National Bank Holdings Corp
Form 10-Q
November 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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: 001-35654

NATIONAL BANK HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	27-0563799
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7800 East Orchard, Suite 300, Greenwood Village, Colorado 80111
(Address of principal executive offices) (Zip Code)
Registrant’s telephone, including area code: (720) 529-3336

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 ý 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 ý 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 definitions of “accelerated filer.” and “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (do not check if a smaller reporting company)	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 ý

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

As of November 6, 2014, NBHC had outstanding 38,922,279 shares of Class A voting common stock and 867,774shares of Class B non-voting common stock, each with $0.01 par value per share, excluding 1,116,046 shares of restricted Class A common stock issued but not yet vested.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, notwithstanding that such statements are not specifically identified. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as “anticipate,” “believe,” “can,” “would,” “should,” “could,” “may,” “predict,” “seek,” “potential,” “will,” “estimate,” “t “continuing,” “ongoing,” “expect,” “intend” and similar words or phrases. These statements are only predictions and involve estimates, known and unknown risks, assumptions and uncertainties. We have based these statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, liquidity, results of operations, business strategy and growth prospects.

Forward-looking statements involve certain important risks, uncertainties and other factors, any of which could cause actual results to differ materially from those in such statements and, therefore, you are cautioned not to place undue reliance on such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- our ability to execute our business strategy, as well as changes in our business strategy or development plans;
- business and economic conditions generally and in the financial services industry;
- economic, market, operational, liquidity, credit and interest rate risks associated with our business;
- effects of any changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;
- changes imposed by regulatory agencies to increase our capital to a level greater than the current level required for well-capitalized financial institutions (including the impact of the joint final rules promulgated by the Federal Reserve Board, Office of the Comptroller of the Currency and the FDIC revising certain regulatory capital requirements to align with the Basel III capital standards and meet certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act);
- effects of inflation, as well as, interest rate, securities market and monetary supply fluctuations;
- changes in the economy or supply-demand imbalances affecting local real estate values;
- changes in consumer spending, borrowings and savings habits;
- our ability to identify potential candidates for, obtain regulatory approval for, and consummate, acquisitions of financial institutions on attractive terms, or at all;
- our ability to integrate acquisitions and to achieve synergies, operating efficiencies and/or other expected benefits within expected time-frames, or at all, or within expected cost projections, and to preserve the goodwill of acquired financial institutions;
- our ability to achieve organic loan and deposit growth and the composition of such growth;
- changes in sources and uses of funds, including loans, deposits and borrowings;
- increased competition in the financial services industry, nationally, regionally or locally, resulting in, among other things, lower returns;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- continued consolidation in the financial services industry;
- our ability to maintain or increase market share and control expenses;
- costs and effects of changes in laws and regulations and of other legal and regulatory developments, including, but not limited to, changes in regulation that affect the fees that we charge, the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations, reviews or other inquiries.
- technological changes;
- the timely development and acceptance of new products and services and perceived overall value of these products and services by our clients;
- changes in our management personnel and our continued ability to hire and retain qualified personnel;
- ability to implement and/or improve operational management and other internal risk controls and processes and our reporting system and procedures;

- regulatory limitations on dividends from our bank subsidiary;
- changes in estimates of future loan reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;
- widespread natural and other disasters, dislocations, political instability, acts of war or terrorist activities, cyberattacks or international hostilities through impacts on the economy and financial markets generally or on us or our counterparties specifically;
- impact of reputational risk on such matters as business generation and retention;

- other risks and uncertainties listed from time to time in the Company's reports and documents filed with the Securities and Exchange Commission; and
- our success at managing the risks involved in the foregoing items.

Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events or circumstances, except as required by applicable law.

PART I: FINANCIAL INFORMATION

Item 1: FINANCIAL STATEMENTS

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

Consolidated Statements of Financial Condition (Unaudited)

(In thousands, except share and per share data)

	September 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$58,525	$67,420
Due from Federal Reserve Bank of Kansas City	50,092	107,894
Interest bearing bank deposits	10,042	14,146
Cash and cash equivalents	118,659	189,460
Investment securities available-for-sale (at fair value)	1,553,641	1,785,528
Investment securities held-to-maturity (fair value of $557,593 and $636,405 at September 30, 2014 and December 31, 2013, respectively)	557,464	641,907
Non-marketable securities	21,640	31,663
Loans (including covered loans of $219,468 and $309,397 at September 30, 2014 and December 31, 2013, respectively)	2,171,372	1,854,094
Allowance for loan losses	(16,591)	(12,521)
Loans, net	2,154,781	1,841,573
Loans held for sale	5,252	5,787
Federal Deposit Insurance Corporation (“FDIC”) indemnification asset, net	44,413	64,447
Other real estate owned	45,885	70,125
Premises and equipment, net	108,100	115,219
Goodwill	59,630	59,630
Intangible assets, net	18,220	22,229
Other assets	125,122	86,547
Total assets	$4,812,807	$4,914,115
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing demand deposits	$724,186	$674,989
Interest bearing demand deposits	369,917	386,762
Savings and money market	1,307,285	1,280,871
Time deposits	1,396,070	1,495,687
Total deposits	3,797,458	3,838,309
Securities sold under agreements to repurchase	109,946	99,547
Due to FDIC	35,120	41,882
Other liabilities	61,321	36,585
Total liabilities	4,003,845	4,016,323
Shareholders’ equity:		
Common stock, par value $0.01 per share: 400,000,000 shares authorized; 52,405,241 and 52,289,347 shares issued; 39,862,824 and 44,918,336 shares outstanding at September 30, 2014 and December 31, 2013, respectively	512	512
Additional paid in capital	992,587	990,216
Retained earnings	40,197	39,966
Treasury stock of 11,392,009 and 6,306,551 shares at September 30, 2014 and December 31, 2013, respectively, at cost	(226,230)	(126,146)
Accumulated other comprehensive income (loss), net of tax	1,896	(6,756)
Total shareholders’ equity	808,962	897,792

Total liabilities and shareholders’ equity	$4,812,807	$4,914,115

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)
(In thousands, except share and per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Interest and dividend income:				
Interest and fees on loans	$33,403	$35,328	$99,704	$105,783
Interest and dividends on investment securities	11,749	13,539	37,523	40,383
Dividends on non-marketable securities	245	388	904	1,170
Interest on interest-bearing bank deposits	95	267	251	762
Total interest and dividend income	45,492	49,522	138,382	148,098
Interest expense:				
Interest on deposits	3,563	3,965	10,625	12,647
Interest on borrowings	34	42	92	80
Total interest expense	3,597	4,007	10,717	12,727
Net interest income before provision for loan losses	41,895	45,515	127,665	135,371
Provision for loan losses	1,515	437	4,944	3,524
Net interest income after provision for loan losses	40,380	45,078	122,721	131,847
Non-interest income:				
FDIC indemnification asset amortization	(6,252)	(4,208)	(19,819)	(11,843)
FDIC loss sharing (expense) income	(943)	(1,191)	(2,549)	3,278
Service charges	4,148	4,334	11,558	11,944
Bank card fees	2,615	2,482	7,548	7,509
Gain on sales of mortgages, net	264	345	674	1,125
Gain on previously charged-off acquired loans	147	224	675	1,118
OREO related write-ups and other income	799	727	2,777	2,713
Other non-interest income	836	625	2,557	1,969
Total non-interest income	1,614	3,338	3,421	17,813
Non-interest expense:				
Salaries and benefits	21,058	22,639	62,260	69,363
Occupancy and equipment	6,155	6,556	18,838	18,391
Telecommunications and data processing	2,848	3,050	8,978	9,805
Marketing and business development	757	1,408	3,542	3,519
FDIC deposit insurance	1,029	1,021	3,109	3,074
ATM/debit card expenses	799	1,179	2,312	3,291
Professional fees	854	791	2,180	3,045
Other non-interest expense	2,540	3,210	7,698	9,667
(Gain) loss from the change in fair value of warrant liability	(1,256)	441	(2,734)	138
Intangible asset amortization	1,336	1,336	4,008	4,009
Other real estate owned expenses	594	459	3,629	7,675
Problem loan expenses	1,267	1,134	3,034	4,361
Banking center closure related expenses	—	3,389	—	3,389
Total non-interest expense	37,981	46,613	116,854	139,727
Income before income taxes	4,013	1,803	9,288	9,933
Income tax expense	676	856	2,391	4,006
Net income	$3,337	$947	$6,897	$5,927
Income per share—basic	$0.08	$0.02	$0.16	$0.11
Income per share—diluted	$0.08	$0.02	$0.16	$0.11
Weighted average number of common shares outstanding:				

Basic	41,837,485	51,454,200	43,403,791	51,940,245
Diluted	41,841,685	51,501,980	43,423,273	51,973,161

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
(In thousands)

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Net income	$3,337	$947	$6,897	$5,927
Other comprehensive income, net of tax:				
Securities available-for-sale:				
Net unrealized gains (losses) arising during the period, net of tax benefit of $1,480 and $5,141 for the three months ended September 30, 2014 and 2013, respectively; and net of tax (expense) benefit of ($6,824) and $22,852 for the nine months ended September 30, 2014 and 2013, respectively.	(2,407)	(8,214)	11,099	(36,015)
	(2,407)	(8,214)	11,099	(36,015)
Net unrealized holding gains on securities transferred between available-for-sale to held-to-maturity:				
Less: amortization of net unrealized holding gains to income, net of tax benefit of $475 and $738 for the three months ended September 30, 2014 and 2013, respectively; and net of tax benefit of $1,505 and $2,943 for the nine months ended September 30, 2014 and 2013, respectively.	(774)	(1,178)	(2,447)	(4,700)
	(774)	(1,178)	(2,447)	(4,700)
Other comprehensive income (loss)	(3,181)	(9,392)	8,652	(40,715)
Comprehensive income (loss)	$156	$(8,445)	$15,549	$(34,788)

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
Nine Months Ended September 30, 2014 and 2013
(In thousands, except share and per share data)

	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive income (loss), net	Total
Balance, December 31, 2012	$523	$1,006,194	$43,273	$(4)	$ 40,573	$1,090,559
Net income	—	—	5,927	—	—	5,927
Stock-based compensation	—	4,003	—	—	—	4,003
(Repurchase of 1,114,628 shares)/retirement of 1,114,868 treasury shares	(11)	(20,583)	—	4	—	(20,590)
Dividends paid ($.15 per share)	—	—	(7,934)	—	—	(7,934)
Other comprehensive loss	—	—	—	—	(40,715)	(40,715)
Balance, September 30, 2013	$512	$989,614	$41,266	$—	$ (142)	$1,031,250
Balance, December 31, 2013	$512	$990,216	$39,966	$(126,146)	$ (6,756)	$897,792
Net income	—	—	6,897	—	—	6,897
Stock-based compensation	—	2,750	—	—	—	2,750
Issuance under equity compensation plan	—	(368)	—	—	—	(368)
Change in corporate tax benefit related to stock-based compensation	—	(11)	—	—	—	(11)
Repurchase of 5,085,458 shares	—	—	—	(100,084)	—	(100,084)
Dividends paid ($.15 per share)	—	—	(6,666)	—	—	(6,666)
Other comprehensive income	—	—	—	—	8,652	8,652
Balance, September 30, 2014	$512	$992,587	$40,197	$(226,230)	$ 1,896	$808,962

See accompanying notes to the unaudited consolidated interim financial statements.

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	For the nine months ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	$6,897	$5,927
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	4,944	3,524
Depreciation and amortization	12,144	11,698
Current income tax receivable	20,364	(11,249)
Deferred income tax asset	(18,445)	(10,848)
Discount accretion, net of premium amortization on securities	3,828	6,692
Loan accretion	(48,978)	(66,906)
Net gain on sale of mortgage loans	(674)	(1,125)
Origination of loans held for sale, net of repayments	(29,622)	(47,754)
Proceeds from sales of loans held for sale	30,106	47,832
Amortization of indemnification asset	19,819	11,843
Gain on the sale of other real estate owned, net	(2,686)	(7,384)
Impairment on other real estate owned	1,789	9,142
Impairment on fixed assets related to banking center closures	—	2,531
Gain on sale of fixed assets	(123)	—
Stock-based compensation	2,750	4,003
(Decrease) increase in due to FDIC, net	(6,762)	693
(Increase) decrease in other assets	(740)	1,739
Increase in other liabilities	19,525	1,338
Net cash provided by (used in) operating activities	14,136	(38,304)
Cash flows from investing activities:		
Proceeds from redemption of FHLB stock	633	1,271
Proceeds from redemption of FRB stock	9,390	—
Maturities of investment securities held-to-maturity	80,052	149,991
Maturities of investment securities available-for-sale	246,422	456,122
Purchase of investment securities held-to-maturity	—	(244,502)
Purchase of investment securities available-for-sale	—	(693,977)
Increase in securities purchased under agreements to resell	—	(75,000)
Net (increase) decrease in loans	(274,575)	91,068
Purchase of premises and equipment, net	(894)	(6,069)
Purchase of bank-owned life insurance	(40,000)	—
Proceeds from sales of loans	3,607	26,984
Proceeds from sales of other real estate owned	27,656	54,705
Increase in FDIC indemnification asset	215	72,634
Net cash provided by (used in) investing activities	52,506	(166,773)
Cash flows from financing activities:		
Net decrease in deposits	(40,851)	(249,216)
Increase in repurchase agreements	10,399	62,786
Issuance under equity compensation plan	(379)	—
Payment of dividends	(6,528)	(7,839)
Repurchase of shares	(100,084)	(20,590)

Net cash used in financing activities	(137,443	)	(214,859	)
Decrease in cash and cash equivalents	(70,801	)	(419,936	)
Cash and cash equivalents at beginning of the year	189,460		769,180	
Cash and cash equivalents at end of period	$118,659		$349,244	
Supplemental disclosure of cash flow information:				
Cash paid during the period for interest	$10,168		$13,741	
Cash paid during the period for taxes	$489		$26,271	
Supplemental schedule of non-cash investing activities:				
Loans transferred to other real estate owned at fair value	$2,519		$32,408	
FDIC indemnification asset claims transferred to other assets	$181		$24,460	
Loans purchased but not settled	$29,906		$—	

See accompanying notes to the unaudited consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
September 30, 2014

Note 1 Basis of Presentation

National Bank Holdings Corporation ("NBHC" or the "Company") is a bank holding company that was incorporated in the State of Delaware in June 2009 with the intent to acquire and operate financial services franchises and other complementary businesses in targeted markets. The Company is headquartered immediately south of Denver, in Greenwood Village, Colorado, and its primary operations are conducted through its wholly owned subsidiary, NBH Bank, N.A. The Company provides a variety of banking products to both commercial and consumer clients through a network of 97 banking centers located in Colorado, the greater Kansas City area and Texas, and through on-line and mobile banking products.

These interim consolidated financial statements serve to update the National Bank Holdings Corporation Annual Report on Form 10-K for the year ended December 31, 2013. The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, NBH Bank, N.A. The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and where applicable, with general practices in the banking industry or guidelines prescribed by bank regulatory agencies. However, they may not include all information and notes necessary to constitute a complete set of financial statements under GAAP applicable to annual periods and accordingly should be read in conjunction with the financial information contained in the Form 10-K. The consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results presented. All such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications of prior years' amounts are made whenever necessary to conform to current period presentation. The results of operations for the interim period is not necessarily indicative of the results that may be expected for the full year or any other interim period.

