EAGLE BANCORP INC
Form 10-Q
May 10, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2018

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 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland	52-2061461
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7830 Old Georgetown Road, Third Floor, Bethesda, Maryland	20814
(Address of principal executive offices)	(Zip Code)

(301) 986-1800

(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company”) in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Accelerated filer
Non-accelerated filer (Do not mark if a smaller reporting company)
Smaller Reporting Company
Emerging Growth Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act

Yes No

As of April 30, 2018, the registrant had 34,306,285 shares of Common Stock outstanding.

EAGLE BANCORP, INC.

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Item 1 – Financial Statements (Unaudited)

EAGLE BANCORP, INC.

Consolidated Balance Sheets (Unaudited)

(dollars in thousands, except per share data)

Assets	March 31, 2018	December 31, 2017
Cash and due from banks	$7,954	$7,445
Federal funds sold	29,552	15,767
Interest bearing deposits with banks and other short-term investments	167,347	167,261
Investment securities available-for-sale, at fair value	578,317	589,268
Federal Reserve and Federal Home Loan Bank stock	34,768	36,324
Loans held for sale	25,873	25,096
Loans	6,602,526	6,411,528
Less allowance for credit losses	(65,807)	(64,758)
Loans, net	6,536,719	6,346,770
Premises and equipment, net	19,808	20,991
Deferred income taxes	30,203	28,770
Bank owned life insurance	61,291	60,947
Intangible assets, net	107,097	107,212
Other real estate owned	1,394	1,394
Other assets	97,737	71,784
Total Assets	$7,698,060	$7,479,029
Liabilities and Shareholders’ Equity		
Liabilities		
Deposits:		
Noninterest bearing demand	$1,909,210	$1,982,912
Interest bearing transaction	366,986	420,417
Savings and money market	2,767,721	2,621,146
Time, $100,000 or more	598,307	515,682
Other time	479,577	313,827
Total deposits	6,121,801	5,853,984
Customer repurchase agreements	48,365	76,561
Other short-term borrowings	275,000	325,000
Long-term borrowings	217,003	216,905
Other liabilities	50,711	56,141
Total Liabilities	6,712,880	6,528,591
Shareholders’ Equity		

Common stock, par value $.01 per share; shares authorized 100,000,000, shares issued and outstanding 34,303,056 and 34,185,163, respectively	341	340
Additional paid in capital	522,316	520,304
Retained earnings	467,933	431,544
Accumulated other comprehensive loss	(5,410)	(1,750)
Total Shareholders' Equity	985,180	950,438
Total Liabilities and Shareholders' Equity	$7,698,060	$7,479,029

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Operations (Unaudited)

(dollars in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
Interest Income		
Interest and fees on loans	$ 84,430	$ 72,471
Interest and dividends on investment securities	3,592	2,833
Interest on balances with other banks and short-term investments	981	483
Interest on federal funds sold	46	7
Total interest income	89,049	75,794
Interest Expense		
Interest on deposits	9,129	5,830
Interest on customer repurchase agreements	50	38
Interest on short-term borrowings	1,111	53
Interest on long-term borrowings	2,979	2,979
Total interest expense	13,269	8,900
Net Interest Income	75,780	66,894
Provision for Credit Losses	1,969	1,397
Net Interest Income After Provision For Credit Losses	73,811	65,497
Noninterest Income		
Service charges on deposits	1,614	1,472
Gain on sale of loans	1,523	2,048
Gain on sale of investment securities	42	505
Increase in the cash surrender value of bank owned life insurance	344	367
Other income	1,781	1,678
Total noninterest income	5,304	6,070
Noninterest Expense		
Salaries and employee benefits	16,858	16,677
Premises and equipment expenses	3,929	3,847
Marketing and advertising	937	894
Data processing	2,317	2,041
Legal, accounting and professional fees	2,973	1,002
FDIC insurance	675	544
Other expenses	3,432	4,227
Total noninterest expense	31,121	29,232
Income Before Income Tax Expense	47,994	42,335
Income Tax Expense	12,279	15,318
Net Income	$ 35,715	$ 27,017
Earnings Per Common Share		
Basic	$ 1.04	$ 0.79

Diluted	$ 1.04	$ 0.79

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Comprehensive Income (Unaudited)

(dollars in thousands)

	Three Months Ended March 31,	
	2018	2017
Net Income	$ 35,715	$ 27,017
Other comprehensive income, net of tax:		
Unrealized (loss) gain on securities available for sale	(5,123)	712
Reclassification adjustment for net gains included in net income	(31)	(322)
Total unrealized loss on investment securities	(5,154)	390
Unrealized gain on derivatives	2,233	1,079
Reclassification adjustment for amounts included in net income	(65)	(369)
Total unrealized gain on derivatives	2,168	710
Other comprehensive (loss) income	(2,986)	1,100
Comprehensive Income	$ 32,729	$ 28,117

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(dollars in thousands except share data)

	Common Shares	Amount	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance January 1, 2018	34,185,163	$ 340	$ 520,304	$ 431,544	$ (1,750)	$ 950,438
Net Income	—	—	—	35,715	—	35,715
Other comprehensive loss, net of tax	—	—	—	—	(2,986)	(2,986)
Stock-based compensation expense	—	—	1,476	—	—	1,476
Issuance of common stock related to options exercised, net of shares withheld for payroll taxes	32,230	—	338	—	—	338
Vesting of time based stock awards issued at date of grant, net of shares withheld for payroll taxes	(12,106)	1	(1)	—	—	—
Time based stock awards granted	94,344	—	—	—	—	—
Issuance of common stock related to employee stock purchase plan	3,425	—	199	—	—	199
Reclassification of the income tax effects of the Tax Cuts and Jobs Act from AOCI (ASU 2018-02)	—	—	—	674	(674)	—
Balance March 31, 2018	34,303,056	$ 341	$ 522,316	$ 467,933	$ (5,410)	$ 985,180
Balance January 1, 2017	34,023,850	$ 338	$ 513,531	$ 331,311	$ (2,381)	$ 842,799
Net Income	—	—	—	27,017	—	27,017
Other comprehensive income, net of tax	—	—	—	—	1,100	1,100
Stock-based compensation expense	—	—	1,856	—	—	1,856
Issuance of common stock related to options exercised, net of shares withheld for payroll taxes	2,675	—	66	—	—	66
Vesting of time based stock awards issued at date of grant, net of shares withheld for payroll taxes	(11,788)	1	(2)	—	—	(1)
Time based stock awards granted	91,097	—	—	—	—	—
Issuance of common stock related to employee stock purchase plan	4,222	—	205	—	—	205
Balance March 31, 2017	34,110,056	$ 339	$ 515,656	$ 358,328	$ (1,281)	$ 873,042

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Three Months Ended March 31,	
	2018	2017
Cash Flows From Operating Activities:		
Net Income	$ 35,715	$ 27,017
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	1,969	1,397
Depreciation and amortization	1,811	1,772
Gains on sale of loans	(1,523)	(2,048)
Securities premium amortization (discount accretion), net	1,087	1,006
Origination of loans held for sale	(102,316)	(153,995)
Proceeds from sale of loans held for sale	103,062	178,105
Net increase in cash surrender value of BOLI	(344)	(367)
(Increase) decrease deferred income tax benefit	(1,433)	17
Net loss on sale of other real estate owned	—	361
Net gain on sale of investment securities	(42)	(505)
Stock-based compensation expense	1,476	1,856
Net tax benefits from stock compensation	108	589
Increase in other assets	(25,519)	(594)
(Decrease) increase in other liabilities	(5,430)	7,478
Net cash provided by operating activities	8,621	62,089
Cash Flows From Investing Activities:		
Purchases of available for sale investment securities	(32,269)	(35,183)
Proceeds from maturities of available for sale securities	21,249	22,922
Proceeds from sale/call of available for sale securities	17,266	51,161
Purchases of Federal Reserve and Federal Home Loan Bank stock	(28,322)	(8,275)
Proceeds from redemption of Federal Reserve and Federal Home Loan Bank stock	29,878	4,302
Net increase in loans	(191,918)	(147,618)
Proceeds from sale of other real estate owned	—	939
Bank premises and equipment acquired	(283)	(1,248)
Net cash used in investing activities	(184,399)	(113,000)
Cash Flows From Financing Activities:		
Increase in deposits	267,817	73,375
(Decrease) increase in customer repurchase agreements	(28,196)	13,284
(Decrease) increase in short-term borrowings	(50,000)	75,000
Proceeds from exercise of equity compensation plans	338	66
Proceeds from employee stock purchase plan	199	205
Net cash provided by financing activities	190,158	161,930
Net Increase In Cash and Cash Equivalents	14,380	111,019
Cash and Cash Equivalents at Beginning of Period	190,473	368,163
Cash and Cash Equivalents at End of Period	$ 204,853	$ 479,182

