FIDELITY SOUTHERN CORP
Form 10-Q
May 08, 2014

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For the quarter ended March 31, 2014
Commission file number 001-34981

Fidelity Southern Corporation
(Exact name of registrant as specified in its charter)

Georgia (State or other jurisdiction of incorporation or organization)	58-1416811 (I.R.S. Employer Identification No.)
3490 Piedmont Road, Suite 1550, Atlanta GA	30305
(Address of principal executive offices)	(Zip Code)

(404) 639-6500
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 “large accelerated filer” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ý	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý
As of April 30, 2014 (the most recent practicable date), the Registrant had outstanding approximately 21,289,718 shares of Common Stock.

FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
Report on Form 10-Q
March 31, 2014

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

($ in thousands)	(Unaudited) March 31, 2014	December 31, 2013
Assets		
Cash and due from banks	$161,822	$111,046
Interest-bearing deposits with banks	3,498	2,108
Federal funds sold	1,632	3,405
Cash and cash equivalents	166,952	116,559
Investment securities available-for-sale	163,803	168,865
Investment securities held-to-maturity	3,795	4,051
Loans held-for-sale (loans at fair value: $112,195 at March 31, 2014; $127,850 at December 31, 2013)	180,550	187,366
Loans (non-covered: $1,796,256 and $1,834,672; covered: $51,836 and $58,365 at March 31, 2014 and December 31, 2013, respectively)	1,848,092	1,893,037
Allowance for loan losses	(30,797)	(33,684)
Loans, net of allowance for loan losses	1,817,295	1,859,353
Premises and equipment, net	48,937	44,555
Other real estate, net (non-covered: $19,573 and $24,791; covered: $4,974 and $6,191, at March 31, 2014 and December 31, 2013, respectively)	24,547	30,982
Bank owned life insurance	34,127	33,855
Servicing rights	55,281	53,202
Other assets	61,600	65,380
Total assets	$2,556,887	$2,564,168
Liabilities		
Deposits		
Noninterest-bearing demand deposits	$525,853	$488,224
Interest-bearing deposits	1,674,536	1,714,228
Total deposits	2,200,389	2,202,452
Other borrowings	43,685	59,233
Subordinated debt	46,393	46,393
Other liabilities	24,029	19,860
Total liabilities	2,314,496	2,327,938
Shareholders' equity		
Preferred stock, no par value. Authorized 10,000,000; zero issued	—	—
Common stock, no par value. Authorized 50,000,000; issued and outstanding 21,276,833 and 21,342,549 at March 31, 2014 and December 31, 2013, respectively	159,654	158,153
Accumulated other comprehensive gain, net of tax	1,606	968
Retained earnings	81,131	77,109
Total shareholders' equity	242,391	236,230
Total liabilities and shareholders' equity	$2,556,887	$2,564,168

See accompanying notes to consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended March 31,	
($ in thousands, except per share data)	2014	2013
Interest income:		
Loans, including fees	$21,791	$23,944
Investment securities	1,249	1,028
Federal funds sold and bank deposits	38	3
Total interest income	23,078	24,975
Interest expense:		
Deposits	2,488	2,627
Other borrowings	44	406
Subordinated debt	275	867
Total interest expense	2,807	3,900
Net interest income	20,271	21,075
Provision for loan losses	(2,450)	3,476
Net interest income after provision for loan losses	22,721	17,599
Noninterest income:		
Service charges on deposit accounts	1,009	949
Other fees and charges	920	887
Mortgage banking activities	10,587	17,795
Indirect lending activities	4,676	1,646
SBA lending activities	844	1,084
Bank owned life insurance	301	313
Other	1,046	2,373
Total noninterest income	19,383	25,047
Noninterest expense:		
Salaries and employee benefits	16,085	14,282
Commissions	3,470	6,390
Occupancy, net	2,603	2,407
Communication	972	760
Other	9,526	8,685
Total noninterest expense	32,656	32,524
Income before income tax expense	9,448	10,122
Income tax expense	3,385	3,631
Net income	6,063	6,491
Preferred stock dividends and accretion of discount	—	(823)
Net income available to common equity	$6,063	$5,668
Earnings per share:		
Basic earnings per share	$0.28	$0.37
Diluted earnings per share	$0.26	$0.33
Net income	$6,063	$6,491
Other comprehensive gain/(loss), net of tax:		
Change in net unrealized gains/(losses) on securities for the period, net of tax/(benefit) of $391 and $(103)	$638	$(169)