The Company's significant accounting policies followed in the preparation of the consolidated financial statements are disclosed in note 2 of the audited financial statements and notes for the year ended December 31, 2013 and are contained in the Company's Annual Report on Form 10-K. There have not been any significant changes to the application of significant accounting policies since December 31, 2013. GAAP requires management to make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. By their nature, estimates are based on judgment and available information. Management has made significant estimates in certain areas, such as the amount and timing of expected cash flows from assets, the valuation of the FDIC indemnification asset and clawback liability, the valuation of other real estate owned (“OREO”), the fair value adjustments on assets acquired and liabilities assumed, the valuation of core deposit intangible assets, the evaluation of investment securities for other-than-temporary impairment (“OTTI”), the valuation of stock-based compensation, the fair values of financial instruments, the allowance for loan losses (“ALL”), and contingent liabilities. Because of the inherent uncertainties associated with any estimation process and future changes in market and economic conditions, it is possible that actual results could differ significantly from those estimates.

Note 2 Recent Accounting Pronouncements

Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure - In January 2014, the FASB issued Accounting Standards Update ("ASU") 2014-04, “Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.” This update amends ASC Topic 310-40 and clarifies that an “in substance repossession or foreclosure” has occurred upon the creditor obtaining either legal title to the property upon completion of foreclosure, or the borrower conveying all interest in the property through completion of a deed in lieu of foreclosure. Upon occurrence, the creditor derecognizes the loan receivable and recognizes the collateralized real estate property. The amendments in the ASU will be effective for the Company for interim and annual periods beginning after December 15, 2014. Early adoption is permitted. Adoption of this amendment can be made using either a modified retrospective transition method or a prospective transition method. The adoption of this standard is not expected to have a material impact on the Company’s consolidated financial statements, results of operations or liquidity.

Revenue from Contracts with Customers - In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." This update supersedes revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The new guidance stipulates that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides specific steps that entities should apply in order to achieve this principle. The amendments are effective for interim and annual periods beginning January 1, 2017 and must be applied retrospectively. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

Note 3 Investment Securities

The Company's investment securities portfolio is comprised of available-for-sale and held-to-maturity investment securities. These investment securities totaled $2.1 billion at September 30, 2014 and $2.4 billion at December 31, 2013. Included in the aforementioned $2.1 billion was $1.6 billion of available-for-sale securities and $0.6 billion of held-to-maturity securities.

Available-for-sale

Available-for-sale investment securities are summarized as follows as of the dates indicated (in thousands):

	September 30, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Asset backed securities	$356	$—	$—	$356
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	419,852	8,089	(814)	427,127
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	1,145,834	9,949	(30,044)	1,125,739
Other securities	419	—	—	419
Total	$1,566,461	$18,038	$(30,858)	$1,553,641

	December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Asset backed securities	4,534	3	—	4,537
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	490,321	7,670	(3,001)	494,990
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	1,320,998	10,764	(46,180)	1,285,582
Other securities	419	—	—	419
Total	$1,816,272	$18,437	$(49,181)	$1,785,528

At September 30, 2014 and December 31, 2013, mortgage-backed securities represented 99.9% and 99.7%, respectively, of the Company's available-for-sale investment portfolio and all mortgage-backed securities were backed by government sponsored enterprises ("GSE") collateral such as Federal Home Loan Mortgage Corporation ("FHLMC") and Federal National Mortgage Association ("FNMA"), and the government sponsored agency Government National Mortgage Association ("GNMA").

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
September 30, 2014

The table below summarizes the unrealized losses as of the dates shown, along with the length of the impairment period (in thousands):

	September 30, 2014					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$75,906	$(274)	$110,728	$(540)	$186,634	$(814)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	107,699	(3,038)	672,803	(27,006)	780,502	(30,044)
Total	$183,605	$(3,312)	$783,531	$(27,546)	$967,136	$(30,858)

	December 31, 2013					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$283,177	$(3,000)	$13	$(1)	$283,190	$(3,001)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	876,225	(44,101)	40,740	(2,079)	916,965	(46,180)
Total	$1,159,402	$(47,101)	$40,753	$(2,080)	$1,200,155	$(49,181)

Management evaluated all of the available-for-sale securities in an unrealized loss position and concluded that no other-than-temporary-impairment existed at September 30, 2014 or December 31, 2013. The unrealized losses in the Company's investments issued or guaranteed by U.S. government agencies or sponsored enterprises at September 30, 2014 were caused by changes in interest rates. The Company had no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

The Company pledges certain securities as collateral for public deposits, securities sold under agreements to repurchase and to secure borrowing capacity at the Federal Reserve Bank, if needed. The fair value of available-for-sale investment securities pledged as collateral totaled $272.1 million at September 30, 2014 and $177.6 million December 31, 2013. The increase in pledged available-for-sale investment securities was primarily attributable to an increase in average deposit account balances during the nine months ended September 30, 2014, an increase in pledged securities for derivative instruments, and well as an increase in securities pledged to the Federal Reserve Bank. Certain investment securities may also be pledged as collateral should the Company utilize its line of credit at the FHLB of Des Moines; however, no investment securities were pledged for this purpose at September 30, 2014 or December 31, 2013.

Mortgage-backed securities do not have a single maturity date and actual maturities may differ from contractual maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average life of the available-for-sale mortgage-backed securities portfolio was 3.6 years as of September 30, 2014 and 3.9 years as of December 31, 2013. This estimate is based on assumptions and actual results may differ. Other securities of $0.4 million have no stated contractual maturity date as of September 30, 2014.

Held-to-maturity

At September 30, 2014 and December 31, 2013 the Company held $557.5 million and $641.9 million of held-to-maturity investment securities, respectively. Held-to-maturity investment securities are summarized as follows as of the dates indicated

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(in thousands):

	September 30, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$444,104	$3,774	$(454)	$447,424
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	113,360	202	(3,393)	110,169
Total investment securities held-to-maturity	$557,464	$3,976	$(3,847)	$557,593

	December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$513,090	$175	$(1,776)	$511,489
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	128,817	104	(4,005)	124,916
Total investment securities held-to-maturity	$641,907	$279	$(5,781)	$636,405

The table below summarizes the unrealized losses as of the dates shown, along with the length of the impairment period (in thousands):

	September 30, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$—	$—	$37,164	$(454)	$37,164	$(454)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	10,289	(91)	82,866	(3,302)	93,155	(3,393)
Total	$10,289	$(91)	$120,030	$(3,756)	$130,319	$(3,847)

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	December 31, 2013					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$472,973	$(1,776)	$—	$—	$472,973	$(1,776)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	105,124	(4,005)	—	—	105,124	(4,005)
Total	$578,097	$(5,781)	$—	$—	$578,097	$(5,781)

Management evaluated all of the held-to-maturity securities in an unrealized loss position and concluded that no other-than-temporary-impairment existed at September 30, 2014 or December 31, 2013. The unrealized losses in the Company's investments issued or guaranteed by U.S. government agencies or sponsored enterprises at September 30, 2014 were caused by changes in interest rates. The Company had no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

The carrying value of held-to-maturity investment securities pledged as collateral totaled $63.6 million and $68.5 million at September 30, 2014 and December 31, 2013, respectively. Actual maturities of mortgage-backed securities may differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average expected life of the held-to-maturity mortgage-backed securities portfolio as of September 30, 2014 and December 31, 2013 was 3.5 years and 3.8 years, respectively. This estimate is based on assumptions and actual results may differ.

Note 4 Loans

The loan portfolio is comprised of loans originated by the Company and loans that were acquired in connection with the Company's acquisitions of Bank of Choice and Community Banks of Colorado in 2011, and Hillcrest Bank and Bank Midwest in 2010. The majority of the loans acquired in the Hillcrest Bank and Community Banks of Colorado transactions are covered by loss sharing agreements with the FDIC, and covered loans are presented separately from non-covered loans due to the FDIC loss sharing agreements associated with these loans. Covered loans comprised 10.1% of the total loan portfolio at September 30, 2014, compared to 16.7% of the total loan portfolio at December 31, 2013.

The table below shows the loan portfolio composition including carrying value by segment of loans accounted for under ASC Topic 310-30 Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality and loans not accounted for under this guidance, which includes our originated loans. The table also shows the amounts covered by the FDIC loss sharing agreements as of September 30, 2014 and December 31, 2013. The carrying value of loans are net of discounts on loans excluded from Accounting Standards Codification ("ASC") Topic 310-30, and fees and costs of $11.7 million and $13.3 million as of September 30, 2014 and December 31, 2013, respectively (in thousands):

	September 30, 2014				
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total	
Commercial	$37,665	$717,507	$755,172	34.8	%
Agriculture	20,071	142,801	162,872	7.5	%

Commercial real estate	213,871	380,445	594,316	27.4	%
Residential real estate	43,979	579,420	623,399	28.7	%
Consumer	5,007	30,606	35,613	1.6	%
Total	$320,593	$1,850,779	$2,171,372	100.0	%
Covered	$183,486	$35,982	$219,468	10.1	%
Non-covered	137,107	1,814,797	1,951,904	89.9	%
Total	$320,593	$1,850,779	$2,171,372	100.0	%

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	December 31, 2013				
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total	
Commercial	$61,511	$421,984	$483,495	26.1	%
Agriculture	27,000	132,952	159,952	8.6	%
Commercial real estate	291,198	283,022	574,220	31.0	%
Residential real estate	63,011	536,913	599,924	32.3	%
Consumer	8,160	28,343	36,503	2.0	%
Total	$450,880	$1,403,214	$1,854,094	100.0	%
Covered	$259,364	$50,033	$309,397	16.7	%
Non-covered	191,516	1,353,181	1,544,697	83.3	%
Total	$450,880	$1,403,214	$1,854,094	100.0	%

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement remains unpaid after the due date of the scheduled payment. During 2013, the Company determined that the cash flows of one covered commercial and industrial loan pool were no longer reasonably estimable, and in accordance with the guidance in ASC 310-30, this pool was put on non-accrual status. During the nine months ended September 30, 2014, this loan pool was returned to accrual status due to improved performance and predictability of cash flows within that pool. At September 30, 2014, this loan pool had a carrying value of $13.2 million. Interest income is recognized on all accruing loans accounted for under ASC 310-30 through accretion of the difference between the carrying value of the loans and the expected cash flows.

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Pooled loans accounted for under ASC 310-30 that are 90 days or more past due and still accreting are generally considered to be performing and are included in loans 90 days or more past due and still accruing. Non-accrual loans include troubled debt restructurings on non-accrual status. At September 30, 2014 and December 31, 2013, $18.9 million and $9.5 million, respectively, of loans excluded from the scope of ASC 310-30 were on non-accrual and $14.8 million of loans accounted for under ASC 310-30 were on non-accrual status at December 31, 2013. Loan delinquency for all loans is shown in the following tables at September 30, 2014 and December 31, 2013, respectively (in thousands):

	Total Loans September 30, 2014							
	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total loans	Loans > 90 days past due and still accruing	Non-accrual
Loans excluded from ASC 310-30								
Commercial	$2,063	$314	$189	$2,566	$714,941	$717,507	$77	$12,203
Agriculture	67	—	—	67	142,734	142,801	—	515
Commercial real estate								
Construction	—	—	—	—	11,835	11,835	—	—
Acquisition/development	42	—	—	42	4,553	4,595	—	—
Multifamily	—	—	95	95	15,784	15,879	94	144
Owner-occupied	78	89	289	456	122,023	122,479	—	946
Non owner-occupied	1,961	—	203	2,164	223,493	225,657	—	203
Total commercial real estate	2,081	89	587	2,757	377,688	380,445	94	1,293
Residential real estate								
Senior lien	764	279	807	1,850	525,722	527,572	48	4,277
Junior lien	269	112	18	399	51,449	51,848	—	417
Total residential real estate	1,033	391	825	2,249	577,171	579,420	48	4,694
Consumer	135	24	6	165	30,441	30,606	6	231
Total loans excluded from ASC 310-30	$5,379	$818	$1,607	$7,804	$1,842,975	$1,850,779	$225	$18,936
Covered loans excluded from ASC 310-30	$78	$188	$30	$296	$35,686	$35,982	$—	$1,540
Non-covered loans excluded from ASC 310-30	5,301	630	1,577	7,508	1,807,289	1,814,797	225	17,396
Total loans excluded from ASC 310-30	$5,379	$818	$1,607	$7,804	$1,842,975	$1,850,779	$225	$18,936
Loans accounted for under ASC 310-30								
Commercial	$400	$—	$4,981	$5,381	$32,284	$37,665	$4,981	$—
Agriculture	—	288	171	459	19,612	20,071	171	—
Commercial real estate	3,878	25,013	35,870	64,761	149,110	213,871	35,870	—
Residential real estate	879	156	1,757	2,792	41,187	43,979	1,757	—
Consumer	147	—	151	298	4,709	5,007	151	—
	$5,304	$25,457	$42,930	$73,691	$246,902	$320,593	$42,930	$—

Total loans accounted for under ASC 310-30								
Covered loans accounted for under ASC 310-30	$3,791	$23,783	$34,497	$62,071	$121,415	$183,486	$34,497	$—
Non-covered loans accounted for under ASC 310-30	1,513	1,674	8,433	11,620	125,487	137,107	8,433	—
Total loans accounted for under ASC 310-30	$5,304	$25,457	$42,930	$73,691	$246,902	$320,593	$42,930	$—
Total loans	$10,683	$26,275	$44,537	$81,495	$2,089,877	$2,171,372	$43,155	$18,936
Covered loans	$3,869	$23,971	$34,527	$62,367	$157,101	$219,468	$34,497	$1,540
Non-covered loans	6,814	2,304	10,010	19,128	1,932,776	1,951,904	8,658	17,396
Total loans	$10,683	$26,275	$44,537	$81,495	$2,089,877	$2,171,372	$43,155	$18,936

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	Total Loans December 31, 2013							
	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total loans	Loans > 90 days past due and still accruing	Non-accrual
Loans excluded from ASC 310-30								
Commercial	$897	$156	$555	$1,608	$420,376	$421,984	$115	$1,280
Agriculture	188	7	—	195	132,757	132,952	—	153
Commercial real estate								
Construction	316	—	—	316	5,023	5,339	—	—
Acquisition/development	45	—	—	45	7,975	8,020	—	1
Multifamily	1,003	—	—	1,003	9,681	10,684	—	1,096
Owner-occupied	52	7	21	80	93,367	93,447	—	692
Non owner-occupied	329	—	203	532	165,000	165,532	—	203
Total commercial real estate	1,745	7	224	1,976	281,046	283,022	—	1,992
Residential real estate								
Senior lien	733	415	1,062	2,210	482,381	484,591	—	5,326
Junior lien	204	—	80	284	52,038	52,322	—	519
Total residential real estate	937	415	1,142	2,494	534,419	536,913	—	5,845
Consumer	191	21	23	235	28,108	28,343	14	247
Total loans excluded from ASC 310-30	$3,958	$606	$1,944	$6,508	$1,396,706	$1,403,214	$129	$9,517
Covered loans excluded from ASC 310-30	194	60	155	409	49,624	50,033	115	1,944
Non-covered loans excluded from ASC 310-30	3,764	546	1,789	6,099	1,347,082	1,353,181	14	7,573
Total loans excluded from ASC 310-30	$3,958	$606	$1,944	$6,508	$1,396,706	$1,403,214	$129	$9,517
Loans accounted for under ASC 310-30								
Commercial	$582	$322	$4,505	$5,409	$56,102	$61,511	$4,505	$14,827
Agriculture	714	—	296	1,010	25,990	27,000	296	—
Commercial real estate	1,902	5,179	49,228	56,309	234,889	291,198	49,227	—
Residential real estate	977	977	1,817	3,771	59,240	63,011	1,817	—
Consumer	327	265	19	611	7,549	8,160	19	—
Total loans accounted for under ASC 310-30	$4,502	$6,743	$55,865	$67,110	$383,770	$450,880	$55,864	$14,827
Covered loans accounted for under ASC 310-30	$1,471	$4,949	$42,356	$48,776	$210,588	$259,364	$42,355	$14,827
Non-covered loans accounted for under ASC 310-30	3,031	1,794	13,509	18,334	173,182	191,516	13,509	—
Total loans accounted for under ASC 310-30	$4,502	$6,743	$55,865	$67,110	$383,770	$450,880	$55,864	$14,827

