an additional provision for loan losses of $350 for the corresponding three month period. Impaired loans had a recorded investment of $8,161 with a valuation allowance of $1,455 as of December 31, 2013, and an additional provision for loan losses of $201 was recorded for the three months ended March 31, 2013.

The estimated fair values of impaired collateral dependent loans such as commercial or residential mortgages are determined primarily by using third-party appraisals. When a collateral dependent loan, such as a commercial or residential mortgage loan, becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral and a further reduction for estimated costs to sell the property is applied, which results in an amount that is considered to be the estimated fair value. If a loan becomes impaired and Management determines an updated appraisal is not necessary, an appropriate adjustment factor is applied based on experience with current valuations of similar collateral in determining the loan s estimated fair value and resulting allowance for loan losses. Third-party appraisals are not customarily obtained in respect of unimpaired loans, unless in management s view changes in circumstances warrant obtaining an updated appraisal.

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The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at March 31, 2014:

		Fair value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	commercial mortgages	$ 2,994	Sales comparison approach	Adjustment for differences between the comparable sales	15% - 60% (26%)
Impaired loans agricultural	commercial, industrial, and	$ 3,004	Sales comparison approach	Adjustment for differences between the comparable sales	20%
Impaired loans agricultural	commercial, industrial, and	$ 200	Income approach	Adjustment for differences in net operating income	54%

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2013:

		Fair value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	commercial mortgages	$ 3,000	Sales comparison approach	Adjustment for differences between the comparable sales	17% - 61% (22%)
Impaired loans agricultural	commercial, industrial, and	$ 3,274	Sales comparison approach	Adjustment for differences between the comparable sales	9%
Impaired loans agricultural	commercial, industrial, and	$ 432	Income approach	Adjustment for differences in net operating income	2%

Fair Value of Financial Instruments

The following table presents the carrying amount and fair value of financial instruments at March 31, 2014:

	Carrying Amount	Fair Value Measurement Using: Level 1	Level 2	Level 3	Total Fair Value
ASSETS					
Cash and cash equivalents	$ 33,866	$ 33,866	$ 0	$ 0	$ 33,866
Interest bearing time deposits with other banks	225	0	225	0	225
Securities available for sale	687,862	990	686,074	798	687,862
Trading securities	4,073	3,867	206	0	4,073
Loans held for sale	329	0	348	0	348
Net loans	1,277,422	0	0	1,274,928	1,274,928
FHLB and other equity interests	7,519	n/a	n/a	n/a	n/a
Accrued interest receivable	8,215	6	4,141	4,068	8,215
LIABILITIES					
Deposits	$ (1,828,658)	$ (1,608,072)	$ (220,150)	$ 0	$ (1,828,222)
FHLB and other borrowings	(91,149)	0	(91,028)	0	(91,028)
Subordinated debentures	(20,620)	0	(11,096)	0	(11,096)
Interest rate swaps	(1,079)	0	(1,079)	0	(1,079)
Accrued interest payable	(827)	(337)	(475)	(15)	(827)

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The following table presents the carrying amount and fair value of financial instruments at December 31, 2013:

	Carrying Amount	Fair Value Measurement Using: Level 1	Level 2	Level 3	Total Fair Value
ASSETS					
Cash and cash equivalents	$ 29,633	$ 29,633	$ 0	$ 0	$ 29,633
Interest bearing time deposits with other banks	275	0	274	0	274
Securities available for sale	685,991	985	684,345	661	685,991
Trading securities	4,127	3,923	204	0	4,127
Loans held for sale	487	0	507	0	507
Net loans	1,279,129	0	0	1,276,622	1,276,622
FHLB and other equity interests	7,533	n/a	n/a	n/a	n/a
Accrued interest receivable	8,032	368	3,302	4,362	8,032
LIABILITIES					
Deposits	$ (1,835,314)	$ (1,569,552)	$ (265,237)	$ 0	$ (1,834,789)
FHLB and other borrowings	(87,950)	0	(87,833)	0	(87,833)
Subordinated debentures	(20,620)	0	(11,178)	0	(11,178)
Interest rate swaps	(1,116)	0	(1,116)	0	(1,116)
Accrued interest payable	(868)	(200)	(653)	(15)	(868)

The methods and assumptions, not otherwise presented, used to estimate fair values are described as follows:

Cash and cash equivalents: The carrying amounts of cash and cash equivalents approximate fair values and are classified as Level 1.

Interest bearing time deposits with other banks: The fair value of interest bearing time deposits with other banks is estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly maturities, resulting in a Level 2 classification.

Loans held for sale: The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

Loans: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values, resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality, resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

FHLB and other equity interests: It is not practical to determine the fair value of Federal Home Loan Bank stock and other equity interests due to restrictions placed on the transferability of these instruments.

Accrued interest receivable: The carrying amount of accrued interest receivable approximates fair value resulting in a classification that is consistent with the asset with which it is associated.

Deposits: The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amount), resulting in a Level 1 classification. Fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits, resulting in a Level 2 classification.

FHLB and other borrowings: The fair values of the Corporation s FHLB and other borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements, resulting in a Level 2 classification.

Subordinated debentures: The fair value of the Corporation s subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of arrangements, resulting in a Level 3 classification.

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Accrued interest payable: The carrying amount of accrued interest payable approximates fair value resulting in a classification that is consistent with the liability with which it is associated.

While estimates of fair value are based on management s judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial assets such as, among other things, the estimated earnings power of core deposits, the earnings potential of trust accounts, the trained workforce, and customer goodwill, which typically are not recognized on the balance sheet, may have value but are not included in the fair value disclosures.

4. SECURITIES

Securities available for sale at March 31, 2014 and December 31, 2013 are as follows:

	March 31, 2014				December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
U.S. Gov t sponsored entities	184,938	2,899	(5,110)	182,727	185,205	2,894		