Total other comprehensive gain, net of tax	$6,701	$6,322

See accompanying notes to consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31,	
	2014	2013
(in thousands)		
Operating activities:		
Net income	$6,063	$6,491
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	(2,450)	3,476
Depreciation and amortization of premises and equipment	870	698
Other amortization	1,984	2,035
Impairment of other real estate	1,393	1,294
Share-based compensation	164	288
Gain on loan sales, including servicing rights origination	(8,816)	(17,986)
Net gain on sale of other real estate	(460)	(1,549)
Net increase in cash value of bank owned life insurance	(272)	(285)
Change in assets and liabilities which provided (used) cash:		
Net decrease (increase) in loans originated for resell	14,621	(12,089)
Other assets	(1,643)	3,764
Other liabilities	2,430	(1,882)
Net cash provided by (used in) operating activities	13,884	(15,745)
Investing activities:		
Purchases of investment securities available-for-sale	—	(10,357)
Purchase of FHLB stock	(900)	(1,732)
Maturities and calls of investment securities held-to-maturity	256	639
Maturities and calls of investment securities available-for-sale	6,112	11,166
Redemption of FHLB stock	2,239	1,143
Net proceeds from sales of loans	52,211	3,244
Net increase in loans	(6,721)	(53,780)
Proceeds from sale of other real estate	5,530	7,867
Purchases of premises and equipment	(3,903)	(1,537)
Net cash provided by (used in) investing activities	54,824	(43,347)
Financing activities:		
Net increase (decrease) in demand deposits, money market accounts, and savings accounts	37,629	(585)
Net decrease in time deposits	(39,692)	(9,275)
Net (decrease) increase in borrowings	(15,548)	60,391
Common stock dividends paid	(848)	(3)
Proceeds from the issuance of common stock	144	409
Preferred stock dividends paid	—	(603)
Net cash (used in) provided by financing activities	(18,315)	50,334
Net increase (decrease) in cash and cash equivalents	50,393	(8,758)
Cash and cash equivalents, beginning of period	116,559	49,020
Cash and cash equivalents, end of period	$166,952	$40,262
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$2,789	$4,618

Income taxes	$66	$4,250
Supplemental disclosures of noncash investing and financing activities:		
Noncash transfers to other real estate	$28	$6,807
Accretion on preferred stock	$—	$220

See accompanying notes to consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2014
(UNAUDITED)
1. SUMMARY OF SIGNFICANT ACCOUNTING POLICIES
The unaudited consolidated financial statements include the accounts of Fidelity Southern Corporation ("FSC" or "Fidelity") and its wholly-owned subsidiaries. FSC owns 100% of Fidelity Bank (the “Bank”) and LionMark Insurance Company, an insurance agency offering consumer credit related insurance products. FSC also owns three subsidiaries established to issue trust preferred securities, which are not consolidated for financial reporting purposes in accordance with current accounting guidance, as FSC is not the primary beneficiary. The “Company” or "our", as used herein, includes FSC and its subsidiaries, unless the context otherwise requires.
These unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles followed within the financial services industry for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements.
In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the calculations of and the amortization of capitalized servicing rights, valuation of deferred income taxes, the valuation of loans held-for-sale and certain derivatives, the valuation of real estate or other assets acquired in connection with foreclosures or in satisfaction of loans, estimates used for fair value acquisition accounting, and Federal Deposit Insurance Corporation (the "FDIC") receivable for loss share agreements. The Company principally operates in one business segment, which is community banking.
In the opinion of management, all adjustments considered necessary for a fair presentation of the financial position and results of operations for the interim periods have been included. All such adjustments are normal recurring accruals. All significant intercompany accounts and transactions have been eliminated in consolidation. These reclassifications had no impact on previously reported net income and shareholders’ equity.
The Company’s significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in the 2013 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission. There were no new accounting policies or changes to existing policies adopted in the first three months of 2014, which had a significant effect on the results of operations or statement of financial condition. For interim reporting purposes, the Company follows the same basic accounting policies and considers each interim period as an integral part of an annual period.
Operating results for the three-month period ended March 31, 2014, are not necessarily indicative of the results that may be expected for the year ended December 31, 2014. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K/A and Annual Report to Shareholders for the year ended December 31, 2013.
Recent Accounting Pronouncements