Total loans	$8,460	$7,349	$57,809	$73,618	$1,780,476	$1,854,094	$55,993	$24,344
Covered loans	$1,665	$5,009	$42,511	$49,185	$260,212	$309,397	$42,470	$16,771
Non-covered loans	6,795	2,340	15,298	24,433	1,520,264	1,544,697	13,523	7,573
Total loans	$8,460	$7,349	$57,809	$73,618	$1,780,476	$1,854,094	$55,993	$24,344

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Credit exposure for all loans as determined by the Company's internal risk rating system was as follows as of September 30, 2014 and December 31, 2013, respectively (in thousands):

	Total Loans September 30, 2014				
	Pass	Special mention	Substandard	Doubtful	Total
Loans excluded from ASC 310-30					
Commercial	$686,475	$2,973	$28,022	$37	$717,507
Agriculture	132,749	92	9,960	—	142,801
Commercial real estate					
Construction	11,835	—	—	—	11,835
Acquisition/development	4,595	—	—	—	4,595
Multifamily	15,735	—	128	16	15,879
Owner-occupied	117,256	161	5,062	—	122,479
Non owner-occupied	204,212	17,788	3,647	10	225,657
Total commercial real estate	353,633	17,949	8,837	26	380,445
Residential real estate					
Senior lien	521,525	103	5,758	186	527,572
Junior lien	50,513	—	1,335	—	51,848
Total residential real estate	572,038	103	7,093	186	579,420
Consumer	30,376	—	230	—	30,606
Total loans excluded from ASC 310-30	$1,775,271	$21,117	$54,142	$249	$1,850,779
Covered loans excluded from ASC 310-30	$21,300	$2,404	$12,154	$124	$35,982
Non-covered loans excluded from ASC 310-30	1,753,971	18,713	41,988	125	1,814,797
Total loans excluded from ASC 310-30	$1,775,271	$21,117	$54,142	$249	$1,850,779
Loans accounted for under ASC 310-30					
Commercial	$13,101	$348	$23,682	$534	$37,665
Agriculture	17,598	203	2,270	—	20,071
Commercial real estate	87,361	4,067	118,453	3,990	213,871
Residential real estate	30,066	1,447	12,466	—	43,979
Consumer	4,310	114	583	—	5,007
Total loans accounted for under ASC 310-30	$152,436	$6,179	$157,454	$4,524	$320,593
Covered loans accounted for under ASC 310-30	$54,336	$3,452	$121,176	$4,522	$183,486
Non-covered loans accounted for under ASC 310-30	98,100	2,727	36,278	2	137,107
Total loans accounted for under ASC 310-30	$152,436	$6,179	$157,454	$4,524	$320,593
Total loans	$1,927,707	$27,296	$211,596	$4,773	$2,171,372
Total covered	$75,636	$5,856	$133,330	$4,646	$219,468
Total non-covered	1,852,071	21,440	78,266	127	1,951,904
Total loans	$1,927,707	$27,296	$211,596	$4,773	$2,171,372

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	Total Loans December 31, 2013				
	Pass	Special mention	Substandard	Doubtful	Total
Loans excluded from ASC 310-30					
Commercial	$374,281	$9,882	$37,414	$407	$421,984
Agriculture	123,216	9,049	687	—	132,952
Commercial real estate					
Construction	5,339	—	—	—	5,339
Acquisition/development	1,366	2,247	4,407	—	8,020
Multifamily	9,588	—	1,068	28	10,684
Owner-occupied	87,984	169	5,294	—	93,447
Non owner-occupied	142,159	18,536	4,837	—	165,532
Total commercial real estate	246,436	20,952	15,606	28	283,022
Residential real estate					
Senior lien	475,041	1,495	7,620	435	484,591
Junior lien	49,874	200	2,248	—	52,322
Total residential real estate	524,915	1,695	9,868	435	536,913
Consumer	28,092	—	251	—	28,343
Total loans excluded from ASC 310-30	$1,296,940	$41,578	$63,826	$870	$1,403,214
Covered loans excluded from ASC 310-30	$22,175	$3,439	$24,005	$414	$50,033
Non-covered loans excluded from ASC 310-30	1,274,765	38,139	39,821	456	1,353,181
Total loans excluded from ASC 310-30	$1,296,940	$41,578	$63,826	$870	$1,403,214
Loans accounted for under ASC 310-30					
Commercial	$23,129	$3,221	$34,440	$721	$61,511
Agriculture	21,900	1,117	3,983	—	27,000
Commercial real estate	115,903	12,493	157,748	5,054	291,198
Residential real estate	43,904	1,098	18,009	—	63,011
Consumer	6,921	244	995	—	8,160
Total loans accounted for under ASC 310-30	$211,757	$18,173	$215,175	$5,775	$450,880
Covered loans accounted for under ASC 310-30	$100,050	$8,498	$145,041	$5,775	$259,364
Non-covered loans accounted for under ASC 310-30	111,707	9,675	70,134	—	191,516
Total loans accounted for under ASC 310-30	$211,757	$18,173	$215,175	$5,775	$450,880
Total loans	$1,508,697	$59,751	$279,001	$6,645	$1,854,094
Total covered	$122,225	$11,937	$169,046	$6,189	$309,397
Total non-covered	1,386,472	47,814	109,955	456	1,544,697
Total loans	$1,508,697	$59,751	$279,001	$6,645	$1,854,094

Impaired Loans

Loans are considered to be impaired when it is probable that the Company will not be able to collect all amounts due in accordance with the contractual terms of the loan agreement. Impaired loans are comprised of loans excluded from ASC 310-30 on non-accrual status and troubled debt restructurings ("TDRs") described below. If a specific allowance is warranted based on the borrower's overall financial condition, the specific allowance is calculated based on discounted cash flows using the loan's initial contractual effective interest rate or the fair value of the collateral less selling costs for collateral dependent loans. At September 30, 2014, the Company measured $24.5 million of impaired loans using discounted cash flows and the loan's initial contractual effective interest rate and $14.2 million of impaired loans based on the fair value of the collateral less selling costs. Impaired loans totaling $8.6 million that individually were less than $250 thousand each, were measured through our general ALL reserves due to their relatively small size.

At September 30, 2014 and December 31, 2013, the Company's recorded investments in impaired loans was $47.2 million and $21.6 million, respectively, of which $11.8 million and $7.7 million were covered by loss sharing agreements, for the aforementioned periods. The increase in impaired loans was primarily in the commercial loan segment, and largely the result of two relationships, the first of which totaled $11.5 million and was fully secured and current as to principal and interest payments as of September 30, 2014. The second relationship totaled $7.4 million, is covered by loss-share and also current as to principal and interest payments as of September 30, 2014. Impaired loans had a collective related allowance for loan losses allocated to them of $0.3 million and $0.9 million at September 30, 2014 and December 31, 2013, respectively. Additional information regarding impaired loans at September 30, 2014 and December 31, 2013 is set forth in the table below (in thousands):

	Impaired Loans					
	September 30, 2014			December 31, 2013		
	Unpaid principal balance	Recorded investment	Allowance for loan losses allocated	Unpaid principal balance	Recorded investment	Allowance for loan losses allocated
With no related allowance recorded:						
Commercial	$25,111	$24,974	$—	$4,981	$4,981	$—
Agriculture	9,314	9,310	—	—	—	—
Commercial real estate						
Construction	—	—	—	—	—	—
Acquisition/development	—	—	—	—	—	—
Multifamily	—	—	—	987	929	—
Owner-occupied	1,746	1,514	—	1,872	1,655	—
Non-owner occupied	—	—	—	561	488	—
Total commercial real estate	1,746	1,514	—	3,420	3,072	—
Residential real estate						
Senior lien	376	363	—	506	494	—
Junior lien	—	—	—	—	—	—
Total residential real estate	376	363	—	506	494	—
Consumer	—	—	—	—	—	—
Total impaired loans with no related allowance recorded	$36,547	$36,161	$—	$8,907	$8,547	$—
With a related allowance recorded:						
Commercial	$1,030	$801	$39	$2,529	$2,379	$416
Agriculture	181	150	—	191	173	1
Commercial real estate						
Construction	—	—	—	—	—	—
Acquisition/development	—	—	—	—	1	—
Multifamily	161	144	16	178	168	28
Owner-occupied	848	606	3	825	607	4
Non-owner occupied	1,142	1,061	12	640	628	4
Total commercial real estate	2,151	1,811	31	1,643	1,404	36
Residential real estate						
Senior lien	7,479	6,575	210	8,147	7,266	474
Junior lien	1,697	1,477	10	1,815	1,605	16
Total residential real estate	9,176	8,052	220	9,962	8,871	490
Consumer	280	250	3	290	273	3
Total impaired loans with a related allowance recorded	$12,818	$11,064	$293	$14,615	$13,100	$946
Total impaired loans	$49,365	$47,225	$293	$23,522	$21,647	$946

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The table below shows additional information regarding the average recorded investment and interest income recognized on impaired loans for the periods presented (in thousands):

	For the nine months ended			
	September 30, 2014		September 30, 2013	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
With no related allowance recorded:				
Commercial	$25,947	$342	$6,169	$276
Agriculture	9,045	217	—	—
Commercial real estate				
Construction	—	—	—	—
Acquisition/development	—	—	—	—
Multifamily	—	—	958	—
Owner-occupied	1,578	63	4,031	226
Non owner-occupied	—	—	5,188	8
Total commercial real estate	1,578	63	10,177	234
Residential real estate				
Senior lien	391	8	752	6
Junior lien	—	—	—	—
Total residential real estate	391	8	752	6
Consumer	—	—	—	—
Total impaired loans with no related allowance recorded	$36,961	$630	$17,098	$516
With a related allowance recorded:				
Commercial	$987	$6	$2,744	$53
Agriculture	165	—	224	—
Commercial real estate				
Construction	—	—	—	—
Acquisition/development	—	—	1	—
Multifamily	156	—	187	—
Owner-occupied	627	10	668	11
Non owner-occupied	1,086	42	636	14
Total commercial real estate	1,869	52	1,492	25
Residential real estate				
Senior lien	6,738	81	7,310	71
Junior lien	1,515	45	1,736	40
Total residential real estate	8,253	126	9,046	111
Consumer	266	1	313	3
Total impaired loans with a related allowance recorded	$11,540	$185	$13,819	$192
Total impaired loans	$48,501	$815	$30,917	$708

Troubled debt restructurings

It is the Company’s policy to review each prospective credit in order to determine the appropriateness and the adequacy of security or collateral prior to making a loan. In the event of borrower default, the Company seeks recovery in compliance with

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lending laws, the respective loan agreements, and credit monitoring and remediation procedures that may include restructuring a loan to provide a concession by the Company to the borrower from their original terms due to borrower financial difficulties in order to facilitate repayment. Additionally, if a borrower’s repayment obligation has been discharged by a court, and that debt has not been reaffirmed by the borrower, regardless of past due status, the loan is considered to be a TDR. At September 30, 2014 and December 31, 2013, the Company had $25.0 million and $11.6 million, respectively, of accruing TDRs that had been restructured from the original terms in order to facilitate repayment. Of these, $9.2 million and $5.7 million, respectively, were covered by FDIC loss sharing agreements. Non-accruing TDRs at September 30, 2014 and December 31, 2013 totaled $3.7 million and $3.6 million, respectively. Of these, $1.4 million and $1.7 million were covered by the FDIC loss sharing agreements as of September 30, 2014 and December 31, 2013, respectively.

During the nine months ended September 30, 2014, the Company restructured fourteen loans with a recorded investment of $20.4 million to facilitate repayment. Substantially all of the loan modifications were an extension of term. Loan modifications to loans accounted for under ASC 310-30 are not considered TDRs. The table below provides additional information related to accruing TDRs at September 30, 2014 and December 31, 2013 (in thousands):

	Accruing TDRs September 30, 2014			
	Recorded investment	Average year-to-date recorded investment	Unpaid principal balance	Unfunded commitments to fund TDRs
Commercial	$12,573	$12,131	$12,573	$840
Agriculture	8,946	8,680	8,949	126
Commercial real estate	620	631	632	—
Residential real estate	2,877	2,932	2,902	2
Consumer	20	21	20	—
Total	$25,036	$24,395	$25,076	$968

	Accruing TDRs December 31, 2013			
	Recorded investment	Average year-to-date recorded investment	Unpaid principal balance	Unfunded commitments to fund TDRs
Commercial	$6,079	$7,113	$6,084	$144
Agriculture	20	20	20	—
Commercial real estate	2,484	2,759	2,743	—
Residential real estate	2,995	3,055	3,023	12
Consumer	27	30	27	12
Total	$11,605	$12,977	$11,897	$168

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The following table summarizes the Company's carrying value of non-accrual TDRs as of September 30, 2014 and December 31, 2013 (in thousands):

	Non - Accruing TDRs			
	September 30, 2014		December 31, 2013	
	Covered	Non-covered	Covered	Non-covered
Commercial	$1	$429	$—	$535
Agriculture	201	180	—	—
Commercial real estate	246	470	296	98
Residential real estate	945	996	1,377	1,031
Consumer	—	199	—	237
Total	$1,393	$2,274	$1,673	$1,901

Accrual of interest is resumed on loans that were on non-accrual only after the loan has performed sufficiently. The Company had three TDRs that were modified within the past 12 months and had defaulted on their restructured terms during the nine months ended September 30, 2014. The defaulted TDRs consisted of a commercial loan and two consumer loans totaling $37 thousand.

During the nine months ended September 30, 2013, the Company had two TDRs that had been modified within the past 12 months that defaulted on its restructured terms. The defaulted TDRs were a commercial loan and a consumer loan totaling $328 thousand. For purposes of this disclosure, the Company considers "default" to mean 90 days or more past due on principal or interest.