Supplemental Cash Flows Information:		
Interest paid	$ 15,352	$ 11,517
Income taxes paid	$ 16,500	$ 6,000
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$ —	$ —
Transfers from other real estate owned to loans	$ —	$ —

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the “Company”), EagleBank (the “Bank”), Eagle Commercial Ventures, LLC (“ECV”), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The Consolidated Financial Statements of the Company included herein are unaudited. The Consolidated Financial Statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2017 were derived from audited Consolidated Financial Statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company’s Accounting Policies as disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited Consolidated Financial Statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Northern Virginia, Suburban Maryland, and Washington, D.C. The primary financial services offered by the Bank include real estate,

commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans, the origination of small business loans, and the origination, securitization and sale of multifamily FHA loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration ("SBA"), is typically sold to third party investors in a transaction apart from the loan's origination. The Bank offers its products and services through twenty banking offices, five lending centers and various electronic capabilities, including remote deposit services and mobile banking services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, has provided subordinated financing for the acquisition, development and construction of real estate projects; these transactions involve higher levels of risk, together with commensurate higher returns.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

New Authoritative Accounting Guidance

Accounting Standards Adopted in 2018

ASU 2014-09, *"Revenue from Contracts with Customers (Topic 606)."* The amendments in ASU 2014-09 supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. The general principle of the amendments require an entity to recognize revenue upon 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 sets forth a five step approach to be utilized for revenue recognition. The Company completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including deposit related fees, interchange fees, and merchant income. Based on this assessment, the Company concluded that ASU 2014-09 did not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on its evaluation, the Company did not identify revenue streams within the scope of ASC 606 that required a material change in their presentation under the gross vs. net requirement of ASC 606. The Company adopted ASU 2014-09 and its related amendments on its required effective date of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts.

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The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, derivatives and investment securities, as well as revenue related to our mortgage servicing activities, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Substantially all of the Company’s revenue is generated from contracts with customers. Descriptions of our revenue-generating activities that are within the scope of ASC 606, which are presented in our income statements as components of noninterest income are as follows:

Service charges on deposit accounts - these represent general service fees for monthly account maintenance and activity- or transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

Other Fees – generally, the Company receives compensation when a customer that it refers opens an account with certain third-parties. This category includes credit card, investment advisory, and interchange fees. The timing and amount of revenue recognition is not materially impacted by the new standard.

Sale of OREO – ASU 2014-09 prescribes derecognition requirements for the sale of OREO that are less prescriptive than existing derecognition requirements. Previously, the Company was required to assess 1) the adequacy of a buyer’s initial and continuing investments and 2) the seller’s continuing involvement with the property. ASU 2014-09 requires an entity to assess whether it is “probable” that it will collect the consideration to which it will be entitled in exchange for transferring the asset to the customer. The new requirements could result in earlier revenue recognition; however, such sales are infrequent and the impact of this change is not expected to be material to our financial statements.

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity’s obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company’s noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals based on fee schedules. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not have contract balances material to our financial statements. As of March 31, 2018 and December 31, 2017, the Company did not have any significant contract balances.

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition cost.

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ASU 2016-01, "*Financial Instruments—(Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.*" ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 was effective for us effective January 1, 2018 and did not have a material impact on our Consolidated Financial Statements. Refer to Note 12 for the valuation of the loan portfolio using the exit price notion.

ASU 2016-15 *"Statement of Cash Flows (Topic 230)"* is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. ASU 2016-15 became effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2017-12, *"Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities"*. ASU 2017-12 amends the hedge accounting recognition and presentation requirements in ASC 815 to improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities to better align the entity's financial reporting for hedging relationships with those risk management activities and to reduce the complexity of and simplify the application of hedge accounting. The Company early adopted ASU 2017-12 effective January 1, 2018. The new standard did not have a material impact to our Consolidated Financial Statements.

ASU 2018-02, "*Income Statement - Reporting Comprehensive Income (Topic 220)- Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*". ASU 2018-02 allows a reclassification from accumulated other comprehensive income (loss) ("AOCI") to retained earnings for the stranded tax effects caused by the revaluation of deferred taxes resulting from the newly enacted corporate tax rate in the Tax Cuts and Jobs Act of 2017. The ASU is effective in years beginning after December 15, 2018, but permits early adoption in a period for which financial

statements have not yet been issued. We have elected to early adopt the ASU as of January 1, 2018. The adoption of the guidance resulted in a $674 thousand cumulative-effect adjustment, done on a portfolio basis, to reclassify the income tax effects resulting from tax reform from AOCI to retained earnings. The adjustment increased retained earnings and decreased AOCI in the first quarter of 2018.

Accounting Standards Pending Adoption

ASU 2016-02, *"Leases (Topic 842)."* Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): (1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company is currently evaluating the provisions of ASU 2016-02, researching software to aid in the transition to the new leasing guidance, and will be closely monitoring developments and additional guidance to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

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ASU 2016-13, *"Measurement of Credit Losses on Financial Instruments (Topic 326)."* This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for us beginning on January 1, 2020; early adoption is permitted for us beginning on January 1, 2019. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). We have substantially concluded our data gap analysis and have contracted with a third party to develop a model to comply with CECL requirements. We have established a steering committee with representation from various departments across the enterprise. The committee has agreed to a project plan and we have regular meetings to ensure adherence to our implementation timeline. The Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

ASU 2017-04, "*Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment".* ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for us on January 1, 2020, with early adoption permitted for interim or annual impairment tests beginning in 2017, and is not expected to have a significant impact on our consolidated financial statements. We expect to implement ASU 2017-04 prior to 2018 year-end.

Note 2. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2018, the Bank maintained balances at the Federal Reserve sufficient to meet reserve requirements, as well as significant excess reserves, on which interest is paid.

Additionally, the Bank maintains interest bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with domestic correspondent banks as compensation for services they provide to the Bank.

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Note 3. Investment Securities Available-for-Sale

Amortized cost and estimated fair value of securities available-for-sale are summarized as follows:

March 31, 2018 (dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U. S. agency securities	$ 196,210	$ 130	$ 4,249	$ 192,091
Residential mortgage backed securities	337,362	113	8,235	329,240
Municipal bonds	48,577	642	614	48,605
Corporate bonds	8,004	159	—	8,163
Other equity investments	218	—	—	218
	$ 590,371	$ 1,044	$ 13,098	$ 578,317

December 31, 2017 (dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U. S. agency securities	$ 198,115	$ 283	$ 2,414	$ 195,984
Residential mortgage backed securities	322,067	187	4,418	317,836
Municipal bonds	60,976	1,295	214	62,057
Corporate bonds	13,010	163	—	13,173
Other equity investments	218	—	—	218
	$ 594,386	$ 1,928	$ 7,046	$ 589,268

In addition, at March 31, 2018 and December 31, 2017 the Company held $34.8 million and $36.3 million, respectively, in equity securities in a combination of Federal Reserve Bank (“FRB”) and Federal Home Loan Bank (“FHLB”) stocks, which are required to be held for regulatory purposes and which are not marketable, and therefore are carried at cost.

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Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in a continuous unrealized loss position are as follows:

		Less than 12 Months Estimated		12 Months or Greater Estimated		Total Estimated	
March 31, 2018	Number of	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
(dollars in thousands)	Securities	Value	Losses	Value	Losses	Value	Losses
U. S. agency securities	44	$113,476	$ 2,469	$54,634	$ 1,780	$168,110	$ 4,249
Residential mortgage backed securities	148	159,464	3,326	146,174	4,909	305,638	8,235
Municipal bonds	13	23,180	614	—	—	23,180	614
	205	$296,120	$ 6,409	$200,808	$ 6,689	$496,928	$ 13,098

		Less than 12 Months Estimated		12 Months or Greater Estimated		Total Estimated	
December 31, 2017	Number of	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
(dollars in thousands)	Securities	Value	Losses	Value	Losses	Value	Losses
U. S. agency securities	38	$102,264	$ 1,073	$55,093	$ 1,341	$157,357	$ 2,414
Residential mortgage backed securities	137	152,350	1,306	147,953	3,112	300,303	4,418
Municipal bonds	8	17,446	214	—	—	17,446	214
	183	$272,060	$ 2,593	$203,046	$ 4,453	$475,106	$ 7,046

The unrealized losses that exist are generally the result of changes in market interest rates and interest spread relationships since original purchases. The weighted average duration of debt securities, which comprise 99.9% of total investment securities, is relatively short at 3.8 years. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. The Company does not believe that the investment securities that were in an unrealized loss position as of March 31, 2018 represent an other-than-temporary impairment. The Company does not intend to sell the investments and it is more likely than not that the Company will not have to sell the securities before recovery of its amortized cost basis, which may be at maturity.