In January 2014, the FASB issued Accounting Standards Update ("ASU") 2014-04 "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The amendments clarify when an in substance repossession or foreclosure occurs, such that the loan should be derecognized and real estate property should be recognized. The amendments will be effective for entities during annual reporting periods beginning after December 15, 2014, and interim reporting periods therein and those requirements should be applied prospectively. Early adoption is permitted. The adoption of this ASU is not expected to have a significant impact on the Company’s Consolidated Financial Statements.
Other accounting standards that have been issued or proposed by the FASB or other standard-settings bodies are expected to have a material impact on the Company financial position, results of operations or cash flows.

Contingencies

Due to the nature of their activities, the Company and its subsidiaries are at times engaged in various legal proceedings that arise in the course of normal business, some of which were outstanding as of March 31, 2014. While it is difficult to predict or determine the outcome of these proceedings, it is the opinion of management, after consultation with its legal counsel, that the ultimate liabilities, if any, will not have a material adverse impact on the Company’s consolidated results of operations, financial position, or cash flows.

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2. INVESTMENT SECURITIES

The amortized cost and fair value of debt securities are categorized in the table below by expected repricing dates. The expected maturities may differ from the contractual maturities of mortgage backed securities because the mortgage holder of the underlying mortgage loans has the right to prepay their mortgage loans without prepayment penalties. The expected maturities may differ from the contractual maturities of callable agencies and municipal securities because the issuer has the right to redeem the callable security at predetermined prices at specified times prior to maturity.

(in thousands)	March 31, 2014 Amortized Cost	March 31, 2014 Fair Value	December 31, 2013 Amortized Cost	December 31, 2013 Fair Value
Available-for-sale:				
Obligations of U.S. Government sponsored enterprises and agencies:				
Due within one year	$510	$514	$514	$518
Due after one year through five years	1,001	1,017	—	—
Due five years through ten years	18,629	18,582	19,605	19,553
Due after ten years	1,004	1,009	1,004	968
Municipal securities:				
Due within one year	2,214	2,254	500	516
Due after one year through five years	7,400	7,644	9,119	9,294
Due five years through ten years	2,531	2,590	2,535	2,559
Due after ten years	2,544	2,521	2,545	2,400
Mortgage-backed securities	125,380	127,672	131,481	133,057
	$161,213	$163,803	$167,303	$168,865
Held-to-maturity:				
Mortgage-backed securities	$3,795	$4,161	$4,051	$4,437

The Bank did not sell or purchase any securities during the three months ended March 31, 2014. The Bank did not sell any securities during the three months ended March 31, 2013. There were $10.4 million in securities available-for-sale purchases for the three months ended March 31, 2013.

The following table summarizes the amortized cost and estimated fair value of available-for-sale and held to maturity investment securities and the related gross unrealized gains and losses at March 31, 2014 and December 31, 2013.

(in thousands)	March 31, 2014 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other than Temporary Impairment	Fair Value
Available-for-sale:					
Obligations of U.S. Government sponsored enterprises and agencies	$21,144	$36	$(58)	$—	$21,122
Municipal securities	14,689	392	(72)	—	15,009
Residential mortgage-backed securities	125,380	2,496	(204)	—	127,672
	$161,213	$2,924	$(334)	$—	$163,803
Held-to-maturity:					
Residential mortgage-backed securities	$3,795	$366	$—	$—	$4,161