Loans accounted for under ASC Topic 310-30

Loan pools accounted for under ASC Topic 310-30 are periodically remeasured to determine expected future cash flows. In determining the expected cash flows, the timing of cash flows and prepayment assumptions for smaller homogeneous loans are based on statistical models that take into account factors such as the loan interest rate, credit profile of the borrowers, the years in which the loans were originated, and whether the loans are fixed or variable rate loans. Prepayments may be assumed on large loans if circumstances specific to that loan warrant a prepayment assumption. No prepayments were presumed for small homogeneous commercial loans; however, prepayment assumptions are made that consider similar prepayment factors listed above for smaller homogeneous loans. The re-measurement of loans accounted for under ASC 310-30 resulted in the following changes in the carrying amount of accretable yield during the nine months ended September 30, 2014 and 2013 (in thousands):

	September 30, 2014	September 30, 2013
Accretable yield beginning balance	$130,624	$133,585
Reclassification from non-accretable difference	30,394	55,351
Reclassification to non-accretable difference	(1,264)	(5,234)
Accretion	(46,646)	(59,616)
Accretable yield ending balance	$113,108	$124,086

Below is the composition of the net book value for loans accounted for under ASC 310-30 at September 30, 2014 and December 31, 2013 (in thousands):

	September 30, 2014	December 31, 2013
Contractual cash flows	$807,075	$984,019
Non-accretable difference	(373,374)	(402,515)
Accretable yield	(113,108)	(130,624)
Loans accounted for under ASC 310-30	$320,593	$450,880

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Note 5 Allowance for Loan Losses

The tables below detail the Company's allowance for loan losses ("ALL") and recorded investment in loans as of and for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	Three months ended September 30, 2014					
	Commercial	Agriculture	Commercial real estate	Residential real estate	Consumer	Total
Beginning balance	$6,421	$1,407	$2,969	$4,310	$465	$15,572
Non 310-30 beginning balance	6,420	610	2,735	4,244	465	14,474
Charge-offs	(86)	—	—	(470)	(230)	(786)
Recoveries	189	8	16	22	55	290
Provision	859	102	166	338	241	1,706
Non 310-30 ending balance	7,382	720	2,917	4,134	531	15,684
ASC 310-30 beginning balance	1	797	234	66	—	1,098
Charge-offs	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—
Provision (recoupment)	—	(184)	(7)	—	—	(191)
ASC 310-30 ending balance	1	613	227	66	—	907
Ending balance	$7,383	$1,333	$3,144	$4,200	$531	$16,591

	Three months ended September 30, 2013					
	Commercial	Agriculture	Commercial real estate	Residential real estate	Consumer	Total
Beginning balance	$2,286	$764	$2,419	$5,907	$471	$11,847
Non 310-30 beginning balance	2,240	495	2,113	4,333	471	9,652
Charge-offs	(401)	—	—	(117)	(276)	(794)
Recoveries	92	—	17	23	75	207
Provision (recoupment)	715	27	(205)	27	186	750
Non 310-30 ending balance	2,646	522	1,925	4,266	456	9,815
ASC 310-30 beginning balance	46	269	306	1,574	—	2,195
Charge-offs	—	(221)	—	(57)	—	(278)
Recoveries	—	—	—	—	—	—
Provision (recoupment)	43	537	(8)	(885)	—	(313)
ASC 310-30 ending balance	89	585	298	632	—	1,604
Ending balance	$2,735	$1,107	$2,223	$4,898	$456	$11,419

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	Nine months ended September 30, 2014					
	Commercial	Agriculture	Commercial real estate	Residential real estate	Consumer	Total
Beginning balance	$4,258	$1,237	$2,276	$4,259	$491	$12,521
Non 310-30 beginning balance	4,029	572	1,984	4,165	491	11,241
Charge-offs	(498)	—	—	(539)	(585)	(1,622)
Recoveries	306	8	70	197	205	786
Provision	3,545	140	863	311	420	5,279
Non 310-30 ending balance	7,382	720	2,917	4,134	531	15,684
ASC 310-30 beginning balance	229	665	292	94	—	1,280
Charge-offs	(2)	—	—	—	(36)	(38)
Recoveries	—	—	—	—	—	—
Provision (recoupment)	(226)	(52)	(65)	(28)	36	(335)
ASC 310-30 ending balance	1	613	227	66	—	907
Ending balance	$7,383	$1,333	$3,144	$4,200	$531	$16,591
Ending allowance balance attributable to:						
Non 310-30 loans individually evaluated for impairment	$39	$—	$31	$220	$3	$293
Non 310-30 loans collectively evaluated for impairment	7,343	720	2,886	3,914	528	15,391
ASC 310-30 loans	1	613	227	66	—	907
Total ending allowance balance	$7,383	$1,333	$3,144	$4,200	$531	$16,591
Loans:						
Non 310-30 individually evaluated for impairment	$25,776	$9,460	$3,325	$8,415	$250	$47,226
Non 310-30 collectively evaluated for impairment	691,731	133,341	377,120	571,005	30,356	1,803,553
ASC 310-30 loans	37,665	20,071	213,871	43,979	5,007	320,593
Total loans	$755,172	$162,872	$594,316	$623,399	$35,613	$2,171,372

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	Nine months ended September 30, 2013					
	Commercial	Agriculture	Commercial real estate	Residential real estate	Consumer	Total
Beginning balance	$2,798	$592	$7,396	$4,011	$583	$15,380
Non 310-30 beginning balance	2,798	323	3,056	4,011	540	10,728
Charge-offs	(1,654)	—	(943)	(741)	(717)	(4,055)
Recoveries	187	13	129	64	224	617
Provision (recoupment)	1,315	186	(317)	932	409	2,525
Non 310-30 ending balance	2,646	522	1,925	4,266	456	9,815
ASC 310-30 beginning balance	—	269	4,340	—	43	4,652
Charge-offs	(407)	(221)	(2,796)	(623)	—	(4,047)
Recoveries	—	—	—	—	—	—
Provision (recoupment)	496	537	(1,246)	1,255	(43)	999
ASC 310-30 ending balance	89	585	298	632	—	1,604
Ending balance	$2,735	$1,107	$2,223	$4,898	$456	$11,419
Ending allowance balance attributable to:						
Non 310-30 loans individually evaluated for impairment	$92	$1	$40	$533	$7	$673
Non 310-30 loans collectively evaluated for impairment	2,554	521	1,885	3,733	449	9,142
ASC 310-30 loans	89	585	298	632	—	1,604
Total ending allowance balance	$2,735	$1,107	$2,223	$4,898	$456	$11,419
Loans:						
Non 310-30 individually evaluated for impairment	$7,670	$223	$11,258	$9,629	$295	$29,075
Non 310-30 collectively evaluated for impairment	264,444	117,241	277,494	513,531	28,018	1,200,728
ASC 310-30 loans	68,250	37,882	325,701	72,409	8,768	513,010
Total loans	$340,364	$155,346	$614,453	$595,569	$37,081	$1,742,813

In evaluating the loan portfolio for an appropriate ALL level, non-impaired loans that were not accounted for under ASC 310-30 were grouped into segments based on broad characteristics such as primary use and underlying collateral. Within the segments, the portfolio was further disaggregated into classes of loans with similar attributes and risk characteristics for purposes of applying loss ratios and determining applicable subjective adjustments to the ALL. The application of subjective adjustments was based upon qualitative risk factors, including economic trends and conditions, industry conditions, asset quality, loss trends, lending management, portfolio growth and loan review/internal audit results.

The Company had $0.5 million net charge-offs of non 310-30 loans during the three months ended September 30, 2014 and $0.8 million net charge-offs of non 310-30 loans during the nine months ended September 30, 2014. With the exception of a large commercial and industrial loan that was added to non-accrual status during the second quarter of 2014, strong credit quality trends of the non 310-30 loan portfolio continued during the three and nine months ended September 30, 2014, and, through management's evaluation, resulted in a provision for loan losses on the non 310-30 loans of $1.7 million and $5.3 million during the three and nine months ended September 30, 2014, respectively.

During the nine months ended September 30, 2014, the Company re-estimated the expected cash flows of the loan pools accounted for under ASC 310-30 utilizing the same cash flow methodology used at the time of acquisition. The re-measurement resulted in net recoupment of impairment of $191 thousand and $335 thousand for the three and nine months ended September 30, 2014, respectively, which was comprised of recoupment of previous valuation allowances of $184 thousand during the three months ended September 30, 2014 in the agriculture segment and $226 thousand during the nine months ended September 30, 2014 in the commercial segment.

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The Company charged off $0.6 million and $3.4 million, net of recoveries, of non ASC 310-30 loans during the three and nine months ended September 30, 2013, respectively. The Company had previously provided specific reserves for $0.4 million and $1.7 million of the net charge-offs realized during the three and nine months ended September 30, 2013. Improvements in credit quality trends of the non 310-30 portfolio were seen in both past due and non-performing loans during the three and nine months ended September 30, 2013, and through management's evaluation, resulted in a provision for loan losses of $0.8 million and $2.5 million, respectively.

The Company's re-measurement of expected future cash flows of ASC 310-30 loans resulted in net recoupment of $0.3 million and a net impairment of $1.0 million for the three and nine months ended September 30, 2013, respectively. During the three months ended September 30, 2013, the re-measurements resulted in a recoupment of $0.9 million of impairment expense in the residential real estate segment and net impairments of $0.5 million in the agriculture segment. During the nine months ended September 30, 2013, the re-measurements resulted in a recoupment of previous valuation allowances of $1.2 million in the commercial real estate segment and net impairments of $1.3 million, $0.5 million and $0.5 million in the residential real estate, agriculture, and commercial segments, respectively.

Note 6 FDIC Indemnification Asset

Under the terms of the purchase and assumption agreements with the FDIC with regard to the Hillcrest Bank and Community Banks of Colorado acquisitions, the Company is reimbursed for a portion of the losses incurred on covered assets. Covered assets may be resolved through repayment, short sale of the underlying collateral, the foreclosure on and sale of collateral, or the sale or charge-off of loans or OREO. Any gains or losses realized from the resolution of covered assets reduce or increase, respectively, the amount recoverable from the FDIC. Covered gains or losses that are incurred in excess of the expected reimbursements (which are reflected in the FDIC indemnification asset balance), are recognized in the consolidated statements of operations as FDIC loss sharing income in the period in which they occur.

Below is a summary of the activity related to the FDIC indemnification asset during the nine months ended September 30, 2014 and 2013 (in thousands):

	For the nine months ended	
	September 30, 2014	September 30, 2013
Balance at beginning of period	$64,447	$86,923
Amortization	(19,819)	(11,843)
FDIC portion of (recoveries) charge-offs exceeding fair value marks	(34)	7,466
Changes for FDIC loss share submissions	(181)	(24,460)
Balance at end of period	$44,413	$58,086

The $19.8 million of amortization of the FDIC indemnification asset recognized during the nine months ended September 30, 2014 resulted from an overall increase in actual and expected cash flows of the underlying covered assets, resulting in lower expected reimbursements from the FDIC. The increase in overall expected cash flows from these underlying assets is reflected in increased accretion rates on covered loans and is being recognized over the expected remaining lives of the underlying covered loans as an adjustment to yield. The loss claims filed with the FDIC are subject to review and approval, including extensive audits by the FDIC or its assigned agents for compliance with the terms in the loss sharing agreements. During the nine months ended September 30, 2014, the Company received a net $181 thousand from the FDIC.

During the nine months ended September 30, 2013, the Company recognized $11.8 million of amortization on the FDIC indemnification asset, and further reduced the carrying value of the FDIC indemnification asset by $24.5 million as a result of claims filed with the FDIC. During the nine months ended September 30, 2013, the Company received $77.0 million in payments from the FDIC.

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Note 7 Other Real Estate Owned

A summary of the activity in the OREO balances during the nine months ended September 30, 2014 and 2013 is as follows (in thousands):

	For the nine months ended September 30,	
	2014	2013
Beginning balance	$70,125	$94,808
Transfers from loan portfolio, at fair value	2,519	32,408
Impairments	(1,789)	(9,142)
Sales	(27,656)	(54,705)
Gain on sale of OREO, net	2,686	7,384
Ending balance	$45,885	$70,753

Of the $45.9 million of OREO at September 30, 2014, $30.1 million, or 65.7%, was covered by loss sharing agreements with the FDIC. At December 31, 2013, $38.8 million, or 55.4%, of the $70.1 million of OREO was covered by loss sharing agreements. Any losses on these assets are substantially offset by a corresponding change in the FDIC indemnification asset.

The OREO balance at December 31, 2013 includes the interests of several outside participating banks totaling $4.2 million, for which an offsetting liability is recorded in other liabilities. At September 30, 2014, the Company did not own property that contained the interest of outside participating banks. The OREO balances exclude $8.5 million and $10.6 million at September 30, 2014 and December 31, 2013, respectively, of the Company’s minority interests in OREO which are held by outside banks where the Company was not the lead bank and does not have a controlling interest. The Company maintains a receivable in other assets for these minority interests.

Note 8 Regulatory Capital

At September 30, 2014 and December 31, 2013, NBH Bank, N.A. and the consolidated holding company exceeded all capital ratio requirements under prompt corrective action or other regulatory requirements, as is detailed in the table below (in thousands):

	September 30, 2014					
	Actual		Required to be considered well capitalized (1)		Required to be considered adequately capitalized	
	Ratio	Amount	Ratio	Amount	Ratio	Amount
Tier 1 leverage ratio						
Consolidated	15.2 %	$729,216	N/A	N/A	4 %	$191,465
NBH Bank, N.A.	11.9 %	568,864	10 %	$476,688	4 %	190,675
Tier 1 risk-based capital ratio (2)						
Consolidated	29.4 %	$729,216	6 %	$148,680	4 %	$99,120
NBH Bank, N.A.	23.1 %	568,864	11 %	270,429	4 %	98,338
Total risk-based capital ratio (2)						
Consolidated	30.1 %	$746,208	10 %	$247,800	8 %	$198,240
NBH Bank, N.A.	23.8 %	585,856	12 %	295,014	8 %	196,676

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	December 31, 2013					
	Actual		Required to be considered well capitalized [1]		Required to be considered adequately capitalized	
	Ratio	Amount	Ratio	Amount	Ratio	Amount
Tier 1 leverage ratio						
Consolidated	16.6 %	$822,688	N/A	N/A	4 %	$197,906
NBH Bank, N.A.	11.3 %	556,876	10 %	$491,294	4 %	196,518
Tier 1 risk-based capital ratio [2]						
Consolidated	38.9 %	$822,688	6 %	$126,865	4 %	$84,577
NBH Bank, N.A.	26.6 %	556,876	11 %	230,334	4 %	83,758
Total risk-based capital ratio [2]						
Consolidated	39.5 %	$835,810	10 %	$211,442	8 %	$169,153
NBH Bank, N.A.	27.2 %	569,998	12 %	251,273	8 %	167,515

[1] These ratio requirements for NBH Bank, N.A. are reflective of the agreements NBH Bank, N.A. has made with its various regulators in connection with the approval of its de novo charter.

[2] Due to the conditional guarantee represented by the loss sharing agreements, the FDIC indemnification asset and covered assets are risk-weighted at 20% for purposes of risk-based capital computations.

Note 9 FDIC Loss Sharing (Expense) Income

In connection with the loss sharing agreements that the Company has with the FDIC with regard to the Hillcrest Bank and Community Banks of Colorado transactions, the Company recognizes the actual reimbursement of costs of resolution of covered assets from the FDIC through the statements of operations. The table below provides additional details of the Company's FDIC loss sharing (expense) income during the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Clawback liability amortization	$(345)	$(314)	$(1,009)	$(937)
Clawback liability remeasurement	(592)	(405)	(1,646)	244
Reimbursement to FDIC for gain on sale of and income from covered OREO	(1,587)	(2,514)	(3,287)	(4,615)
Reimbursement to FDIC for recoveries	(62)	—	(180)	(22)
FDIC reimbursement of covered asset resolution costs	1,643	2,042	3,573	8,608
Total	$(943)	$(1,191)	$(2,549)	$3,278

Note 10 Stock-based Compensation and Benefits

The Company provides stock-based compensation in accordance with shareholder-approved plans. During the second quarter of 2014, shareholders approved the 2014 Omnibus Incentive Plan (the "2014 Plan"). The 2014 Plan replaces the NBH Holdings Corp. 2009 Equity Incentive Plan (the "Prior Plan"), pursuant to which the Company granted equity awards prior to the approval of the 2014 Plan. Pursuant to the 2014 Plan, the compensation committee of the board of directors has the authority to grant, from time to time, awards of options, stock appreciation rights, restricted stock, restricted stock units, performance units, other stock-based awards, or any combination thereof to eligible persons.

The aggregate number of Class A common stock available for issuance under the 2014 Plan is 4,519,533 shares. Any shares that are subject to stock options or stock appreciation rights under the 2014 Plan will be counted against the amount available for issuance as one share for every one share granted, and any shares that are subject to awards under the 2014 Plan other than stock options or stock appreciation rights will be counted against the amount available for issuance as 3.25 shares for every one share granted. The 2014 Plan provides for recycling of shares from both the Prior Plan and the 2014 Plan, the terms of which are further described in the Company's Proxy Statement for its 2014 Annual Meeting of Shareholders.