The amortized cost and estimated fair value of investments available-for-sale at March 31, 2018 and December 31, 2017 by contractual maturity are shown in the table below. Expected maturities for residential mortgage backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2018		December 31, 2017	
(dollars in thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
U. S. agency securities maturing:				
One year or less	$111,940	$108,886	$109,893	$108,198
After one year through five years	70,523	69,917	74,106	73,916
Five years through ten years	13,747	13,288	14,116	13,870
Residential mortgage backed securities	337,362	329,240	322,067	317,836
Municipal bonds maturing:				
One year or less	5,078	5,139	5,068	5,171
After one year through five years	19,366	19,654	19,405	19,879
Five years through ten years	23,064	22,686	35,432	35,846
After ten years	1,069	1,126	1,071	1,161
Corporate bonds maturing:				
After one year through five years	6,504	6,663	11,510	11,673
After ten years	1,500	1,500	1,500	1,500
Other equity investments	218	218	218	218
	$590,371	$578,317	$594,386	$589,268

For the three months ended March 31, 2018, gross realized gains on sales of investments securities were $67 thousand and gross realized losses on sales of investment securities were $25 thousand. For the year ended December 31, 2017, gross realized gains on sales of investment securities were $796 thousand and gross realized losses on sales of investment securities were $254 thousand.

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Proceeds from sales and calls of investment securities for the three months ended March 31, 2018 were $17.3 million compared to $51.2 million for the same period in 2017.

The carrying value of securities pledged as collateral for certain government deposits, securities sold under agreements to repurchase, and certain lines of credit with correspondent banks at March 31, 2018 and December 31, 2017 was $454.8 million and $465.4 million, respectively, which is well in excess of required amounts in order to operationally provide significant reserve amounts for new business. As of March 31, 2018 and December 31, 2017, there were no holdings of securities of any one issuer, other than the U.S. Government and U.S. agency securities, which exceeded ten percent of shareholders' equity.

Note 4. Mortgage Banking Derivative

As part of its mortgage banking activities, the Bank enters into interest rate lock commitments, which are commitments to originate loans where the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Bank then locks in the loan and interest rate with an investor and commits to deliver the loan if settlement occurs ("best efforts") or commits to deliver the locked loan in a binding ("mandatory") delivery program with an investor. Certain loans under interest rate lock commitments are covered under forward sales contracts of mortgage backed securities ("MBS"). Forward sales contracts of MBS are recorded at fair value with changes in fair value recorded in noninterest income. Interest rate lock commitments and commitments to deliver loans to investors are considered derivatives. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Bank determines the fair value of interest rate lock commitments and delivery contracts by measuring the fair value of the underlying asset, which is impacted by current interest rates, taking into consideration the probability that the interest rate lock commitments will close or will be funded.

Certain additional risks arise from these forward delivery contracts in that the counterparties to the contracts may not be able to meet the terms of the contracts. The Bank does not expect any counterparty to any MBS to fail to meet its obligation. Additional risks inherent in mandatory delivery programs include the risk that, if the Bank does not close the loans subject to interest rate risk lock commitments, it will still be obligated to deliver MBS to the counterparty under the forward sales agreement. Should this be required, the Bank could incur significant costs in acquiring replacement loans or MBS and such costs could have an adverse effect on mortgage banking operations.

The fair value of the mortgage banking derivatives is recorded as a freestanding asset or liability with the change in value being recognized in current earnings during the period of change.

At March 31, 2018 the Bank had mortgage banking derivative financial instruments with a notional value of $55.3 million related to its forward contracts as compared to $37.1 million at December 31, 2017. The fair value of these mortgage banking derivative instruments at March 31, 2018 was $51 thousand included in other assets and $84 thousand included in other liabilities as compared to $43 thousand included in other assets and $10 thousand included in other liabilities at December 31, 2017.

Included in other noninterest income for the three months ended March 31, 2018 was a net loss of $87 thousand, relating to mortgage banking derivative instruments as compared to a net gain of $290 thousand as of March 31, 2017. The amount included in other noninterest income for the three months ended March 31, 2018 pertaining to its mortgage banking hedging activities was a net realized gain of $91 thousand as compared to a net realized loss of $845 thousand as of March 31, 2017.

Note 5. Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily in the Washington, D.C. metropolitan area and surrounding communities. A substantial portion of the Bank's loan portfolio consists of loans to businesses secured by real estate and other business assets.

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Loans, net of unamortized net deferred fees, at March 31, 2018 and December 31, 2017 are summarized by type as follows:

	March 31, 2018		December 31, 2017	
(dollars in thousands)	Amount	%	Amount	%
Commercial	$1,426,042	22 %	$1,375,939	21 %
Income producing - commercial real estate	3,137,498	47 %	3,047,094	48 %
Owner occupied - commercial real estate	800,747	12 %	755,444	12 %
Real estate mortgage - residential	103,932	2 %	104,357	2 %
Construction - commercial and residential	1,000,266	15 %	973,141	15 %
Construction - C&I (owner occupied)	40,547	1 %	58,691	1 %
Home equity	90,271	1 %	93,264	1 %
Other consumer	3,223	—	3,598	—
Total loans	6,602,526	100 %	6,411,528	100 %
Less: allowance for credit losses	(65,807)		(64,758)	
Net loans	$6,536,719		$6,346,770	

Unamortized net deferred fees amounted to $24.3 million and $23.9 million at March 31, 2018 and December 31, 2017, respectively.

As of March 31, 2018 and December 31, 2017, the Bank serviced $208.7 million and $195.3 million, respectively, of multifamily FHA loans, SBA loans and other loan participations which are not reflected as loan balances on the Consolidated Balance Sheets.

Loan Origination / Risk Management

The Company’s goal is to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include: carefully enforcing loan policies and procedures, evaluating each borrower’s business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for loan repayment, and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.

The composition of the Company’s loan portfolio is heavily weighted toward commercial real estate, both owner occupied and income producing real estate. At March 31, 2018, owner occupied - commercial real estate and

construction - C&I (owner occupied) represent approximately 13% of the loan portfolio. At March 31, 2018, non-owner occupied commercial real estate and real estate construction represented approximately 62% of the loan portfolio. The combined owner occupied and commercial real estate loans represent approximately 75% of the loan portfolio. These loans are underwritten to mitigate lending risks typical of this type of loan such as declines in real estate values, changes in borrower cash flow and general economic conditions. The Bank typically requires a maximum loan to value of 80% and minimum cash flow debt service coverage of 1.15 to 1.0. Personal guarantees may be required, but may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

The Company is also an active traditional commercial lender providing loans for a variety of purposes, including working capital, equipment and account receivable financing. This loan category represents approximately 22% of the loan portfolio at March 31, 2018 and was generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited. SBA loans represent approximately 2% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the unguaranteed portion of the credit. The Company generally sells the guaranteed portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans are subject to a maximum loan size established by the SBA as well as internal loan size guidelines.

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Approximately 1% of the loan portfolio at March 31, 2018 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a small portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

Approximately 2% of the loan portfolio consists of residential mortgage loans. The repricing duration of these loans was 19 months. These credits represent first liens on residential property loans originated by the Bank. While the Bank's general practice is to originate and sell (servicing released) loans made by its Residential Lending department, from time to time certain loan characteristics do not meet the requirements of third party investors and these loans are instead maintained in the Bank's portfolio until they are resold to another investor at a later date or mature.

Loans are secured primarily by duly recorded first deeds of trust or mortgages. In some cases, the Bank may accept a recorded junior trust position. In general, borrowers will have a proven ability to build, lease, manage and/or sell a commercial or residential project and demonstrate satisfactory financial condition. Additionally, an equity contribution toward the project is customarily required.

Construction loans require that the financial condition and experience of the general contractor and major subcontractors be satisfactory to the Bank. Guaranteed, fixed price contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for larger scale projects.

Loans intended for residential land acquisition, lot development and construction are made on the premise that the land: 1) is or will be developed for building sites for residential structures, and; 2) will ultimately be utilized for construction or improvement of residential zoned real properties, including the creation of housing. Residential development and construction loans will finance projects such as single family subdivisions, planned unit developments, townhouses, and condominiums. Residential land acquisition, development and construction loans generally are underwritten with a maximum term of 36 months, including extensions approved at origination.

Commercial land acquisition and construction loans are secured by real property where loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner user commercial properties. Borrowers are generally required to put equity into each project at levels determined by the appropriate Loan Committee. Commercial land acquisition and construction loans generally are underwritten with a maximum term of 24 months.

Substantially all construction draw requests must be presented in writing on American Institute of Architects documents and certified either by the contractor, the borrower and/or the borrower's architect. Each draw request shall also include the borrower's soft cost breakdown certified by the borrower or their Chief Financial Officer. Prior to an advance, the Bank or its contractor inspects the project to determine that the work has been completed, to justify the

draw requisition.