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(in thousands)	December 31, 2013 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other than Temporary Impairment	Fair Value
Available-for-sale:					
Obligations of U.S. Government sponsored enterprises and agencies	$21,123	$4	$(88)	$—	$21,039
Municipal securities	14,699	240	(170)	—	14,769
Residential mortgage-backed securities	131,481	2,049	(473)	—	133,057
	$167,303	$2,293	$(731)	$—	$168,865
Held-to-maturity:					
Residential mortgage-backed securities	$4,051	$386	$—	$—	$4,437

At March 31, 2014 and December 31, 2013, all securities in an unrealized loss position had been in a loss position for less than 12 months, and result from fluctuations in interest rates and not credit-related issues. As of March 31, 2014, management does not intend to sell the temporarily impaired securities and it is not more likely than not that the Company will be required to sell the investments before recovery of the amortized cost basis. Accordingly, as of March 31, 2014, management believes the impairment detailed in the prior table is temporary and no impairment loss has been recognized in the Company's Consolidated Statements of Comprehensive Income.

3. LOANS HELD-FOR-SALE

Loans held-for-sale at March 31, 2014 and December 31, 2013 totaled $180.6 million and $187.4 million, respectively, and are shown in the table below:

(in thousands)	March 31, 2014	December 31, 2013
SBA	$8,355	$9,516
Real estate – mortgage – residential	112,195	127,850
Consumer installment	60,000	50,000
Total loans held-for-sale	$180,550	$187,366

4. LOANS

Loans outstanding, by class, are summarized in the following table and are presented net of deferred fees and costs of $5.6 million and $5.3 million at March 31, 2014 and December 31, 2013, respectively. Non-covered loans represent existing portfolio loans prior to the FDIC-assisted transactions, loans acquired but not covered under the Loss Share Agreements, and additional loans originated subsequent to the FDIC-assisted transactions.

	Non-covered		Covered	
(in thousands)	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
Commercial	$490,993	$493,093	$34,355	$37,885
SBA	137,731	134,221	600	603
Total commercial loans	628,724	627,314	34,955	38,488
Construction loans	95,330	92,929	6,113	8,769
Indirect automobile	925,101	975,223	—	—
Installment	14,563	13,876	1,369	1,486
Total consumer loans	939,664	989,099	1,369	1,486
First mortgage	66,559	59,075	1,987	1,853
Second mortgage	65,979	66,255	7,412	7,769
Total mortgage loans	132,538	125,330	9,399	9,622
Total loans	$1,796,256	$1,834,672	$51,836	$58,365

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Loans in nonaccrual status totaled approximately $56.6 million, and $59.6 million at March 31, 2014 and December 31, 2013, respectively. Period-end nonaccrual loans, segregated by class of loans, are described in the following table.

(in thousands)	Non-covered March 31, 2014	December 31, 2013	Covered March 31, 2014	December 31, 2013
Commercial	$10,782	$10,890	$9,934	$10,094
SBA	15,911	15,385	—	—
Total commercial loans	26,693	26,275	9,934	10,094
Construction	8,924	9,093	3,865	6,193
Indirect automobile	2,122	2,362	—	—
Installment	508	601	871	1,249
Total consumer loans	2,630	2,963	871	1,249
First mortgage	1,876	1,886	411	561
Second mortgage	860	727	536	541
Total mortgage loans	2,736	2,613	947	1,102
Total loans	$40,983	$40,944	$15,617	$18,638

Loans delinquent 30-89 days and troubled debt restructured loans accruing interest, segregated by class of loans at March 31, 2014 and December 31, 2013, were as follows:

	March 31, 2014		December 31, 2013	
(in thousands)	Accruing Delinquent 30-89 Days	Troubled Debt Restructured Loans Accruing	Accruing Delinquent 30-89 Days	Troubled Debt Restructured Loans Accruing
Commercial	$418	$7,130	$1,620	$7,242
SBA	1,440	2,818	169	2,520
Construction	12	598	—	1,662
Indirect automobile	1,117	2,122	1,561	2,209
Installment	178	—	305	—
First mortgage	249	643	1,314	647
Second mortgage	631	—	163	—
Total loans	$4,045	$13,311	$5,132	$14,280

There was one loan in the construction portfolio 90 days or more past due and still accruing as of March 31, 2014 for $488,000. There were no loans 90 days or more past due and still accruing at December 31, 2013.