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To date, the Company has issued stock options and restricted stock under the plans. The compensation committee sets the option exercise price at the time of grant but in no case is the exercise price less than the fair market value of a share of stock at the date of grant.

The Company issued stock options and restricted stock in accordance with the plans during the nine months ended September 30, 2014. The following table summarizes stock option activity for the nine months ended September 30, 2014:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at December 31, 2013	3,515,486	$19.92	6.13	$5,183,567
Granted	114,148	18.93		
Forfeited	(4,360)	18.36		
Surrendered	(9,705)	20.00		
Exercised	(295)	20.00		
Expired	(2,083)	20.00		
Outstanding at September 30, 2014	3,613,191	$19.89	5.53	$168,864
Options fully vested and exercisable at September 30, 2014	2,957,498	$19.99	5.30	$—
Options expected to vest	611,407	$19.50	6.39	$142,375

Stock option expense is included in salaries and benefits in the accompanying consolidated statements of operations and totaled $0.3 million and $0.5 million for the three months ended September 30, 2014 and 2013, respectively, and $1.0 million and $1.8 million for the nine months ended September 30, 2014 and 2013, respectively. At September 30, 2014, there was $1.0 million of total unrecognized compensation cost related to non-vested stock options granted under the plans. The cost is expected to be recognized over a weighted average period of 0.9 years.

Expense related to non-vested restricted stock totaled $0.8 million during each of the three months ended September 30, 2014 and 2013 and $1.8 million and $2.2 million during the nine months ended September 30, 2014 and 2013, respectively, and is included in salaries and benefits in the Company's consolidated statements of operations. As of September 30, 2014, there was $2.5 million of total unrecognized compensation cost related to non-vested restricted shares granted under the plans, which is expected to be recognized over a weighted average period of 0.7 years. The following table summarizes restricted stock activity for the nine months ended September 30, 2014:

	Total Restricted Shares	Weighted Average Grant-Date Fair Value
Unvested at December 31, 2013	1,064,460	$15.16
Vested	(29,651)	19.50
Granted	147,086	18.98
Forfeited	(13,780)	14.58
Surrendered	(18,610)	19.16
Unvested at September 30, 2014	1,149,505	$15.48

Note 11 Warrants

At September 30, 2014 and December 31, 2013, the Company had 830,750 issued and outstanding warrants to purchase Company stock. The warrants were granted to certain lead shareholders of the Company, all with an exercise price of $20.00 per share. The term of the warrants is for ten years from the date of grant and the expiration dates of the warrants range from October 20, 2019 to September 30, 2020. The fair value of the warrants was estimated to be $3.5 million and $6.3 million at September 30, 2014 and December 31, 2013, respectively. The fair value of the warrants was estimated using a Black-Scholes option pricing model utilizing the following assumptions at the indicated dates:

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	September 30, 2014		December 31, 2013	
Risk-free interest rate	1.87	%	2.16	%
Expected volatility	25.85	%	33.80	%
Expected term (years)	5-6		6-7	
Dividend yield	1.05	%	0.93	%

The Company’s shares became publicly traded on September 20, 2012 and prior to that, had limited private trading. Due to the limited historical volatility of the Company's own stock, expected volatility was calculated using a time-based weighted migration of the Company’s own stock price volatility coupled with the median historical volatility, for a period commensurate with the expected term of the warrants, of those of a peer group. The risk-free rate for the expected term of the warrants was based on the U.S. Treasury yield curve and based on the expected term. The expected term was estimated based on the contractual term of the warrants.

The Company recorded a benefit of $1.3 million and $2.7 million for the three and nine months ended September 30, 2014, respectively, and an expense of $0.4 million and $0.1 million for the three and nine months ended September 30, 2013, respectively, in the consolidated statements of operations resulting from the change in fair value of the warrant liability.

Note 12 Common Stock

During the three and nine months ended September 30, 2014, the Company repurchased 2,774,863 and 5,085,458 shares for $55.0 million and $100.1 million at weighted average prices of $19.82 and $19.66 per share, respectively. On October 21, 2014, the Board of Directors authorized a new share repurchase program for up to $50.0 million in share repurchases from time to time in either the open market or through privately negotiated transactions.

The Company had 38,995,050 shares of Class A common stock and 867,774 shares of Class B common stock outstanding as of September 30, 2014, and 41,890,562 shares of Class A common stock and 3,027,774 shares of Class B common stock outstanding as of December 31, 2013. Additionally, as of September 30, 2014 and December 31, 2013, the Company had 1,149,505 and 1,064,460 shares, respectively, of restricted Class A common stock issued but not yet vested under the 2014 Plan and the Prior Plan.

Note 13 Income Per Share

The Company calculates income per share under the two-class method, as certain non-vested share awards contain non-forfeitable rights to dividends. As such, these awards are considered securities that participate in the earnings of the Company. Non-vested shares are discussed further in note 10.

The Company had 39,862,824 and 51,213,044 shares outstanding (inclusive of Class A and B) as of September 30, 2014 and 2013, respectively. Certain stock options and non-vested restricted shares are potentially dilutive securities, but are not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive for three and nine months ended September 30, 2014 and 2013, respectively.

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The following table illustrates the computation of basic and diluted income per share for the three and nine months ended September 30, 2014 and 2013 (in thousands, except share and earnings per share information):

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Distributed earnings	$2,159	$ 2,622	$6,666	$7,934
Undistributed earnings (distributions in excess of earnings)	1,178	(1,675)	231	(2,007)
Net income	$3,337	$ 947	$6,897	$5,927
Less: earnings allocated to participating securities	(12)	(5)	(28)	(12)
Earnings allocated to common shareholders	$3,325	$ 942	$6,869	$5,915
Weighted average shares outstanding for basic earnings per common share	41,837,485	51,454,200	43,403,791	51,940,245
Dilutive effect of equity awards	4,200	45,301	19,482	32,916
Dilutive effect of warrants	—	2,479	—	—
Weighted average shares outstanding for diluted earnings per common share	41,841,685	51,501,980	43,423,273	51,973,161
Basic earnings per share	$0.08	$ 0.02	$0.16	$0.11
Diluted earnings per share	$0.08	$ 0.02	$0.16	$0.11

The Company had 3,613,191 and 3,538,012 outstanding stock options to purchase common stock at weighted average exercise prices of $19.89 and $19.92 per share at September 30, 2014 and 2013, respectively, which have time-vesting criteria, and as such, any dilution is derived only for the time frame in which the vesting criteria had been met and where the inclusion of those stock options is dilutive. Additionally, the Company had 830,750 outstanding warrants to purchase the Company's common stock as of September 30, 2014 and 2013. The warrants have an exercise price of $20.00, which was out-of-the-money for purposes of dilution calculations during the three and nine months ended September 30, 2014. The Company had 1,149,505 and 1,087,154 unvested restricted shares outstanding as of September 30, 2014 and 2013, respectively, which have performance, market and/or time-vesting criteria, and as such, any dilution is derived only for the time frame in which the vesting criteria had been met and where the inclusion of those restricted shares is dilutive.

Note 14 Derivatives

Risk management objective of using derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company has established policies that neither carrying value nor fair value at risk should exceed established guidelines. The Company has designed strategies to confine these risks within the established limits and identify appropriate trade-offs in the financial structure of its balance sheet. These strategies include the use of derivative financial instruments to help achieve the desired balance sheet repricing structure while meeting the desired objectives of its clients. Currently the Company employs certain interest rate swaps that are designated as fair value hedges as well as economic hedges. The Company manages a matched book with respect to its derivative instruments in order to minimize its net risk exposure resulting from such transactions.

Fair values of derivative instrument of the balance sheet

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Statements of Financial Condition as of September 30, 2014 and December 31, 2013 (dollars in thousands).

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Information about the valuation methods used to measure fair value is provided in note 16.

		Asset Derivatives			Liability Derivatives	
		Fair Value			Fair Value	
	Balance Sheet Location	September 30, 2014	December 31, 2013	Balance Sheet Location	September 30, 2014	December 31, 2013
Derivatives designated as hedging instruments						
Interest rate products	Other assets	$17	$ 129	Other liabilities	$1,259	$ —
Total derivatives designated as hedging instruments		$17	$ 129		$1,259	$ —
Derivatives not designated as hedging instruments						
Interest rate products	Other assets	$721	$ 73	Other liabilities	$774	$ 74
Total derivatives not designated as hedging instruments		$721	$ 73		$774	$ 74

Fair value hedges of interest rate risk

Interest rate swaps designated as fair value hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying notional amount. As of September 30, 2014, the Company had nine interest rate swaps with a notional amount of $63.7 million that were designated as fair value hedges of interest rate risk associated with the Company’s fixed-rate loans. The Company had one outstanding interest rate swap with a notional amount of $10.0 million that was designated as a fair value hedge as of December 31, 2013.

For derivatives designated and that qualify as fair value hedges, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in earnings. The Company includes the gain or loss on the hedged items in the same line item as the offsetting loss or gain on the related derivatives. During the three and nine months ended September 30, 2014, the Company recognized a net loss of $45.9 thousand and $185.5 thousand, respectively, in non-interest expense related to hedge ineffectiveness. During the three and nine months ended September 30, 2013, the Company did not participate in fair value hedges that would result in hedge ineffectiveness.

Non-designated hedges

Derivatives not designated as hedges are not speculative and consist of interest rate swaps with commercial banking clients that facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the client swaps and the offsetting swaps are recognized directly in earnings. As of September 30, 2014, the Company had nine matched interest rate swap transactions with an aggregate notional amount of $27.3 million related to this program. As of December 31, 2013, the Company had three matched interest rate swap transactions with an aggregate notional amount of $7.3 million related to this program.

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Effect of Derivative Instruments on the Consolidated Statement of Operations

The tables below present the effect of the Company’s derivative financial instruments on the consolidated statement of operations for the three and nine months ended September 30, 2014 and 2013 (in thousands).

Derivatives in fair value hedging relationships	Location of loss recognized in income on derivatives	Amount of loss recognized in income on derivatives			
		Three months ended September 30,		For the nine months ended September 30,	
		2014	2013	2014	2013
Interest rate products	Interest income	$(36)	$—	$(1,371)	$—
Total		$(36)	$—	$(1,371)	$—

Derivatives in fair value hedging relationships	Location of gain or (loss) recognized in income on derivatives	Amount of gain or (loss) recognized in income on hedged items			
		Three months ended September 30,		For the nine months ended September 30,	
		2014	2013	2014	2013
Interest rate products	Interest income	$(10)	$—	$1,185	$—
Total		$(10)	$—	$1,185	$—

		Amount of loss recognized in income on derivatives			
		Three months ended September 30,		For the nine months ended September 30,	
Derivatives not designated as hedging instruments	Location of loss recognized in income on derivatives	2014	2013	2014	2013
Interest rate products	Other non-interest income	$(1)	$(7)	$(51)	(7)
Total		$(1)	$(7)	$(51)	(7)

Credit-risk-related Contingent Features

The Company has agreements with its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness for reasons other than an error or omission of an administrative or operational nature, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well/adequately capitalized institution, then the counterparty has the right to terminate the derivative positions and the Company would be required to settle its obligations under the agreements. As of September 30, 2014, the termination value of derivatives in a net liability position related to these agreements was $2.5 million, which includes accrued interest but excludes any adjustment for nonperformance risk. The Company has minimum collateral posting thresholds with certain of its derivative counterparties and as of September 30, 2014, the Company had posted $2.7 million in eligible collateral.

Note 15 Commitments and Contingencies

In the normal course of business, the Company enters into various off-balance sheet commitments to help meet the financing needs of clients. These financial instruments include commitments to extend credit, commercial and consumer lines of credit and standby letters of credit. The same credit policies are applied to these commitments as the loans on the consolidated statements of financial condition; however, these commitments involve varying degrees of credit risk in excess of the amount recognized in the consolidated statements of financial condition. At September 30, 2014 and December 31, 2013, the Company had loan commitments totaling $475.4 million and $383.9 million, respectively, and standby letters of credit that totaled $7.2 million and $5.9 million, respectively. The total amounts of unused commitments do not necessarily represent future credit exposure or cash requirements, as commitments often expire without being drawn upon. However, the contractual amount of these commitments, offset by any additional collateral pledged, represents the Company’s potential credit loss exposure. Amounts funded under non-cancelable commitments in effect at the date of acquisition are covered under the applicable loss sharing agreements if certain conditions are met.

Total unfunded commitments at September 30, 2014 and December 31, 2013 were as follows (in thousands):

	September 30, 2014			December 31, 2013		
	Covered	Non-covered	Total	Covered	Non-covered	Total
Commitments to fund loans						
Residential	$—	$ 2,015	$2,015	$—	$ 1,303	$1,303
Commercial and commercial real estate	11	200,113	200,124	415	169,214	169,629
Construction and land development	—	31,447	31,447	—	2,911	2,911
Consumer	—	4,224	4,224	—	4,435	4,435
Credit card lines of credit	—	18,733	18,733	—	17,322	17,322
Unfunded commitments under lines of credit	7,895	210,961	218,856	13,162	175,177	188,339
Commercial and standby letters of credit	234	6,929	7,163	443	5,487	5,930
Total	$8,140	$ 474,422	$482,562	$14,020	$ 375,849	$389,869

Commitments to fund loans—Commitments to fund loans are legally binding agreements to lend to clients in accordance with predetermined contractual provisions providing there have been no violations of any conditions specified in the contract. These commitments are generally at variable interest rates and are for specific periods or contain termination clauses and may require the payment of a fee. The total amounts of unused commitments are not necessarily representative of future credit exposure or cash requirements, as commitments often expire without being drawn upon.

Credit card lines of credit—The Company extends lines of credit to clients through the use of credit cards issued by the Bank. These lines of credit represent the maximum amounts allowed to be funded, many of which will not exhaust the established limits, and as such, these amounts are not necessarily representations of future cash requirements or credit exposure.

Unfunded commitments under lines of credit—In the ordinary course of business, the Company extends revolving credit to its clients. These arrangements may require the payment of a fee.

Commercial and standby letters of credit—As a provider of financial services, the Company routinely issues commercial and standby letters of credit, which may be financial standby letters of credit or performance standby letters of credit. These are various forms of “back-up” commitments to guarantee the performance of a client to a third party. While these arrangements represent a potential cash outlay for the Company, the majority of these letters of credit will expire without being drawn upon. Letters of credit are subject to the same underwriting and credit approval process as traditional loans, and as such, many of them have various forms of collateral securing the commitment, which may include real estate, personal property, receivables or marketable securities.

Contingencies

In the ordinary course of business, the Company and the Bank may be subject to litigation. Based upon the available information and advice from the Company’s legal counsel, management does not believe that any potential, threatened or pending litigation to which it is a party will have a material adverse effect on the Company’s liquidity, financial condition or results of operations.

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Note 16 Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to disclose the fair value of its financial instruments. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For disclosure purposes, the Company groups its financial and non-financial assets and liabilities into three different levels based on the nature of the instrument and the availability and reliability of the information that is used to determine fair value. The three levels are defined as follows:

- Level 1—Includes assets or liabilities in which the inputs to the valuation methodologies are based on unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2—Includes assets or liabilities in which the inputs to the valuation methodologies are based on similar assets or liabilities in inactive markets, quoted prices for identical or similar assets or liabilities in inactive markets, and inputs other than quoted prices that are observable, such as interest rates, yield curves, volatilities, prepayment speeds, and other inputs obtained from observable market input.
- Level 3—Includes assets or liabilities in which the inputs to the valuation methodology are based on at least one significant assumption that is not observable in the marketplace. These valuations may rely on management's judgment and may include internally-developed model-based valuation techniques.