Commercial permanent loans are generally secured by improved real property which is generating income in the normal course of operation. Debt service coverage, assuming stabilized occupancy, must be satisfactory to support a permanent loan. The debt service coverage ratio is ordinarily at least 1.15 to 1.0. As part of the underwriting process, debt service coverage ratios are stress tested assuming a 200 basis point increase in interest rates from their current levels.

Commercial permanent loans generally are underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

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The Company’s loan portfolio includes ADC real estate loans including both investment and owner occupied projects. ADC loans amounted to $1.43 billion at March 31, 2018. A portion of the ADC portfolio, both speculative and non-speculative, includes loan funded interest reserves at origination. ADC loans that provide for the use of interest reserves represent approximately 81% of the outstanding ADC loan portfolio at March 31, 2018. The decision to establish a loan-funded interest reserve is made upon origination of the ADC loan and is based upon a number of factors considered during underwriting of the credit including: (1) the feasibility of the project; (2) the experience of the sponsor; (3) the creditworthiness of the borrower and guarantors; (4) borrower equity contribution; and (5) the level of collateral protection. When appropriate, an interest reserve provides an effective means of addressing the cash flow characteristics of a properly underwritten ADC loan. The Company does not significantly utilize interest reserves in other loan products. The Company recognizes that one of the risks inherent in the use of interest reserves is the potential masking of underlying problems with the project and/or the borrower’s ability to repay the loan. In order to mitigate this inherent risk, the Company employs a series of reporting and monitoring mechanisms on all ADC loans, whether or not an interest reserve is provided, including: (1) construction and development timelines which are monitored on an ongoing basis which track the progress of a given project to the timeline projected at origination; (2) a construction loan administration department independent of the lending function; (3) third party independent construction loan inspection reports; (4) monthly interest reserve monitoring reports detailing the balance of the interest reserves approved at origination and the days of interest carry represented by the reserve balances as compared to the then current anticipated time to completion and/or sale of speculative projects; and (5) quarterly commercial real estate construction meetings among senior Company management, which includes monitoring of current and projected real estate market conditions. If a project has not performed as expected, it is not the customary practice of the Company to increase loan funded interest reserves.

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The following tables detail activity in the allowance for credit losses by portfolio segment for the three months ended March 31, 2018 and 2017. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(dollars in thousands)	Commercial	Income Producing - Commercial Real Estate	Owner Occupied - Commercial Real Estate	Real Estate Mortgage Residential	Construction - Commercial and Residential	Home Equity	Other Consumer	Total
Three months ended March 31, 2018								
Allowance for credit losses:								
Balance at beginning of period	$ 13,102	$ 25,376	$ 5,934	$ 944	$ 18,492	$ 770	$ 140	$ 64,758
Loans charged-off	(853)	(121)	(132)	—	—	—	—	(1,106)
Recoveries of loans previously charged-off	3	—	1	2	60	117	3	186
Net loans (charged-off) recoveries	(850)	(121)	(131)	2	60	117	3	(920)
Provision for credit losses	1,106	1,213	(332)	(212)	190	(188)	192	1,969
Ending balance	$ 13,358	$ 26,468	$ 5,471	$ 734	$ 18,742	$ 699	$ 335	$ 65,807
As of March 31, 2018								
Allowance for credit losses:								
Individually evaluated for impairment	$ 3,014	$ 2,628	$ 500	$ —	$ 500	$ —	$ 80	$ 6,722
Collectively evaluated for impairment	10,344	23,840	4,971	734	18,242	699	255	59,085
Ending balance	$ 13,358	$ 26,468	$ 5,471	$ 734	$ 18,742	$ 699	$ 335	$ 65,807
Three months ended March 31, 2017								
Allowance for credit losses:								
Balance at beginning of period	$ 14,700	$ 21,105	$ 4,010	$ 1,284	$ 16,487	$ 1,328	$ 160	$ 59,074
Loans charged-off	(137)	(500)	—	—	—	—	(63)	(700)
Recoveries of loans previously charged-off	13	50	1	2	3	1	7	77
Net loans (charged-off) recoveries	(124)	(450)	1	2	3	1	(56)	(623)
Provision for credit losses	7	729	15	(180)	866	(241)	201	1,397

Ending balance	$ 14,583	$ 21,384	$ 4,026	$ 1,106	$ 17,356	$1,088	$ 305	$59,848
As of March 31, 2017								
Allowance for credit losses:								
Individually evaluated for impairment	$ 3,030	$ 1,488	$ 350	$ —	$ 350	$—	$ 50	$5,268
Collectively evaluated for impairment	11,553	19,896	3,676	1,106	17,006	1,088	255	54,580
Ending balance	$ 14,583	$ 21,384	$ 4,026	$ 1,106	$ 17,356	$1,088	$ 305	$59,848

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The Company’s recorded investments in loans as of March 31, 2018 and December 31, 2017 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company’s impairment methodology was as follows:

(dollars in thousands)	Commercial	Income Producing - Commercial Real Estate	Owner Occupied - Commercial Real Estate	Real Estate Mortgage Residential	Construction - Commercial and Residential	Home Equity	Other Consumer	Total
March 31, 2018								
Recorded investment in loans:								
Individually evaluated for impairment	$ 15,468	$ 9,394	$ 7,771	$ 1,451	$ 4,707	$ 494	$ 91	$ 39,376
Collectively evaluated for impairment	1,410,574	3,128,104	792,976	102,481	1,036,106	89,777	3,132	6,563,150
Ending balance	$ 1,426,042	$ 3,137,498	$ 800,747	$ 103,932	$ 1,040,813	$ 90,271	$ 3,223	$ 6,602,526
December 31, 2017								
Recorded investment in loans:								
Individually evaluated for impairment	$ 8,726	$ 10,192	$ 5,501	$ 478	$ 4,709	$ 494	$ 91	$ 30,191
Collectively evaluated for impairment	1,367,213	3,036,902	749,943	103,879	1,027,123	92,770	3,507	6,381,337
Ending balance	$ 1,375,939	$ 3,047,094	$ 755,444	$ 104,357	$ 1,031,832	$ 93,264	$ 3,598	$ 6,411,528

At March 31, 2018, nonperforming loans acquired from Fidelity & Trust Financial Corporation (“Fidelity”) and Virginia Heritage Bank (“Virginia Heritage”) have a carrying value of $321 thousand and $452 thousand, and an unpaid principal balance of $379 thousand and $1.5 million, respectively, and were evaluated separately in accordance with ASC Topic 310-30, *“Loans and Debt Securities Acquired with Deteriorated Credit Quality*.” At December 31, 2017, nonperforming loans acquired from Fidelity and Virginia Heritage had a carrying value of $297 thousand and $479 thousand, respectively, and an unpaid principal balance of $347 thousand and $1.5 million, respectively, and were evaluated separately in accordance with ASC Topic 310-30. The various impaired loans were recorded at estimated fair value with any excess being charged-off or treated as a non-accretable discount. Subsequent downward adjustments to the valuation of impaired loans acquired will result in additional loan loss provisions and related

allowance for credit losses.

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Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company's primary credit quality indicators are to use an internal credit risk rating system that categorizes loans into pass, watch, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company's credit quality indicators:

Pass:	Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
Watch:	Loan paying as agreed with generally acceptable asset quality; however the obligor's performance has not met expectations. Balance sheet and/or income statement has shown deterioration to the point that the obligor could not sustain any further setbacks. Credit is expected to be strengthened through improved obligor performance and/or additional collateral within a reasonable period of time.
Special Mention:	Loans in the classes that comprise the commercial portfolio segment that have potential weaknesses that deserve management's close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan. The special mention credit quality indicator is not used for classes of loans that comprise the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans that are considered special mention.
Classified:	Classified (a) Substandard - Loans inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Classified (b) Doubtful - Loans that have all the weaknesses inherent in a loan 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. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

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The Company’s credit quality indicators are updated generally on a quarterly basis, but no less frequently than annually. The following table presents by class and by credit quality indicator, the recorded investment in the Company’s loans and leases as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	Pass	Watch and Special Mention	Substandard	Doubtful	Total Loans
March 31, 2018					
Commercial	$1,381,816	$ 28,758	$ 15,468	$ —	$1,426,042
Income producing – commercial real estate	3,123,614	4,490	9,394	—	3,137,498
Owner occupied – commercial real estate	756,551	36,425	7,771	—	800,747
Real estate mortgage – residential	101,831	650	1,451	—	103,932
Construction – commercial and residential	1,036,106	—	4,707	—	1,040,813
Home equity	89,091	686	494	—	90,271
Other consumer	3,131	1	91	—	3,223
Total	$6,492,140	$ 71,010	$ 39,376	$ —	$6,602,526
December 31, 2017					
Commercial	$1,333,050	$ 34,163	$ 8,726	$ —	$1,375,939
Income producing – commercial real estate	3,033,046	3,856	10,192	—	3,047,094
Owner occupied – commercial real estate	696,754	53,189	5,501	—	755,444
Real estate mortgage – residential	103,220	659	478	—	104,357
Construction – commercial and residential	1,027,123	—	4,709	—	1,031,832
Home equity	92,084	686	494	—	93,264
Other consumer	3,505	2	91	—	3,598
Total	$6,288,782	$ 92,555	$ 30,191	$ —	$6,411,528

Nonaccrual and Past Due Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management’s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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The following table presents, by class of loan, information related to nonaccrual loans as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	March 31, 2018	December 31, 2017
Commercial	$3,595	$ 3,493
Income producing - commercial real estate	50	832
Owner occupied - commercial real estate	5,361	5,501
Real estate mortgage - residential	1,745	775
Construction - commercial and residential	2,051	2,052
Home equity	494	494
Other consumer	91	91
Total nonaccrual loans (1)(2)	$13,387	$ 13,238

(1) Excludes troubled debt restructurings (“TDRs”) that were performing under their restructured terms totaling $11.5 million at March 31, 2018 and $12.3 million at December 31, 2017.