Troubled Debt Restructurings ("TDRs") are loans in which the borrower is experiencing financial difficulty and the Company has granted an economic concession to the borrower. Prior to modifying a borrower's loan terms, the Company performs an evaluation of the borrower's financial condition and ability to service the loan under the potential modified loan terms. The types of concessions granted are generally interest rate reductions or term extensions. If a loan is accruing at the time of modification, the loan remains on accrual status and is subject to the Company's charge-off and nonaccrual policies. If a loan is on nonaccrual status before it is determined to be a TDR, then the loan remains on nonaccrual status. TDRs may be returned to accrual status if there has been at least a six-month sustained period of repayment performance by the borrower. Interest income recognition on impaired loans is dependent upon nonaccrual status.

During the periods ended March 31, 2014 and 2013, certain loans were modified, resulting in TDRs. The modification of the terms of such loans included one or a combination of the following modifications: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

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The following table presents loans, by class, which were modified as TDRs that occurred during the three months ended March 31, 2014 and 2013 along with the type of modification:

	Troubled Debt Restructured During the Three Months Ended March 31, 2014		Troubled Debt Restructured During the Three Months Ended March 31, 2013	
(in thousands)	Interest Rate	Term	Interest Rate	Term
Commercial	$—	$—	$214	$—
SBA	—	—	—	—
Construction	—	—	—	—
Indirect automobile	—	174	—	433
Installment	127	96	—	—
First mortgage	155	—	—	76
Second mortgage	—	217	—	140
Total loans	$282	$487	$214	$649

The following table presents the amount of loans which were restructured in the previous twelve months ended March 31, 2013 and March 31, 2012 and subsequently defaulting during the periods ended March 31, 2014 and March 31, 2013:

	Troubled Debt Restructured during the last twelve months and subsequently defaulting during the periods ended [(1)]	
(in thousands)	March 31, 2014	March 31, 2013
Commercial	$—	$—
SBA	—	—
Construction	—	—
Indirect automobile	—	351
Installment	96	—
First mortgage	—	76
Second mortgage	—	—
Total loans	$96	$427

(1) A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The Company had TDRs with a balance of $24.8 million and $25.6 million at March 31, 2014 and December 31, 2013, respectively. There were charge-offs of TDR loans of $25,000 for the three months ended March 31, 2014 and $1.9 million for the three months ended March 31, 2013. Charge-offs on such loans are factored into the rolling historical loss rate, which is one of the considerations used in establishing the allowance for loan losses. The Company is not committed to lend additional amounts as of March 31, 2014 and December 31, 2013 to customers with outstanding loans that are classified as TDRs.

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Impaired loans are evaluated based on the present value of expected future cash flows discounted at each loan's original effective interest rate, or at the loan's observable market price, or the fair value of the collateral, if the loan is collateral-dependent. Impaired loans at March 31, 2014 and December 31, 2013, by class, are shown in the table below:

(in thousands)	March 31, 2014 Unpaid Principal	March 31, 2014 Amortized Cost	March 31, 2014 Related Allowance	December 31, 2013 Unpaid Principal	December 31, 2013 Amortized Cost	December 31, 2013 Related Allowance
Impaired loans with allowance						
Commercial	$9,706	$9,588	$4,096	$9,501	$9,381	$4,037
SBA	10,267	9,199	1,208	9,762	8,079	607
Construction	7,796	3,804	347	15,408	10,500	625
Indirect automobile	2,604	2,122	12	2,364	2,362	13
Installment	1,813	501	362	461	431	302
First mortgage	2,068	2,068	882	2,270	2,270	805
Second mortgage	946	848	794	879	789	735
Total impaired loans with allowance	$35,200	$28,130	$7,701	$40,645	$33,812	$7,124

(in thousands)	March 31, 2014 Unpaid Principal	March 31, 2014 Amortized Cost	December 31, 2013 Unpaid Principal	December 31, 2013 Amortized Cost
Impaired loans with no allowance				
Commercial	$14,898	$14,337	$12,495	$11,522
SBA	16,222	14,028	12,706	10,545
Construction	10,534	8,240	2,758	1,266
Indirect automobile	—	—	—	—
Installment	15	7	1,461	170
First mortgage	717	717	725	725
Second mortgage	208	198	62	56
Total impaired loans with no allowance	$42,594	$37,527	$30,207	$24,284

Average impaired loans and interest income recognized for the three months ended March 31, 2014 and March 31, 2013, by class, are summarized in the table below.