Level 1 inputs are considered to be the most transparent and reliable and level 3 inputs are considered to be the least transparent and reliable. The Company assumes the use of the principal market to conduct a transaction of each particular asset or liability being measured and then considers the assumptions that market participants would use when pricing the asset or liability. Whenever possible, the Company first looks for quoted prices for identical assets or liabilities in active markets (level 1 inputs) to value each asset or liability. However, when inputs from identical assets or liabilities on active markets are not available, the Company utilizes market observable data for similar assets and liabilities. The Company maximizes the use of observable inputs and limits the use of unobservable inputs to occasions when observable inputs are not available. The need to use unobservable inputs generally results from the lack of market liquidity of the actual financial instrument or of the underlying collateral. Although, in some instances, third party price indications may be available, limited trading activity can challenge the observability of these quotations.

Changes in the valuation inputs used for measuring the fair value of financial instruments may occur due to changes in current market conditions or other factors. Such changes may necessitate a transfer of the financial instruments to another level in the hierarchy based on the new inputs used. The Company recognizes these transfers at the end of the reporting period that the transfer occurs. During the nine months ended September 30, 2014 and 2013, there were no transfers of financial instruments between the hierarchy levels.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of each instrument under the valuation hierarchy:

Fair Value of Financial Instruments Measured on a Recurring Basis

Investment securities available-for-sale—Investment securities available-for-sale are carried at fair value on a recurring basis. To the extent possible, observable quoted prices in an active market are used to determine fair value and, as such, these securities are classified as level 1. At September 30, 2014 and December 31, 2013, the Company did not hold any level 1 securities. When quoted market prices in active markets for identical assets or liabilities are not available, quoted prices of securities with similar characteristics, discounted cash flows or other pricing characteristics are used to estimate fair values and the securities are then classified as level 2. At September 30, 2014 and December 31, 2013, the Company's level 2 securities included asset backed securities, mortgage-backed securities comprised of residential mortgage pass-through securities, and other residential mortgage-backed securities. All other investment securities are classified as level 3.

Derivatives—The Company's derivative instruments are limited to interest rate swaps that may be accounted for as fair value hedges or non-designated hedges. The fair values of the swaps incorporate credit valuation adjustments in order to appropriately reflect nonperformance risk in the fair value measurements. The credit valuation adjustment is the dollar amount of the fair value adjustment related to credit risk and utilizes a probability weighted calculation to quantify the potential loss over the life of the trade. The credit valuation adjustments are calculated by determining the total expected exposure of the derivatives (which incorporates both the current and potential future exposure) and then applying the respective counterparties' credit spreads to the exposure offset by marketable collateral posted, if any. Certain derrivative transactions are executed with counterparties who are large financial institutions ("dealers"). International Swaps and Derivative Association Master Agreements ("ISDA") and Credit Support Annexes ("CSA") are employed for all contracts with dealers. These contracts contain bilateral collateral arrangements. The fair value inputs of these financial instruments are determined using discounted cash flow analysis through the use of third-party models whose significant inputs are readily observable market parameters, primarily yield curves, with appropriate adjustments for liquidity and credit risk, and are classified as level 2.

Warrant liability—The Company measures the fair value of the warrant liability on a recurring basis using a Black-Scholes option pricing model. The Company's shares became publicly traded on September 20, 2012 and prior to that, had limited private trading; therefore, expected volatility was estimated using a time-based weighted migration of the Company's own stock price volatility coupled with the median historical volatility, for a period commensurate with the expected term of the warrants, of those of 8 comparable companies with publicly traded shares, and is deemed a significant unobservable input to the valuation model.

Clawback liability—The Company periodically measures the net present value of expected future cash payments to be made by the Company to the FDIC that must be made within 45 days of the conclusion of the loss sharing. The expected cash flows are calculated in accordance with the loss sharing agreements and are based primarily on the expected losses on the covered assets, which involve significant inputs that are not market observable.

The tables below present the financial instruments measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013 on the consolidated statements of financial condition utilizing the hierarchy structure described above (in thousands):

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale:				
Asset backed securities	$—	$356	$—	$356
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	427,127	—	427,127
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	1,125,739	—	1,125,739
Other securities	—	—	419	419
Derivatives	—	738	—	738
Total assets at fair value	$—	$1,553,960	$419	$1,554,379
Liabilities:				
Warrant liability	$—	$—	$3,547	$3,547
Clawback liability	—	—	35,120	35,120
Derivatives	—	2,033	—	2,033
Total liabilities at fair value	$—	$2,033	$38,667	$40,700

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	December 31, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale:				
Asset backed securities	$—	$4,537	$—	$4,537
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	494,990	—	494,990
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	1,285,582	—	1,285,582
Other securities	—	—	419	419
Derivatives	—	202	—	202
Total assets at fair value	$—	$1,785,311	$419	$1,785,730
Liabilities:				
Warrant liability	$—	$—	$6,281	$6,281
Clawback liability	—	—	32,465	32,465
Derivatives	—	74		74
Total liabilities at fair value	$—	$74	$38,746	$38,820

The table below details the changes in level 3 financial instruments during the nine months ended September 30, 2014 and September 30, 2013 (in thousands):

	Warrant liability	Clawback liability
Balance at December 31, 2012	$5,461	$31,271
Change in value	138	(244)
Amortization	—	937
Net change in level 3	$138	$693
Balance at September 30, 2013	$5,599	$31,964
Balance at December 31, 2013	$6,281	$32,465
Change in value	(2,734)	1,646
Amortization	—	1,009
Net change in Level 3	(2,734)	2,655
Balance at September 30, 2014	$3,547	$35,120

Fair Value of Financial Instruments Measured on a Non-recurring Basis

Certain assets may be recorded at fair value on a non-recurring basis as conditions warrant. These non-recurring fair value measurements typically result from the application of lower of cost or fair value accounting or a write-down occurring during the period.

The Company records collateral dependent loans that are considered to be impaired at their estimated fair value. A loan is considered impaired when it is probable that the Company will be unable to collect all contractual amounts due in accordance with the terms of the loan agreement. Collateral dependent impaired loans are measured based on the fair value of the collateral. The Company relies on third-party appraisals and internal assessments in determining the estimated fair values of these loans. The inputs used to determine the fair values of loans are considered level 3 inputs in the fair value hierarchy. During the nine months ended September 30, 2014, the Company measured 24 loans not accounted for under ASC 310-30 at fair value on a non-recurring basis. These loans carried specific reserves totaling $0.2 million at September 30, 2014. During the nine months ended September 30, 2014, the Company added specific reserves of $0.3 million for seven loans with carrying balances of $2.5

million at September 30, 2014. The Company also eliminated specific reserves of $0.9 million for ten loans during the nine months ended September 30, 2014, primarily due to pay downs on these loans.

The Company may be required to record fair value adjustments on loans held-for-sale on a non-recurring basis. The non-recurring fair value adjustments could involve lower of cost or fair value accounting and may include write-downs.

OREO is recorded at the lower of the loan balance or the fair value of the collateral less estimated selling costs. The estimated fair values of OREO are updated periodically and further write-downs may be taken to reflect a new basis. The Company recognized $1.8 million of OREO impairments in its consolidated statements of operations during the nine months ended September 30, 2014, of which $1.1 million, or 60.2%, were on OREO that was covered by loss sharing agreements with the FDIC. During the nine months ended September 30, 2013, the Company recognized $9.1 million of OREO impairments in its consolidated statements of operations, of which $6.6 million, or 73.2% , were on OREO that was covered by loss sharing agreements with the FDIC. The fair values of OREO are derived from third party price opinions or appraisals that generally use an income approach or a market value approach. If reasonable comparable appraisals are not available, then the Company may use internally developed models to determine fair values. The inputs used to determine the fair values of OREO are considered level 3 inputs in the fair value hierarchy.

The table below provides information regarding the assets recorded at fair value on a non-recurring basis during the nine months ended September 30, 2014 and 2013 (in thousands):

	September 30, 2014				
	Level 1	Level 2	Level 3	Total	Losses from fair value changes
Other real estate owned	$—	$—	$45,885	$45,885	$1,789
Impaired loans	—	—	47,225	47,225	145

	September 30, 2013				
	Level 1	Level 2	Level 3	Total	Losses from fair value changes
Other real estate owned	$—	$—	$70,753	$70,753	$9,142
Impaired loans	—	—	29,075	29,075	1,305

The Company did not record any liabilities for which the fair value was made on a non-recurring basis during the nine months ended September 30, 2014.

The following table provides information about the valuation techniques and unobservable inputs used in the valuation of financial instruments falling within level 3 of the fair value hierarchy as of September 30, 2014. The table below excludes non-recurring fair value measurements of collateral value used for impairment measures for OREO. These valuations utilize third party appraisal or broker price opinions, and are classified as level 3 due to the significant judgment involved (in thousands):

	Fair value at September 30, 2014	Valuation Technique	Unobservable Input	Quantitative Measures
Other securities	$419	Cash investment in private equity fund	Cash investment	
Impaired loans	47,225	Appraised value	Appraised values	
			Discount rate	0-25%
Clawback liability	35,120	Contractually defined discounted cash flows	Intrinsic loss estimates	$323.3 million - $405 million

			Expected credit losses	—
			Discount rate	4%
Warrant liability	3,547	Black-Scholes	Volatility	18%-36%

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Note 17 Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is determined based upon quoted market prices to the extent possible; however, in many instances, there are no quoted market prices for the Company’s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques that may be significantly impacted by the assumptions used, including the discount rate and estimates of future cash flows. Changes in any of these assumptions could significantly affect the fair value estimates. The fair value of the financial instruments listed below does not reflect a premium or discount that could result from offering all of the Company’s holdings of financial instruments at one time, nor does it reflect the underlying value of the Company, as ASC Topic 825 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. In connection with the Hillcrest Bank, Bank Midwest, Bank of Choice and Community Banks of Colorado acquisitions, the Company recorded all of the acquired assets and assumed liabilities at fair value at the respective dates of acquisition. The fair value of financial instruments at September 30, 2014 and December 31, 2013, including methods and assumptions utilized for determining fair value of financial instruments, are set forth below (in thousands):

		September 30, 2014		December 31, 2013	
	Level in fair value measurement hierarchy	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
ASSETS:					
Cash and cash equivalents	Level 1	$118,659	$118,659	$189,460	$189,460
Asset backed securities available-for-sale	Level 2	356	356	4,537	4,537
Mortgage-backed securities—residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises available-for-sale	Level 2	427,127	427,127	494,990	494,990
Mortgage-backed securities—other residential mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored enterprises available-for-sale	Level 2	1,125,739	1,125,739	1,285,582	1,285,582
Other securities	Level 3	419	419	419	419
Mortgage-backed securities—residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises held-to-maturity	Level 2	444,104	447,424	513,090	511,489
Mortgage-backed securities—other residential mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored enterprises held-to-maturity	Level 2	113,360	110,169	128,817	124,916
Capital stock of FHLB	Level 2	6,010	6,010	6,643	6,643
Capital stock of FRB	Level 2	15,630	15,630	25,020	25,020
Loans receivable, net	Level 3	2,154,781	2,194,983	1,841,573	1,923,888
Loans held-for-sale	Level 2	5,252	5,252	5,787	5,787
Accrued interest receivable	Level 2	12,851	12,851	11,355	11,355
Derivatives	Level 2	738	738	202	202
LIABILITIES:					
Deposit transaction accounts	Level 2	2,401,388	2,401,388	2,342,622	2,342,622
Time deposits	Level 2	1,396,070	1,397,401	1,495,687	1,498,798
Securities sold under agreements to repurchase	Level 2	109,946	109,946	99,547	99,547
Due to FDIC	Level 3	35,120	35,120	41,882	41,882
Warrant liability	Level 3	3,547	3,547	6,281	6,281
Accrued interest payable	Level 2	3,607	3,607	3,058	3,058
Derivatives	Level 2	2,033	2,033	74	74

Cash and cash equivalents

Cash and cash equivalents have a short-term nature and the estimated fair value is equal to the carrying value.

Investment securities

The estimated fair value of investment securities is based on quoted market prices or bid quotations received from securities dealers. Other investment securities, including securities that are held for regulatory purposes are carried at cost, less any other than temporary impairment.

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Loans receivable

The estimated fair value of the loan portfolio is estimated using a discounted cash flow analysis using a discount rate based on interest rates offered at the respective measurement dates for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered a reasonable estimate of any required adjustment to fair value to reflect the impact of credit risk. The estimates of fair value do not incorporate the exit-price concept prescribed by ASC Topic 820 Fair Value Measurements and Disclosures.

Loans held-for-sale

Loans held-for-sale are carried at the lower of aggregate cost or estimated fair value. The portfolio consists primarily of fixed rate residential mortgage loans that are sold within 45 days. The estimated fair value is based on quoted market prices for similar loans in the secondary market and are classified as level 2.

Accrued interest receivable

Accrued interest receivable has a short-term nature and the estimated fair value is equal to the carrying value.

Deposits

The estimated fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, savings, NOW accounts, and money market accounts, is equal to the amount payable on demand. The fair value of interest-bearing time deposits is based on the discounted value of contractual cash flows of such deposits, taking into account the option for early withdrawal. The discount rate is estimated using the rates offered by the Company, at the respective measurement dates, for deposits of similar remaining maturities.

Derivative assets and liabilities

Fair values for derivative assets and liabilities are fully described in note 16.

Securities sold under agreements to repurchase

The vast majority of the Company’s repurchase agreements are overnight transactions that mature the day after the transaction, and as a result of this short-term nature, the estimated fair value is equal to the carrying value.

Due to FDIC

The amount due to FDIC is specified in the purchase agreements and, as it relates to the clawback liability, is discounted to reflect the uncertainty in the timing and payment of the amount due by the Company.

Warrant liability

The warrant liability is estimated using a Black-Scholes model, the assumptions of which are detailed in note 18 of our audited consolidated financial statements.

Accrued interest payable

Accrued interest payable has a short-term nature and the estimated fair value is equal to the carrying value.

Item 2: MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following management's discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes as of and for the three and nine months ended September 30, 2014, and with our annual report on Form 10-K (file number 001-35654), which includes our audited consolidated financial statements and related notes as of and for the years ended December 31, 2013, 2012, and 2011. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions that may cause actual results to differ materially from management's expectations. Factors that could cause such differences are discussed in the section entitled “Cautionary Note Regarding Forward-Looking Statements” located elsewhere in this quarterly report and in Item 1A“Risk Factors” in the annual report on Form 10-K, referenced above, and should be read herewith.

Readers are cautioned that meaningful comparability of current period financial information to prior periods may be limited. Following our Hillcrest Bank acquisition on October 22, 2010, we completed three additional acquisitions: Bank Midwest on December 10, 2010, Bank of Choice on July 22, 2011 and Community Banks of Colorado on October 21, 2011. As a result, our operating results are limited to the periods since these acquisitions, and the comparability of periods is compromised due to the timing of these acquisitions. Additionally, in accordance with Accounting Standards Codification (“ASC”) Topic 805, Business Combinations, the assets acquired and liabilities assumed were recorded at fair value at their respective dates of acquisition. The comparability of data is also compromised by the FDIC loss sharing agreements in place that cover a portion of losses incurred on certain assets acquired in the Hillcrest Bank and the Community Banks of Colorado acquisitions.