(2) Gross interest income of $205 thousand and $304 thousand would have been recorded for the three months ended March 31, 2018 and 2017, respectively, if nonaccrual loans shown above had been current and in accordance with their original terms, while the interest actually recorded on such loans was zero and $90 thousand for the three months ended March 31, 2018 and 2017, respectively. See Note 1 to the Consolidated Financial Statements for a description of the Company’s policy for placing loans on nonaccrual status.

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The following table presents, by class of loan, an aging analysis and the recorded investments in loans past due as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Recorded Investment in Loans
March 31, 2018						
Commercial	$6,179	$1,209	$3,595	$10,983	$1,415,059	$1,426,042
Income producing – commercial real estate	13,452	4,562	50	18,064	3,119,434	3,137,498
Owner occupied – commercial real estate	3,336	1,105	5,361	9,802	790,945	800,747
Real estate mortgage – residential	6,590	—	1,745	8,335	95,597	103,932
Construction – commercial and residential	—	5,268	2,051	7,319	1,033,494	1,040,813
Home equity	—	90	494	584	89,687	90,271
Other consumer	5	17	91	113	3,110	3,223
Total	$29,562	$12,251	$13,387	$55,200	$6,547,326	$6,602,526
December 31, 2017						
Commercial	$2,705	$748	$3,493	$6,946	$1,368,993	$1,375,939
Income producing – commercial real estate	4,398	6,930	832	12,160	3,034,934	3,047,094
Owner occupied – commercial real estate	522	3,906	5,501	9,929	745,515	755,444
Real estate mortgage – residential	6,993	1,244	775	9,012	95,345	104,357
Construction – commercial and residential	—	5,268	2,052	7,320	1,024,512	1,031,832
Home equity	307	—	494	801	92,463	93,264
Other consumer	45	6	91	142	3,456	3,598
Total	$14,970	$18,102	$13,238	$46,310	$6,365,218	$6,411,528

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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The following table presents, by class of loan, information related to impaired loans for the periods ended March 31, 2018 and March 31, 2017.

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment Quarter To Date	Average Recorded Investment Year To Date	Interest Income Recognized Quarter To Date	Interest Income Recognized Year To Date
March 31, 2018									
Commercial	$ 4,944	$ 1,132	$ 3,693	$ 4,825	$ 3,014	$ 5,175	$ 5,175	$ 20	$ 20
Income producing – commercial real estate	9,248	—	9,248	9,248	2,628	9,646	9,646	120	120
Owner occupied – commercial real estate	6,432	5,650	782	6,432	500	6,514	6,514	11	11
Real estate mortgage – residential	1,745	1,745	—	1,745	—	1,260	1,260	—	—
Construction – commercial and residential	2,051	1,533	518	2,051	500	2,052	2,052	—	—
Home equity	494	494	—	494	—	494	494	—	—
Other consumer	91	—	91	91	80	91	91	—	—
Total	$ 25,005	$ 10,554	$ 14,332	$ 24,886	$ 6,722	$ 25,232	$ 25,232	$ 151	$ 151
March 31, 2017									
Commercial	$ 8,249	$ 2,843	$ 2,737	$ 5,580	$ 3,030	$ 5,604	$ 5,604	$ 42	$ 42
Income producing – commercial real estate	10,019	702	9,317	10,019	1,488	12,478	12,478	48	48
Owner occupied – commercial real estate	2,998	2,207	791	2,998	350	2,741	2,741	—	—
Real estate mortgage – residential	310	310	—	310	—	433	433	—	—
Construction – commercial and residential	3,255	2,717	538	3,255	350	2,664	2,664	—	—
Other consumer	94	—	94	94	50	110	110	—	—
Total	$ 24,925	$ 8,779	$ 13,477	$ 22,256	$ 5,268	$ 24,030	$ 24,030	$ 90	$ 90

Modifications

A modification of a loan constitutes a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying a loan. Commercial and

industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Construction loans modified in a TDR may also involve extending the interest-only payment period. As of March 31, 2018, all performing TDRs were categorized as interest-only modifications.

Loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance associated with the loan. An allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

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The following table presents by class, the recorded investment of loans modified in TDRs held by the Company during the three months ended March 31, 2018 and 2017.

	For the Three Months Ended March 31, 2018					
(dollars in thousands)	Number of Contracts	Commercial	Income Producing - Commercial Real Estate	Owner Occupied - Commercial Real Estate	Construction - Commercial Real Estate	Total
Troubled debt restructings						
Restructured accruing	8	$ 1,230	$ 9,198	$ 1,071	$ —	$11,499
Restructured nonaccruing	5	1,649	—	—	—	1,649
Total	13	$ 2,879	$ 9,198	$ 1,071	$ —	$13,148
Specific allowance		$ 595	$ 2,350	$ —	$ —	$2,945
Restructured and subsequently defaulted		$ —	$ 121	$ —	$ —	$121

	For the Three Months Ended March 31, 2017					
(dollars in thousands)	Number of Contracts	Commercial	Income Producing - Commercial Real Estate	Owner Occupied - Commercial Real Estate	Construction - Commercial Real Estate	Total
Troubled debt restructings						
Restructured accruing	7	$ 3,137	$ 4,397	$ 367	$ —	$7,901
Restructured non-accruing	2	193	—	—	702	895
Total	9	$ 3,330	$ 4,397	$ 367	$ 702	$8,796
Specific allowance		$ 855	$ 1,100	$ —	$ —	$1,955
Restructured and subsequently defaulted		$ 237	$ —	$ —	$ —	$237

The Company had thirteen TDR's at March 31, 2018 totaling approximately $13.1 million. Eight of these loans totaling approximately $11.5 million, are performing under their modified terms. During the three months of 2018, there was one default on a $121 thousand restructured loan which was charged off, as compared to the same period in 2017, which had one default on a $237 thousand restructured loan. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. There was one performing TDR totaling $786 thousand that was reclassified to nonperforming loans during the three months ended March 31, 2018, as compared to the same period in 2017, which had no performing TDRs reclassified to nonperforming loans. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were no loans modified in a TDR during the three months ended March 31, 2018 and 2017.

Note 6. Interest Rate Swap Derivatives

The Company uses interest rate swap agreements to assist in its interest rate risk management. The Company's objective in using interest rate derivatives designated as cash flow hedges is to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company entered into forward starting interest rate swaps in April 2015 as part of its interest rate risk management strategy intended to mitigate the potential risk of rising interest rates on the Bank's cost of funds. The notional amounts of the interest rate swaps designated as cash flow hedges do not represent amounts exchanged by the counterparties, but rather, the notional amount is used to determine, along with other terms of the derivative, the amounts to be exchanged between the counterparties. The interest rate swaps are designated as cash flow hedges and involve the receipt of variable rate amounts from two counterparties in exchange for the Company making fixed payments beginning in April 2016. The Company's intent is to hedge its exposure to the variability in potential future interest rate conditions on existing financial instruments.

As of March 31, 2018, the Company had three forward starting designated cash flow hedge interest rate swap transactions outstanding that had an aggregate notional amount of $250 million associated with the Company's variable rate deposits. The net unrealized gain before income tax on the swaps was $4.8 million at March 31, 2018 compared to a net unrealized gain before income tax of $2.3 million at December 31, 2017. The gain in value since year end 2017 is due to the increase in expected net cash inflows from the swap over its remaining term due to higher market interest rates.

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For derivatives designated as cash flow hedges, changes in the fair value of the derivative are initially reported in other comprehensive income (outside of earnings), net of tax, and subsequently reclassified to earnings when the hedged transaction affects earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions.

Amounts reported in accumulated other comprehensive income related to designated cash flow hedge derivatives will be reclassified to interest income/expense as interest payments are made/received on the Company’s variable-rate assets/liabilities. During the quarter ended March 31, 2018, the Company reclassified $88 thousand related to designated cash flow hedge derivatives from accumulated other comprehensive income to interest expense. During the next twelve months, the Company estimates (based on existing interest rates) that $923 thousand will be reclassified as a decrease in interest expense.