(in thousands)	Three Months Ended March 31, 2014 Average Impaired Loans	2014 Interest Income Recognized on Impaired Loans	2013 Average Impaired Loans	2013 Interest Income Recognized on Impaired Loans
Commercial	$22,358	$ 293	$29,714	$247
SBA	21,379	259	24,928	292
Construction	11,092	137	16,484	43
Indirect automobile	2,176	46	3,391	38
Installment	569	83	519	33
First mortgage	2,983	9	3,666	9
Second mortgage	952	48	2,106	10
Total	$61,509	$ 875	$80,808	$672

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The Company uses an asset quality ratings system to assign a numeric indicator of the credit quality and level of existing credit risk inherent in a loan. These ratings are adjusted periodically as the Company becomes aware of changes in the credit quality of the underlying loans. The following are definitions of the asset ratings.

•Rating #1 - #4 (High - Acceptable Quality) – These categories include loans with good to acceptable business and credit risk.

•Rating #5 (Special Mention) – A special mention asset has potential weaknesses that deserve management's close attention.

•Rating #6 (Substandard) – A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any.

•Rating #7 (Doubtful) – Doubtful assets have all the weaknesses inherent in assets classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

•Rating #8 (Loss) – Loss assets are considered uncollectable and of such little value that their continuance as recorded assets is not warranted.

The table below shows the weighted average asset rating by class as of March 31, 2014 and December 31, 2013:

	Weighted Average Asset Rating	
	March 31, 2014	December 31, 2013
Commercial	3.92	3.93
SBA	4.42	4.40
Construction	4.39	4.49
Indirect automobile	3.01	3.01
Installment	3.65	3.78
First mortgage	3.07	3.06
Second mortgage	3.31	3.31

The Company uses FICO scoring to help evaluate the likelihood consumer borrowers will pay their credit obligations as agreed. The weighted-average FICO score for the indirect loan portfolio, included in consumer installment loans, was 737 at March 31, 2014 and 733 at December 31, 2013.

Purchased Credit Impaired ("PCI") Loans:

The carrying amount of PCI loans at March 31, 2014 and December 31, 2013 follows.

(in thousands)	March 31, 2014	December 31, 2013
Commercial	$36,506	$40,060
Construction	6,113	8,769
Consumer	2,856	3,050
Mortgage	9,758	9,997
Outstanding balance	$55,233	$61,876

Accretable yield, or income expected to be collected on PCI loans at March 31, 2014 and March 31, 2013, is as follows.

(in thousands)	March 31, 2014	March 31, 2013
Beginning balance, January 1	$14,045	$20,171
Accretion of income	(771)	(1,611)
Other activity, net	(257)	(110)
Ending balance	$13,017	$18,450

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5. ALLOWANCE FOR LOAN LOSS

The allowance for loan losses is established as losses are estimated to have occurred through a provision charged to operations. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level which, in management's opinion, is adequate to absorb credit losses inherent in the portfolio. The Company utilizes both peer group analysis, as well as a historical analysis of the Company's portfolio to validate the overall adequacy of the allowance for loan losses. In addition to these objective criteria, the Company subjectively assesses the adequacy of the allowance for loan losses with consideration given to current economic conditions, changes to loan policies, the volume and type of lending, composition of the portfolio, the level of classified and criticized credits, seasoning of the loan portfolio, payment status and other factors.

A summary of changes in the allowance for loan losses, by loan portfolio category, for the three months ended March 31, 2014 and 2013 is as follows:

	Three Months Ended March 31, 2014			
(in thousands)	Commercial	Construction	Consumer	Mortgage