Overview

National Bank Holdings Corporation is a bank holding company formed in 2009. Through our subsidiary, NBH Bank, N.A., we provide a variety of banking products to both commercial and consumer clients through a network of 97 banking centers, located in Colorado, the greater Kansas City area and Texas, and through on-line and mobile banking products. We operate under the following brand names: Community Banks of Colorado in Colorado, Bank Midwest in Kansas and Missouri, and Hillcrest Bank in Texas.

In just under four years, we have completed the acquisition and integration of four problem or failed banks, three of which were FDIC-assisted. We have transformed these four banks into one collective banking operation with steadily increasing organic growth, prudent underwriting, and meaningful market share with continued opportunity for expansion. Our long-term business model utilizes our organic development infrastructure, low-risk balance sheet, continuous operational development and a disciplined acquisition strategy to create value and provide opportunities for growth.

As of September 30, 2014, we had $4.8 billion in assets, $2.2 billion in loans, $3.8 billion in deposits and $0.8 billion in equity. We believe that our established presence positions us well for growth opportunities in our current and complementary markets. Our focus is on building strong banking relationships with small to mid-sized businesses and consumers, while maintaining a low risk profile designed to generate reliable income streams and attractive returns. Through our acquisitions, we have established a solid financial services franchise with a sizable presence for deposit gathering and client relationship building necessary for growth.

Operating Highlights and Key Challenges

Our operations resulted in the following highlights as of and for the nine months ended September 30, 2014 (except as noted):

Loan portfolio

- Organic loan originations totaled $687.0 million, representing a 46.2% increase from the same period of 2013.
- We had $1.9 billion of loans outstanding that are associated with a “strategic” client relationship - a 37.0% annualized growth for the nine months ended September 30, 2014.
- Successfully exited $98.8 million, or 37.7% annualized, of the non-strategic loan portfolio during the nine months ended September 30, 2014.

Credit quality

- Non 310-30 loans

Strong loss-share coverage on 48.2% of non-performing assets.

Net charge-offs on average non 310-30 loans remained low at 0.07% annualized.

Non 310-30 loans grew from 70.6% to 85.2% of the total loan portfolio, an increase of 14.6% from the same period of 2013.

- ASC 310-30 loans

Added a net $29.1 million to accretable yield for the acquired loans accounted for under ASC 310-30.

The $14.8 million covered commercial and industrial loan pool that had previously been on non-accrual status at December 31, 2013 was returned to accrual status during the first quarter of 2014 due to improved performance and predictability of cash flows within that pool.

Client deposit funded balance sheet

- Average transaction deposits and client repurchase agreements increased $26.9 million for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013, or 1.1%.
- Transaction account balances improved to 63.2% of total deposits as of September 30, 2014 from 61.0% at December 31, 2013.
- As of September 30, 2014, total deposits and client repurchase agreements made up 97.6% of our total liabilities.
- We did not have any brokered deposits as of September 30, 2014.

Revenues and expenses

- The average annual yield on our loan portfolio was 6.67% for the nine months ended September 30, 2014 compared to 8.11% for the nine months ended September 30, 2013, driven by the increasing originated loan balances coupled with declining balances of higher-yielding purchased loans.
- Cost of deposits decreased five basis points to 0.37% for the nine months ended September 30, 2014 from 0.42% for the nine months ended September 30, 2013 due to a $219.4 million decrease in average interest bearing deposits and a $36.9 million increase in average demand deposits.
- Net interest margin widened to 3.84% on a fully taxable equivalent basis during the nine months ended September 30, 2014, from 3.82% during the nine months ended September 30, 2013, driven by strong yields on the high-yielding 310-30 loans coupled with a five basis point decrease in the cost of average interest bearing liabilities.
- Operating costs before problem loan/OREO workout expenses, the benefit of the change in the warrant liability and banking center closure expenses declined $11.2 million, or 9.1%, during the nine months ended September 30, 2014, compared to the same period in 2013. The decrease in operating costs was attributable to implemented efficiency initiatives and banking center closures.
- Problem loan/OREO workout expenses totaled $6.7 million for the nine months ended September 30, 2014, decreasing $5.4 million, or 44.6%, from the same period in 2013.

Strong capital position

- As of September 30, 2014, our consolidated tier 1 leverage ratio was 15.2% and our consolidated tier 1 risk-based capital ratio was 29.4%.
- The after-tax accretable yield on ASC 310-30 loans plus the after-tax yield on the FDIC indemnification asset, net, in excess of 4.5%, an approximate yield on new loan originations, and discounted at 5%, adds $0.85 per share to our tangible book value per share as of September 30, 2014.
- Tangible common book value per share was $18.49 before consideration of the excess accretable yield value of $0.85 per share.
- During the nine months ended September 30, 2014, we repurchased 5.1 million shares, or 11.32% of outstanding shares, at a weighted average price of $19.66 per share. Since early 2013 and through November 6, 2014, we have repurchased 12.6 million shares, or 24.07% of outstanding shares, at an attractive weighted average price of $19.73 per share.
- During the nine months ended September 30, 2014, we repurchased 5.1 million of our shares at a weighted average price per share of $19.66. On October 21, 2014, we announced that the Board of Directors approved a new authorization to repurchase another $50.0 million of the Company’s common stock.

Key Challenges

There are a number of significant challenges confronting us and our industry. We face a variety of challenges in implementing our business strategy, including being a new entity, the challenges of acquiring distressed franchises and rebuilding them, effectively managing our capital, low interest rates and intense competition for loans.

General economic conditions have been modestly improving in recent quarters. However, continued uncertainty about the strength of the recovery remains and has hindered the pace and advancement of an economic recovery, both nationally and in our markets. Residential real estate values have largely recovered from their lows, and we continue to consider this with guarded optimism. Commercial real estate values have been recovering slightly slower than residential real estate, and it is difficult to determine how strong this recovery is and how long it will last. A significant portion of our loan portfolio is secured by real estate and any deterioration in real estate values or credit quality or elevated levels of non-performing assets would ultimately have a negative impact on the quality of our loan portfolio.

Our total loan balances increased $317.3 million during the nine months ended September 30, 2014, or 22.9% annualized on the strength of $687.0 million of loan originations. While we have reached our loan growth inflection point, whereby total originations are now outpacing problem loan resolution, interest rates remain low and intense loan competition has been limiting the yields we have been able to obtain on interest earning assets. For example, our acquired loans generally have produced higher yields than our originated loans due to the recognition of accretion of fair value adjustments and accretable yield. We expect downward pressure on the yields on our total loan portfolio to the extent that our originated loan portfolio does not provide sufficient yields to replace the high yields on the acquired loan portfolio as they pay down or pay off. Additionally, growth in our interest income will be dependent on our ability to generate sufficient volumes of high-quality originated loans.

Increased regulation, such as the rules and regulations promulgated under the Dodd-Frank Act and potentially higher required capital ratios, is adding costs and uncertainty to all U.S. banks and could reduce our competitiveness as compared to other financial service providers or lead to industry-wide decreases in profitability. While certain external factors are out of our control and may provide obstacles during the implementation of our business strategy, we believe we are prepared to deal with these challenges. We seek to remain flexible, yet methodical and proactive, in our strategic decision making so that we can quickly respond to market changes and the inherent challenges and opportunities that accompany such changes.

Performance Overview

As a financial institution, we routinely evaluate and review our consolidated statements of financial condition and results of operations. We evaluate the levels, trends and mix of the statements of financial condition and statements of operations line items and compare those levels to our budgeted expectations, our peers, industry averages and trends.

Within our statements of financial condition, we specifically evaluate and manage the following:

Loan balances - We monitor our loan portfolio to evaluate loan originations, payoffs, and profitability. We forecast loan originations and payoffs within the overall loan portfolio, and we work to resolve problem loans and OREO in an expeditious manner. We track the runoff of our covered assets as well as the loan relationships that we have identified as “non-strategic” and put particular emphasis on the buildup of “strategic” relationships.

Asset quality - We monitor the asset quality of our loans and OREO through a variety of metrics, and we work to resolve problem assets in an efficient manner. Specifically, we monitor the resolution of problem loans through payoffs, pay downs and foreclosure activity. We marked all of our acquired assets to fair value at the date of their respective acquisitions, taking into account our estimation of credit quality.

Many of the loans that we acquired in the Hillcrest Bank, Bank of Choice and Community Banks of Colorado acquisitions had deteriorated credit quality at the respective dates of acquisition. These loans are accounted for under ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. This guidance is described more fully below under “-Application of Critical Accounting Policies” and in note 2 in our consolidated financial statements in our 2013 Annual Report on Form 10-K.

Our evaluation of traditional credit quality metrics and the allowance for loan losses (“ALL”) levels, especially when compared to industry averages or to other financial institutions, takes into account that any credit quality deterioration that existed at the date of acquisition was considered in the original valuation of those assets on our balance sheet. Additionally, many of these assets are covered by loss sharing agreements. All of these factors limit the comparability of our credit quality and ALL levels to peers or other financial institutions.

Deposit balances - We monitor our deposit levels by type, market and rate. Our loans are funded through our deposit base, and we seek to optimize our deposit mix in order to provide reliable, low-cost funding sources.

Liquidity - We monitor liquidity based on policy limits and through projections of sources and uses of cash. In order to test the adequacy of our liquidity, we routinely perform various liquidity stress test scenarios that incorporate wholesale funding maturities, if any, certain deposit run-off rates and access to borrowings. We manage our liquidity primarily through our balance sheet mix, including our cash and our investment security portfolio, and the interest rates that we offer on our loan and deposit products, coupled with contingency funding plans as necessary.

Capital - We monitor our capital levels, including evaluating the effects of share repurchases and potential acquisitions, to ensure continued compliance with regulatory requirements and with the OCC Operating Agreement that we entered into in connection with our Bank Midwest acquisition, which is described under “Supervision and Regulation”in our 2013 Annual Report on Form 10-K. We review our tier 1 leverage capital ratios, our tier 1 risk-based capital ratios and our total risk-based capital ratios on a regular basis.

Within our consolidated results of operations, we specifically evaluate the following:

Net interest income - Net interest income represents the amount by which interest income on interest earning assets exceeds interest expense incurred on interest bearing liabilities. We generate interest income through interest and dividends on loans, investment securities and interest bearing bank deposits. Our acquired loans have generally produced higher yields than our originated loans due to the recognition of accretion of fair value adjustments and accretable yield and, as a result, we have historically had downward pressure on our interest income. While there is still some volatility in our interest income due to the nature of our portfolio, solid loan originations are helping to stabilize interest income by offsetting the decrease in interest income from the higher yielding purchased loans with the interest income earned on new loan originations. We incur interest expense on our interest bearing deposits and repurchase agreements and would also incur interest expense on any future borrowings, including any debt assumed in acquisitions. We strive to maximize our interest income by acquiring and originating loans and investing excess cash in investment securities. Furthermore, we seek to minimize our interest expense through low-cost funding sources, thereby maximizing our net interest income.

Provision for loan losses - The provision for loan losses includes the amount of expense that is required to maintain the ALL at an adequate level to absorb probable losses inherent in the non 310-30 loan portfolio at the balance sheet date. Additionally, we incur a provision for loan losses on loans accounted for under ASC 310-30 as a result of a decrease in the net present value of the expected future cash flows during the periodic remeasurement of the cash flows associated with these pools of loans. The determination of the amount of the provision for loan losses and the related ALL is complex and involves a high degree of judgment and subjectivity to maintain a level of ALL that is considered by management to be appropriate under GAAP.

Non-interest income - Non-interest income consists of service charges, bank card fees, gains on sales of mortgages, gains on sales of investment securities, gains on previously charged-off acquired loans, OREO related write-ups and other income and other non-interest income. Also included in non-interest income is FDIC indemnification asset amortization and other FDIC loss sharing income, which consists of reimbursement of costs related to the resolution of covered assets, and amortization of our clawback liability. For additional information, see "Application of Critical Accounting Policies-Acquisition Accounting Application and the Valuation of Assets Acquired and Liabilities Assumed" and note 2 in our consolidated financial statements in our 2013 Annual Report on Form 10-K. Due to fluctuations in the amortization rates on the FDIC indemnification asset and the amortization of the clawback liability and due to varying levels of expenses and income related to the resolution of covered assets, the FDIC loss sharing income is not consistent on a period-to-period basis and, is expected to decline over time as covered assets are resolved and as the FDIC loss sharing agreements expire over the next few years.

Non-interest expense - The primary components of our non-interest expense are salaries and benefits, occupancy and equipment, telecommunications and data processing and intangible asset amortization. Any expenses related to the resolution of covered assets are also included in non-interest expense. These expenses are dependent on individual resolution circumstances and, as a result, are not consistent from period to period. We seek to manage our non-interest expense in order to maximize efficiencies.

Net income - We utilize traditional industry return ratios such as return on average assets, return on average tangible assets, return on average equity, return on average tangible equity and return on risk-weighted assets to measure and assess our returns in relation to our balance sheet profile.

In evaluating the financial statement line items described above, we evaluate and manage our performance based on key earnings indicators, balance sheet ratios, asset quality metrics and regulatory capital ratios, among others. The table below presents some of the primary performance indicators that we use to analyze our business on a regular basis for the periods indicated:

	As of and for the three months ended			As of and for the nine months ended	
	September 30, 2014	December 31, 2013	September 30, 2013	September 30, 2014	September 30, 2013
Key Ratios[1]					
Return on average assets	0.27 %	0.08 %	0.07 %	0.19 %	0.15 %
Return on average tangible assets[2]	0.34 %	0.15 %	0.14 %	0.26 %	0.22 %
Return on average equity	1.56 %	0.42 %	0.36 %	1.05 %	0.74 %
Return on average tangible common equity[2]	2.12 %	0.82 %	0.73 %	1.55 %	1.13 %
Return on risk weighted assets	0.53 %	0.19 %	0.19 %	0.37 %	0.40 %
Interest-earning assets to interest-bearing liabilities (end of period)[3]	137.71 %	137.05 %	139.44 %	137.71 %	139.44 %
Loans to deposits ratio (end of period)	57.32 %	48.46 %	44.24 %	57.32 %	44.24 %
Average equity to average assets	17.50 %	19.02 %	19.97 %	17.99 %	20.41 %
Non-interest bearing deposits to total deposits (end of period)	19.07 %	17.59 %	17.45 %	19.07 %	17.45 %
Net interest margin	3.73 %	3.78 %	3.80 %	3.82 %	3.82 %
Net interest margin (fully taxable equivalent)[2][4]	3.75 %	3.78 %	3.80 %	3.84 %	3.82 %
Interest rate spread[5]	3.63 %	3.66 %	3.68 %	3.72 %	3.69 %
Yield on earning assets	4.05 %	4.11 %	4.14 %	4.14 %	4.18 %
Yield on earning assets (fully taxable equivalent)[2][3]	4.07 %	4.11 %	4.14 %	4.16 %	4.18 %
Cost of interest bearing liabilities[3]	0.44 %	0.45 %	0.46 %	0.44 %	0.49 %
Cost of deposits	0.37 %	0.38 %	0.40 %	0.37 %	0.42 %
Non-interest expense to average assets	3.10 %	3.50 %	3.56 %	3.20 %	3.57 %
Efficiency ratio[2][6]	84.22 %	93.36 %	92.68 %	86.09 %	88.60 %
Efficiency ratio (fully taxable equivalent)[2]	83.78 %	93.36 %	92.68 %	85.69 %	88.60 %
Dividend payout ratio	62.50 %	250.00 %	250.00 %	93.75 %	136.36 %
Asset Quality Data[7][8][9]					
Non-performing loans to total loans	0.87 %	1.31 %	1.77 %	0.87 %	1.77 %
Covered non-performing loans to total non-performing loans	8.13 %	68.89 %	62.43 %	8.13 %	62.43 %
Non-performing assets to total assets	1.37 %	1.94 %	1.99 %	1.37 %	1.99 %
Covered non-performing assets to total non-performing assets	48.23 %	58.50 %	62.04 %	48.23 %	62.04 %
Allowance for loan losses to total loans	0.76 %	0.68 %	0.66 %	0.76 %	0.66 %
Allowance for loan losses to total non-covered loans	0.85 %	0.81 %	0.83 %	0.85 %	0.83 %
Allowance for loan losses to non-performing loans	87.62 %	51.43 %	37.01 %	87.62 %	37.01 %
Net charge-offs (recoveries) to average loans	0.09 %	(0.07 %)	0.20 %	0.06 %	0.58 %

[1] Ratios are annualized.