The Company is exposed to credit risk in the event of nonperformance by the interest rate swap counterparty. The Company minimizes this risk by entering into derivative contracts with only large, stable financial institutions, and the Company has not experienced, and does not expect, any losses from counterparty nonperformance on the interest rate swaps. The Company monitors counterparty risk in accordance with the provisions of ASC Topic 815, *“Derivatives and Hedging.”* In addition, the interest rate swap agreements contain language outlining collateral-pledging requirements for each counterparty. Collateral must be posted when the market value exceeds certain threshold limits.

The designated cash flow hedge interest rate swap agreements detail: 1) that collateral be posted when the market value exceeds certain threshold limits associated with the secured party’s exposure; 2) if the Company defaults on any of its indebtedness (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; 3) if the Company fails to maintain its status as a well capitalized institution then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

As of March 31, 2018, the aggregate fair value of all designated cash flow hedge derivative contracts with credit risk contingent features (i.e., those containing collateral posting or termination provisions based on our capital status) that were in a net asset position totaled $4.8 million (none of these contracts were in a net liability position as of March 31, 2018). The Company has minimum collateral posting thresholds with certain of its derivative counterparties. As of March 31, 2018, the Company was not required to post collateral with its derivative counterparties against its obligations under these agreements because these agreements were in a net asset position. If the Company had breached any provisions under the agreements at March 31, 2018, it could have been required to settle its obligations under the agreements at the termination value.

The table below identifies the balance sheet category and fair values of the Company’s designated cash flow hedge derivative instruments as of March 31, 2018 and December 31, 2017.

		March 31, 2018			December 31, 2017		
	Swap Number	Notional Amount	Fair Value	Balance Sheet Category	Notional Amount	Fair Value	Balance Sheet Category
(dollars in thousands)							
Interest rate swap	(1)	$75,000	$1,070	Other Assets	$75,000	$598	Other Assets
Interest rate swap	(2)	100,000	1,775	Other Assets	100,000	821	Other Assets
Interest rate swap	(3)	75,000	1,943	Other Assets	75,000	837	Other Assets
	Total	$250,000	$4,788		$250,000	$2,256	

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The table below presents the pre-tax net gains (losses) of the Company's cash flow hedges for the three months ended March 31, 2018 and 2017.

		Three Months Ended March 31, 2018			Three Months Ended March 31, 2017		
			Reclassified from AOCI into Income			Reclassified from AOCI into Income	
(dollars in thousands)	Swap Number	Amount of Pre-tax gain (loss) Recognized in OCI	Category	Amount of Gain (Loss)	Amount of Pre-tax gain (loss) Recognized in OCI	Category	Amount of Gain (Loss)
Interest rate swap	(1)	$471	Interest Expense	$ (1)	$100	Interest Expense	$ (154)
Interest rate swap	(2)	907	Interest Expense	(47)	35	Interest Expense	(231)
Interest rate swap	(3)	1,065	Interest Expense	(40)	328	Interest Expense	(193)
	Total	$2,443		$ (88)	$463		$ (578)

The table below presents the effect of the Company's derivative financial instruments on the Consolidated Statements of Operations at March 31, 2018 and 2017.

	Location and Amount of Gain or (Loss) Recognized in Income on Cash Flow Hedging Relationships			
	Three Months Ended March 31, 2018		**Three Months Ended March 31, 2017**	
(dollars in thousands)	**Interest Income (Expense)**	**Other Income (Expense)**	**Interest Income (Expense)**	**Other Income (Expense)**
Total amounts of income and expense line items presented in the Consolidated Statements of Operations in which the effects of cash flow hedges are recorded	$(88)	$ —	$(578)	$ —
The effects of cash flow hedging:				
Gain or (loss) on cash flow hedging relationships in Subtopic 815-20				
Interest contracts				

Amount of gain or (loss) reclassified from accumulated other comprehensive income into income	$(88)	$ —	$(578)	$ —

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Balance Sheet Offsetting: Our designated cash flow hedge interest rate swap derivatives are eligible for offset in the Consolidated Balance Sheets and are subject to master netting arrangements. Our derivative transactions with counterparties are generally executed under International Swaps and Derivative Association ("ISDA") master agreements which include "right of set-off" provisions. In such cases there is generally a legally enforceable right to offset recognized amounts and there may be an intention to settle such amounts on a net basis. The Company generally offsets such financial instruments for financial reporting purposes. The table below presents a gross presentation, the effects of offsetting, and a net presentation of the Company's cash flow hedge derivatives as of March 31, 2018 and December 31, 2017.

Three Months Ended March 31, 2018
Offsetting of Derivative Assets **(dollars in thousands)**

				Gross Amounts Not Offset in the Balance Sheet		
	Gross Amounts of Recognized Assets	**Gross Amounts Offset in the Balance Sheet**	**Net Amounts of Assets presented in the Balance Sheet**	**Financial Instruments**	**Cash Collateral Posted**	**Net Amount**
Counterparty 1	$3,706	$—	$3,706	$—	$—	$3,706
Counterparty 2	1,073	—	1,073	—	—	1,073
	$4,779	$—	$4,779	$—	$—	$4,779

Year Ended December 31, 2017
Offsetting of Derivative Assets **(dollars in thousands)**

				Gross Amounts Not Offset in the Balance Sheet		
	Gross Amounts of Recognized Liabilities	**Gross Amounts Offset in the Balance Sheet**	**Net Amounts of Liabilities presented in the Balance Sheet**	**Financial Instruments**	**Cash Collateral Posted**	**Net Amount**
Counterparty 1	$1,619	$—	$1,619	$—	$—	$1,619
Counterparty 2	582	—	582	—	—	582
	$2,201	$—	$2,201	$—	$—	$2,201

Note 7. Other Real Estate Owned

The activity within Other Real Estate Owned ("OREO") for the three months ended March 31, 2018 and the year ended December 31, 2017 is presented in the table below. There was one residential real estate loan in the process of foreclosure as of March 31, 2018 totaling $999 thousand. There were no residential real estate loans in the process of foreclosure as of March 31, 2017. For the three months ended March 31, 2018, there were no sales of OREO property, as compared to March 31, 2017 which had one sale for a net loss of $361 thousand with proceeds of $939 thousand.

(dollars in thousands)	Three Months Ended March 31, 2018	Year Ended December 31, 2017
Balance at January 1,	$ 1,394	$ 2,694
Real estate acquired from borrowers	—	1,145
Valuation allowance	—	—
Properties sold	—	(2,445)
Ending balance	$ 1,394	$ 1,394

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Note 8. Long-Term Borrowings

The following table presents information related to the Company's long-term borrowings as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	March 31, 2018	December 31, 2017
Subordinated Notes, 5.75%	$70,000	$70,000
Subordinated Notes, 5.0%	150,000	150,000
Less: debt issuance costs	(2,997)	(3,095)
Long-term borrowings	$217,003	$216,905

On August 5, 2014, the Company completed the sale of $70.0 million of its 5.75% subordinated notes, due September 1, 2024 (the "2024 Notes"). The 2024 Notes were offered to the public at par and qualify as Tier 2 capital for regulatory purposes to the fullest extent permitted under the Basel III Rule capital requirements. The net proceeds were approximately $68.8 million, which includes $1.2 million in deferred financing costs which are being amortized over the life of the 2024 Notes.

On July 26, 2016, the Company completed the sale of $150.0 million of its 5.00% Fixed-to-Floating Rate Subordinated Notes, due August 1, 2026 (the "2026 Notes"). The 2026 Notes were offered to the public at par and qualify as Tier 2 capital for regulatory purposes to the fullest extent permitted under the Basel III Rule capital requirements. The net proceeds were approximately $147.35 million, which includes $2.6 million in deferred financing costs which are being amortized over the life of the 2026 Notes.

Note 9. Net Income per Common Share

The calculation of net income per common share for the three months ended March 31, 2018 and 2017 was as follows.

	Three Months Ended March 31,	
(dollars and shares in thousands, except per share data)	2018	2017
Basic:		
Net income available to common shareholders	$35,715	$27,017

Average common shares outstanding	34,261	34,070
Basic net income per common share	$1.04	$0.79
Diluted:		
Net income available to common shareholders	$35,715	$27,017
Average common shares outstanding	34,261	34,070
Adjustment for common share equivalents	145	214
Average common shares outstanding-diluted	34,406	34,284
Diluted net income per common share	$1.04	$0.79
Anti-dilutive shares	—	7

Note 10. Stock-Based Compensation

The Company maintains the 2016 Stock Plan (“2016 Plan”), the 2006 Stock Plan (“2006 Plan”) and the 2011 Employee Stock Purchase Plan (“2011 ESPP”).

In connection with the acquisition of Virginia Heritage, the Company assumed the Virginia Heritage 2006 Stock Option Plan and the 2010 Long Term Incentive Plan (the “Virginia Heritage Plans”).

No additional options may be granted under the 2006 Plan or the Virginia Heritage Plans.

The Company adopted the 2016 Plan upon approval by the shareholders at the 2016 Annual Meeting held on May 12, 2016. The 2016 Plan provides directors and selected employees of the Bank, the Company and their affiliates with the opportunity to acquire shares of stock, through awards of options, time vested restricted stock, performance-based restricted stock and stock appreciation rights. Under the 2016 Plan, 1,000,000 shares of common stock were initially reserved for issuance.

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For awards that are service based, compensation expense is being recognized over the service (vesting) period based on fair value, which for stock option grants is computed using the Black-Scholes model. For restricted stock awards granted under the 2016 plan, fair value is based on the Company's closing price on the date of grant. For awards that are performance-based, compensation expense is recorded based on the probability of achievement of the goals underlying the grant. For restricted stock awards granted under the 2006 plan, fair value is based on the average of the high and low stock price of the Company's shares on the date of grant.

In February 2018, the Company awarded 94,344 shares of time vested restricted stock to senior officers, directors, and certain employees. The shares vest in three substantially equal installments beginning on the first anniversary of the date of grant.

In February 2018, the Company awarded senior officers a targeted number of 42,533 performance vested restricted stock units (PRSUs). The vesting of PRSUs is 100% after three years with payouts based on threshold, target or maximum average performance targets over the three year period relative to a peer index. There are two performance metrics: 1) average annual earnings per share growth; and 2) average annual return on average assets. Each metric is measured against companies in the KBW Regional Banking Index.

The Company has unvested restricted stock awards and PRSU grants of 274,796 shares at March 31, 2018. Unrecognized stock based compensation expense related to restricted stock awards and PRSU grants totaled $13.5 million at March 31, 2018. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 2.33 years.

The following tables summarize the unvested restricted stock awards activity for the three months ended March 31, 2018 and 2017.

	Three Months Ended March 31,			
	2018		2017	
Perfomance Awards	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Unvested at beginning	62,338	$ 50.45	33,226	$ 42.60
Issued	42,533	60.45	36,523	57.49
Forfeited	(5,913)	50.28	—	—
Vested	—	—	—	—
Unvested at end	98,958	$ 54.76	69,749	$ 50.40

	Three Months Ended March 31,			
	2018		2017	
Time Vested Awards	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Unvested at beginning	164,043	$ 53.57	262,966	$ 33.60
Issued	94,344	60.45	91,097	62.70
Forfeited	(5,165)	55.60	(371)	42.93
Vested	(77,384)	49.67	(176,134)	28.73
Unvested at end	175,838	$ 58.92	177,558	$ 53.34

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Below is a summary of stock option activity for the three months ended March 31, 2018 and 2017. The information excludes restricted stock units and awards.

	Three Months Ended March 31,			
	2018		2017	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Beginning balance	143,224	$ 9.13	216,859	$ 8.80
Issued	—	—	—	—
Exercised	(32,230)	10.48	(2,675)	24.67
Forfeited	(500)	24.86	—	—
Expired	—	—	—	—
Ending balance	110,494	$ 8.67	214,184	$ 8.60

The following summarizes information about stock options outstanding at March 31, 2018. The information excludes restricted stock units and awards.

Outstanding:		Stock Options	Weighted-Average	Weighted-Average Remaining
Range of Exercise Prices		Outstanding	Exercise Price	Contractual Life
$5.76	$10.72	97,995	$ 5.76	0.78
$10.73	$11.40	5,089	11.17	3.63
$11.41	$24.86	660	20.03	4.82
$24.87	$49.91	6,750	47.83	7.87
		110,494	$ 8.67	1.36

Exercisable:		Stock Options	Weighted-Average
Range of Exercise Prices		Exercisable	Exercise Price
$5.76	$10.72	80,646	$ 5.76
$10.73	$11.40	5,089	11.17
$11.41	$24.86	660	20.03
$24.87	$49.91	2,000	47.62
		88,395	$ 7.13

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions as shown in the table below used for grants during the years ended December 31, 2017 and 2016. There were no grants of stock options during the three months ended March 31, 2018.

	Three Months Ended March 31, 2018	Years Ended December 31, 2017	2016
Expected volatility	n/a	n/a	24.23%
Weighted-Average volatility	n/a	n/a	24.23%
Expected dividends	—	—	—
Expected term (in years)	n/a	n/a	7.0
Risk-free rate	n/a	n/a	1.37 %
Weighted-average fair value (grant date)	n/a	n/a	$14.27

The total intrinsic value of outstanding stock options was $5.7 million and $11.0 million, respectively, at March 31, 2018 and 2017. The total intrinsic value of stock options exercised during the three months ended March 31, 2018 and 2017 was $1.6 million and $103 thousand. The total fair value of stock options vested was $34 thousand for both the three months ended March 31, 2018 and 2017. Unrecognized stock-based compensation expense related to stock options totaled $57 thousand at March 31, 2018. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 1.76 years.

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Approved by shareholders in May 2011, the 2011 ESPP reserved 550,000 shares of common stock (as adjusted for stock dividends) for issuance to employees. Whole shares are sold to participants in the plan at 85% of the lower of the stock price at the beginning or end of each quarterly offering period. The 2011 ESPP is available to all eligible employees who have completed at least one year of continuous employment, work at least 20 hours per week and at least five months a year. Participants may contribute a minimum of $10 per pay period to a maximum of $6,250 per offering period or $25,000 annually (not to exceed more than 10% of compensation per pay period). At March 31, 2018, the 2011 ESPP had 399,383 shares reserved for issuance.

Included in salaries and employee benefits in the accompanying Consolidated Statements of Operations, the Company recognized $1.5 million and $1.9 million in stock-based compensation expense for the three months ended March 31, 2018 and 2017, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

Note 11. Other Comprehensive Income

The following table presents the components of other comprehensive income (loss) for the three months ended March 31, 2018 and 2017.

(dollars in thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended March 31, 2018			
Net unrealized loss on securities available-for-sale	$(6,221)	$1,098	$(5,123)
Less: Reclassification adjustment for net gains included in net income	(42)	(11)	(31)
Total unrealized loss	(6,263)	1,087	(5,154)
Net unrealized gain on derivatives	2,607	374	2,233
Less: Reclassification adjustment for losses included in net income	(88)	(23)	(65)
Total unrealized gain	2,519	351	2,168
Other Comprehensive Loss	$(3,744)	$1,438	$(2,986)
Three Months Ended March 31, 2017			
Net unrealized gain on securities available-for-sale	$1,165	$453	$712
Less: Reclassification adjustment for net gains included in net income	(505)	(183)	(322)
Total unrealized gain	660	270	390
Net unrealized gain on derivatives	1,752	673	1,079
Less: Reclassification adjustment for losses included in net income	(578)	(209)	(369)
Total unrealized gain	1,174	464	710

Other Comprehensive Income	$1,834	$734	$1,100

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The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended March 31, 2018 and 2017.

(dollars in thousands)	Securities Available For Sale	Derivatives	Accumulated Other Comprehensive Income (Loss)
Three Months Ended March 31, 2018			
Balance at Beginning of Period	$ (3,131)	$ 1,381	$ (1,750)
Other comprehensive income (loss) before reclassifications	(5,123)	2,233	(2,890)
Amounts reclassified from accumulated other comprehensive income (loss)	(31)	(65)	(96)
Total other comprehensive income (loss)	(5,154)	2,168	(2,986)
Reclassification of the Income Tax Effects of the Tax Cuts and Jobs Act from AOCI	(674)	—	(674)
Balance at End of Period	$ (8,959)	$ 3,549	$ (5,410)
Three Months Ended March 31, 2017			
Balance at Beginning of Period	$ (1,955)	$ (426)	$ (2,381)
Other comprehensive income before reclassifications	712	1,079	1,791
Amounts reclassified from accumulated other comprehensive income	(322)	(369)	(691)
Total other comprehensive income	390	710	1,100
Balance at End of Period	$ (1,565)	$ 284	$ (1,281)

The following table presents the amounts reclassified out of each component of accumulated other comprehensive (loss) income for the three months ended March 31, 2018 and 2017.

Details about Accumulated Other Comprehensive Income Components (dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive (Loss) Income		Affected Line Item in the Statement Where Net Income is Presented
	March 31, 2018	**March 31, 2017**	
Realized gain on sale of investment securities	$42	$505	Gain on sale of investment securities
Interest expense derivative deposits	(88)	(578)	Interest expense on deposits
	12	26	Tax expense
Total Reclassifications for the Period	$(34)	$(47)	Net Income

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Note 12. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, *"Fair Value Measurements and Disclosures,"* establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1	Quoted prices in active exchange markets for identical assets or liabilities; also includes certain U.S. Treasury and other U.S. Government and agency securities actively traded in over-the-counter markets.
Level 2	Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data; also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency securities, corporate debt securities, derivative instruments, and residential mortgage loans held for sale.
Level 3	Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data. This category generally includes certain private equity investments, retained interests from securitizations, and certain collateralized debt obligations.