[2] Ratio represents non-GAAP financial measure. See non-GAAP reconciliation on page 48.

[3]

Interest earning assets include assets that earn interest/accretion or dividends, except for the FDIC indemnification asset, which is not part of interest earning assets. Any market value adjustments on investment securities are excluded from interest-earning assets. Interest bearing liabilities include liabilities that must be paid interest.

(4) Net interest margin represents net interest income, including accretion income on interest earning assets, as a percentage of average interest earning assets.

(5) Interest rate spread represents the difference between the weighted average yield on interest earning assets and the weighted average cost of interest bearing liabilities.

(6) The efficiency ratio represents non-interest expense, less intangible asset amortization, as a percentage of net interest income plus non-interest income on a fully taxable basis.

(7) Non-performing loans were redefined during the third quarter of 2014 to only include non-accrual loans and restructured loans on non-accrual, and exclude any loans accounted for under ASC 310-30 in which the pool is still performing. All previous periods have been restated.

(8) Non-performing assets include non-performing loans, other real estate owned and other repossessed assets.

(9) Total loans are net of unearned discounts and fees.

About Non-GAAP Financial Measures

Certain of the financial measures and ratios we present, including “tangible assets,” “return on average tangible assets,” “return on average tangible common equity,” “tangible common book value,” “tangible common book value per share,” “tangible common equity,” "tangible common equity to tangible assets," and "fully taxable equivalent" metrics are supplemental measures that are not required by, or are not presented in accordance with, U.S. generally accepted accounting principles (GAAP). We refer to these financial measures and ratios as “non-GAAP financial measures.” We consider the use of select non-GAAP financial measures and ratios to be useful for financial and operational decision making and useful in evaluating period-to-period comparisons. We believe that these non-GAAP financial measures provide meaningful supplemental information regarding our performance by excluding certain expenditures or assets that we believe are not indicative of our primary business operating results or by presenting certain metrics on a fully taxable equivalent basis. We believe that management and investors benefit from referring to these non-GAAP financial measures in assessing our performance and when planning, forecasting, analyzing and comparing past, present and future periods.

These non-GAAP financial measures are presented for supplemental informational purposes only and should not be considered a substitute for financial information presented in accordance with GAAP. The non-GAAP financial measures we present may differ from non-GAAP financial measures used by our peers or other companies. In particular, the items that we exclude in our adjustments are not necessarily consistent with the items that our peers may exclude from their results of operations and key financial measures and therefore may limit the comparability of similarly named financial measures and ratios. We compensate for these limitations by providing the equivalent GAAP measures whenever we present the non-GAAP financial measures and by including a reconciliation of the impact of the components adjusted for in the non-GAAP financial measure so that both measures and the individual components may be considered when analyzing our performance.

A reconciliation of our non-GAAP financial measures to the comparable GAAP financial measures is as follows (in thousands, except share and per share information).

	As of and for the three months ended		
	September 30, 2014	December 31, 2013	September 30, 2013
Total shareholders’ equity	$808,962	$897,792	$1,031,250
Less: goodwill and intangible assets, net	(77,850)	(81,859)	(83,196)
Add: deferred tax liability related to goodwill	5,834	4,671	4,284
Tangible common equity (non-GAAP)	$736,946	$820,604	$952,338
Total assets	$4,812,807	$4,914,115	$5,161,969
Less: goodwill and intangible assets, net	(77,850)	(81,859)	(83,196)
Add: deferred tax liability related to goodwill	5,834	4,671	4,284
Tangible assets (non-GAAP)	$4,740,791	$4,836,927	$5,083,057
Tangible common equity to tangible assets calculations:			
Total shareholders’ equity to total assets	16.81%	18.27%	19.98%
Less: impact of goodwill and intangible assets, net	(1.27)%	(1.30)%	(1.24)%
Tangible common equity to tangible assets (non-GAAP)	15.54%	16.97%	18.74%
Common book value per share calculations:			
Total shareholders' equity	$808,962	$897,792	$1,031,250
Divided by: ending shares outstanding	39,862,824	44,918,336	51,213,044
Common book value per share	$20.29	$19.99	$20.14
Tangible common book value per share calculations:			
Tangible common equity (non-GAAP)	$736,946	$820,604	$952,338
Divided by: ending shares outstanding	39,862,824	44,918,336	51,213,044
Tangible common book value per share (non-GAAP)	$18.49	$18.27	$18.60
Tangible common book value per share, excluding accumulated other comprehensive income (loss) calculations:			
Tangible common equity (non-GAAP)	$736,946	$820,604	$952,338
Less: accumulated other comprehensive income (loss), net of tax	(1,896)	6,756	142
Tangible common book value, excluding accumulated other comprehensive income (loss), net of tax	735,050	827,360	952,480
Divided by: ending shares outstanding	39,862,824	44,918,336	51,213,044
Tangible common book value per share, excluding accumulated other comprehensive income (loss), net of tax (non-GAAP)	$18.44	$18.42	$18.60

Return on Average Tangible Assets and Return on Average Tangible Equity

	As of and for the three months ended			As of and for the nine months ended	
	September 30, 2014	December 31, 2013	September 30, 2013	September 30, 2014	September 30, 2013
Net income	$3,337	$1,000	$947	$6,897	$5,927
Add: impact of core deposit intangible amortization expense, after tax	815	809	808	2,445	2,425
Net income adjusted for impact of core deposit intangible amortization expense, after tax	$4,152	$1,809	$1,755	$9,342	$8,352
Average assets	$4,854,809	$5,014,174	$5,198,498	$4,881,890	$5,229,479
Less: average goodwill and intangible assets, net of deferred tax asset related to goodwill	72,781	77,973	79,725	74,134	81,022
Average tangible assets (non-GAAP)	$4,782,028	$4,936,201	$5,118,773	$4,807,756	$5,148,457
Average shareholder's equity	$849,351	$953,836	$1,037,968	$878,233	$1,067,370
Less: average goodwill and intangible assets, net of deferred tax asset related to goodwill	72,781	77,973	79,725	74,134	81,022
Average tangible common equity (non-GAAP)	$776,570	875,863	$958,243	$804,099	$986,348
Return on average assets	0.27 %	0.08 %	0.07 %	0.19 %	0.15 %
Return on average tangible assets (non-GAAP)	0.34 %	0.15 %	0.14 %	0.26 %	0.22 %
Return on average equity	1.56 %	0.42 %	0.36 %	1.05 %	0.74 %
Return on average tangible common equity (non-GAAP)	2.12 %	0.82 %	0.73 %	1.55 %	1.13 %

Fully Taxable Equivalent Yield on Earning Assets and Net Interest Margin

	As of and for the three months ended			As of and for the nine months ended	
	September 30, 2014	December 31, 2013	September 30, 2013	September 30, 2014	September 30, 2013
Interest income	$45,492	$47,377	$49,522	$138,382	$148,098
Add: impact of taxable equivalent adjustment	231	—	—	610	—
Interest income, fully taxable equivalent (non-GAAP)	$45,723	47,377	$49,522	$138,992	$148,098
Net interest income	$41,895	$43,590	$45,515	$127,665	$135,371
Add: impact of taxable equivalent adjustment	231	—	—	610	—
Net interest income, fully taxable equivalent (non-GAAP)	$42,126	43,590	$45,515	$128,275	$135,371

Average earning assets	4,453,822		4,573,216		4,747,260		4,464,363		4,740,791	
Yield on earning assets	4.05	%	4.11	%	4.14	%	4.14	%	4.18	%
Yield on earning assets,fully taxable equivalent (non-GAAP)	4.07	%	4.11	%	4.14	%	4.16	%	4.18	%
Net interest margin	3.73	%	3.78	%	3.80	%	3.82	%	3.82	%
Net interest margin, fully taxable equivalent (non-GAAP)	3.75	%	3.78	%	3.80	%	3.84	%	3.82	%

	As of and for the three months ended			As of and for the nine months ended	
	September 30, 2014	December 31, 2013	September 30, 2013	September 30, 2014	September 30, 2013
Net interest income	$41,895	$43,590	$45,515	$127,665	$135,371
Add: impact of taxable equivalent adjustment	231	—	—	610	—
Net interest income, fully taxable equivalent (non-GAAP)	$42,126	$43,590	$45,515	$128,275	$135,371
Non-interest income	$1,614	$2,364	$3,338	$3,421	$17,813
Non-interest expense	$37,981	$44,238	$46,613	$116,854	$139,727
Less: core deposit intangible asset amortization	(1,336)	(1,337)	(1,336)	(4,008)	(4,009)
Non-interest expense, adjusted for core deposit intangible asset amortization	$36,645	$42,901	$45,277	$112,846	$135,718
Efficiency ratio	84.22%	93.36%	92.68%	86.09%	88.60%
Efficiency ratio, fully taxable equivalent (non-GAAP)	83.78%	93.36%	92.68%	85.69%	88.60%

Application of Critical Accounting Policies

We use accounting principles and methods that conform to GAAP and general banking practices. We are required to apply significant judgment and make material estimates in the preparation of our financial statements and with regard to various accounting, reporting and disclosure matters. Assumptions and estimates are required to apply these principles where actual measurement is not possible or practical. The most significant of these estimates relate to the fair value determination of assets acquired and liabilities assumed in business combinations and the application of acquisition accounting, the accounting for acquired loans and the related FDIC indemnification asset, the determination of the ALL, and the valuation of stock-based compensation. These critical accounting policies and estimates are summarized in the sections captioned “Application of Critical Accounting Policies” in Management's Discussion and Analysis in our 2013 Annual Report on Form 10-K, and are further analyzed with other significant accounting policies in note 2, “Summary of Significant Accounting Policies” in the notes to our consolidated financial statements for the year ended December 31, 2013. There have been no significant changes to the application of critical accounting policies since December 31, 2013.

Financial Condition

Total assets were $4.8 billion at September 30, 2014 compared to $4.9 billion at December 31, 2013, a decrease of $0.1 billion, or 2.1%. The decrease in total assets was primarily attributable to the successful repurchase of 5.1 million of our outstanding shares for $100.1 million. We continued our strategy of remixing our earning assets during the nine months ended September 30, 2014, using the run-off from the investment securities portfolio and non-strategic loans to fund loan growth. Total loans were $2.2 billion at September 30, 2014, and grew $317.3 million, or 22.9% annualized, from December 31, 2013. We originated $687.0 million of loans during the nine months ended September 30, 2014, which grew the balances in our strategic portfolio $416.1 million from December 31, 2013 to September 30, 2014, or an annualized rate of 37.0%. We reduced our non-strategic loan portfolio to $0.3 billion at September 30, 2014, a decrease of $98.8 million from December 31, 2013, or 37.7% annualized, which was a reflection of our successful workout progress on acquired problem loans (many of which were covered). Our FDIC indemnification asset decreased $20.0 million during the nine months ended September 30, 2014, primarily as a result of amortization that resulted from an increase in actual and expected cash flows on the underlying covered assets, resulting in lower expected reimbursements from the FDIC. Other assets increased $38.6 million due to an investment of $40.1 million of bank-owned life insurance assets during the nine months ended September 30, 2014. Total deposits totaled $3.8 billion at September 30, 2014 and decreased $40.9 million from December 31, 2013. Lower cost demand, savings, and money market ("transaction") deposits increased $58.8 million and was more than offset by a $99.6 million decrease in time deposits as we sought to retain only those depositors who were interested in time deposits at market rate and developing a banking relationship and continued our focus on migrating toward a client-based deposit mix with higher concentrations of transaction deposits.

Investment Securities

Available-for-sale

Total investment securities available-for-sale were $1.6 billion at September 30, 2014, compared to $1.8 billion at December 31, 2013, a decrease of $231.9 million, or 13.0%. During the nine months ended September 30, 2014, maturities and pay downs of available-for-sale securities totaled $246.4 million. There were no purchases of available-for-sale securities during the nine months ended September 30, 2014. Our available-for-sale investment securities portfolio is summarized as follows for the periods indicated (in thousands):

	September 30, 2014						December 31, 2013					
	Amortized cost	Fair value	Percent of portfolio		Weighted average yield		Amortized cost	Fair value	Percent of portfolio		Weighted average yield	
Asset-backed securities	$356	$356	0.02	%	0.63	%	$4,534	$4,537	0.26	%	0.61	%
Mortgage-backed securities (“MBS”):												
Residential mortgage pass-through securities issued or guaranteed by	419,852	427,127	27.49	%	2.23	%	490,321	494,990	27.72	%	2.22	%

U.S. Government agencies or sponsored enterprises												
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	1,145,834	1,125,739	72.46	%	1.80	%	1,320,998	1,285,582	72.00	%	1.83	%
Other securities	419	419	0.03	%	0.00	%	419	419	0.02	%	0.00	%
Total investment securities available-for-sale	$1,566,461	$1,553,641	100.00	%	1.92	%	$1,816,272	$1,785,528	100.00	%	1.94	%

As of September 30, 2014, approximately 99.9% of the available-for-sale investment portfolio was backed by mortgages as compared to 99.7% at December 31, 2013. The residential mortgage pass-through securities portfolio is comprised of both fixed rate and adjustable rate Federal Home Loan Mortgage Corporation (“FHLMC”), Federal National Mortgage Association

(“FNMA”) and Government National Mortgage Association (“GNMA”) securities. The other mortgage-backed securities are comprised of securities backed by FHLMC, FNMA and GNMA securities.

At September 30, 2014 and December 31, 2013, adjustable rate securities comprised 7.6% and 7.8%, respectively, of the available-for-sale MBS portfolio. The remainder of the portfolio was comprised of fixed rate amortizing securities with 10 to 30 year contractual maturities, with a weighted average coupon of 2.2% per annum, at September 30, 2014 and December 31, 2013.

The available-for-sale investment portfolio included $12.8 million and $30.7 million of net unrealized losses, at September 30, 2014 and December 31, 2013, respectively, inclusive of $18.0 million and $18.4 million of unrealized gains, respectively. In addition to the U.S. Government agency or sponsored enterprise backings of our MBS portfolio, we believe any unrecognized losses are a result of prevailing interest rates, and as such, we do not believe that any of the securities with unrealized losses were other-than-temporarily-impaired.

The estimated weighted average life of the available-for-sale MBS portfolio as of September 30, 2014 and December 31, 2013 was 3.6 years and 3.9 years, respectively, the decrease of which is primarily due to an adjustment in expected prepayment speeds and aging of the portfolio. This estimate is based on various assumptions, including repayment characteristics, and actual results may differ. As of September 30, 2014, the duration of the total available-for-sale investment portfolio was 3.4 years. As of December 31, 2013, the duration of the total available-for-sale investment portfolio was 3.6 years.

Held-to-maturity

At September 30, 2014, we held $557.5 million of held-to-maturity investment securities, compared to $641.9 million at December 31, 2013, a decrease of $84.4 million, or 13.2%. During the nine months ended September 30, 2014 we did not purchase any held-to-maturity securities. Held-to-maturity investment securities are summarized as follows as of the date indicated (in