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Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of March 31, 2018 and December 31, 2017.

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
March 31, 2018				
Assets:				
Investment securities available for sale:				
U. S. agency securities	$ —	$ 192,091	$ —	$ 192,091
Residential mortgage backed securities	—	329,240	—	329,240
Municipal bonds	—	48,605	—	48,605
Corporate bonds	—	6,663	1,500	8,163
Other equity investments	—	—	218	218
Loans held for sale	—	25,873	—	25,873
Mortgage banking derivatives	—	—	51	51
Interest rate swap derivatives	—	4,788	—	4,788
Total assets measured at fair value on a recurring basis as of March 31, 2018	$ —	$ 607,260	$ 1,769	$ 609,029
Liabilities:				
Mortgage banking derivatives	$ —	$ —	$ 84	$ 84
Interest rate swap derivatives	—	13	—	13
Total liabilities measured at fair value on a recurring basis as of March 31, 2018	$ —	$ 13	$ 84	$ 97
December 31, 2017				
Assets:				
Investment securities available for sale:				
U. S. agency securities	$ —	$ 195,984	$ —	$ 195,984
Residential mortgage backed securities	—	317,836	—	317,836
Municipal bonds	—	62,057	—	62,057
Corporate bonds	—	11,673	1,500	13,173
Other equity investments	—	—	218	218
Loans held for sale	—	25,096	—	25,096
Mortgage banking derivatives	—	—	43	43
Interest rate swap derivatives	—	2,256	—	2,256
Total assets measured at fair value on a recurring basis as of December 31, 2017	$ —	$ 614,902	$ 1,761	$ 616,663

Liabilities:				
Mortgage banking derivatives	$ —	$ —	$ 10	$ 10
Interest rate swap derivatives	—	—	—	—
Total liabilities measured at fair value on a recurring basis as of December 31, 2017	$ —	$ —	$ 10	$ 10

Investment Securities Available-for-Sale: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include U.S. agency debt securities, mortgage backed securities issued by Government Sponsored Entities ("GSE's") and municipal bonds. Securities classified as Level 3 include securities in less liquid markets, the carrying amounts approximate the fair value.

Loans held for sale: The Company has elected to carry loans held for sale at fair value. This election reduces certain timing differences in the Consolidated Statement of Operations and better aligns with the management of the portfolio from a business perspective. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of residential mortgage loans are recorded as a component of noninterest income in the Consolidated Statements of Operations. Gains and losses on sales of multifamily FHA securities are recorded as a component of noninterest income in the Consolidated Statements of Operations. As such, the Company classifies loans subjected to fair value adjustments as Level 2 valuation.

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The following table summarizes the difference between the aggregate fair value and the aggregate unpaid principal balance for loans held for sale measured at fair value as of March 31, 2018 and December 31, 2017.

	March 31, 2018		
(dollars in thousands)	Fair Value	Aggregate Unpaid Principal Balance	Difference
Residential mortgage loans held for sale	$25,873	$ 25,469	$ 404
FHA mortgage loans held for sale	$—	$ —	$ —

	December 31, 2017		
(dollars in thousands)	Fair Value	Aggregate Unpaid Principal Balance	Difference
Residential mortgage loans held for sale	$25,096	$ 24,674	$ 422
FHA mortgage loans held for sale	$—	$ —	$ —

No residential mortgage loans held for sale were 90 or more days past due or on nonaccrual status as of March 31, 2018 or December 31, 2017.

Interest rate swap derivatives: These derivative instruments consist of forward starting interest rate swap agreements, which are accounted for as cash flow hedges under ASC 815. The Company’s derivative position is classified within Level 2 of the fair value hierarchy and is valued using models generally accepted in the financial services industry and that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations. The fair value of the derivatives is determined using discounted cash flow models. These models’ key assumptions include the contractual terms of the respective contract along with significant observable inputs, including interest rates, yield curves, nonperformance risk and volatility. Derivative contracts are executed with a Credit Support Annex, which is a bilateral agreement that requires collateral postings when the market value exceeds certain threshold limits. These agreements protect the interests of the Company and its counterparties should either party suffer a credit rating deterioration.

Mortgage banking derivatives: The Company relies on a third-party pricing service to value its mortgage banking derivative financial assets and liabilities, which the Company classifies as a Level 3 valuation. The external valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale includes grouping the interest rate lock commitments by interest rate and terms, applying an estimated pull-through rate based on historical experience, and then multiplying by quoted investor prices determined to be

reasonably applicable to the loan commitment groups based on interest rate, terms, and rate lock expiration dates of the loan commitment groups. The Company also relies on an external valuation model to estimate the fair value of its forward commitments to sell residential mortgage loans (i.e., an estimate of what the Company would receive or pay to terminate the forward delivery contract based on market prices for similar financial instruments), which includes matching specific terms and maturities of the forward commitments against applicable investor pricing.

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The following is a reconciliation of activity for assets and liabilities measured at fair value based on Significant Other Unobservable Inputs (Level 3):

(dollars in thousands)	Investment Securities	Mortgage Banking Derivatives	Total
Assets:			
Beginning balance at January 1, 2018	$ 1,718	$ 43	$1,761
Realized loss included in earnings - net mortgage banking derivatives	—	8	8
Purchases of available-for-sale securities	—	—	—
Principal redemption	—	—	—
Ending balance at March 31, 2018	$ 1,718	$ 51	$1,769
Liabilities:			
Beginning balance at January 1, 2018	$ —	$ 10	$10
Realized loss included in earnings - net mortgage banking derivatives	—	74	74
Principal redemption	—	—	—
Ending balance at March 31, 2018	$ —	$ 84	$84

(dollars in thousands)	Investment Securities	Mortgage Banking Derivatives	Total
Assets:			
Beginning balance at January 1, 2017	$ 1,718	$ 114	$1,832
Realized loss included in earnings - net mortgage banking derivatives	—	(71)	(71)
Purchases of available-for-sale securities	—	—	—
Principal redemption	—	—	—
Ending balance at December 31, 2017	$ 1,718	$ 43	$1,761
Liabilities:			
Beginning balance at January 1, 2017	$ —	$ 55	$55
Realized loss included in earnings - net mortgage banking derivatives	—	(45)	(45)
Principal redemption	—	—	—
Ending balance at December 31, 2017	$ —	$ 10	$10

The other equity securities classified as Level 3 consist of equity investments in the form of common stock of two local banking companies which are not publicly traded, and for which the carrying amount approximates fair value.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company measures certain assets at fair value on a nonrecurring basis and the following is a general description of the methods used to value such assets.

Impaired loans: The Company does not record loans at fair value on a recurring basis; however, from time to time, a loan is considered impaired and an allowance for loan loss is established. The Company considers a loan impaired when it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the note agreement, including both principal and interest. Management has determined that nonaccrual loans and loans that have had their terms restructured in a troubled debt restructuring meet this impaired loan definition. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, *"Receivables."* The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At March 31, 2018, substantially all of the Company's impaired loans were evaluated based upon the fair value of the collateral. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3. For individually evaluated impaired loans, the amount of impairment is based upon the present value of expected future cash flows discounted at the loan's effective interest rate or the estimated fair value of the underlying collateral for collateral-dependent loans, which the Company classifies as a Level 3 valuation.

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Other real estate owned: Other real estate owned is initially recorded at fair value less estimated selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral, which the Company classifies as a Level 3 valuation. Assets measured at fair value on a nonrecurring basis are included in the table below:

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
March 31, 2018				
Impaired loans:				
Commercial	$ —	$ —	$ 1,811	$ 1,811
Income producing - commercial real estate	—	—	6,620	6,620
Owner occupied - commercial real estate	—	—	5,932	5,932
Real estate mortgage - residential	—	—	1,745	1,745
Construction - commercial and residential	—	—	1,551	1,551
Home equity	—	—	494	494
Other consumer	—	—	11	11
Other real estate owned	—	—	1,394	1,394
Total assets measured at fair value on a nonrecurring basis as of March 31, 2018	$ —	$ —	$ 19,558	$ 19,558

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
December 31, 2017				
Impaired loans:				
Commercial	$ —	$ —	$ 2,266	$ 2,266
Income producing - commercial real estate	—	—	7,664	7,664
Owner occupied - commercial real estate	—	—	5,214	5,214
Real estate mortgage - residential	—	—	775	775
Construction - commercial and residential	—	—	1,552	1,552
Home equity	—	—	494	494
Other consumer	—	—	11	11
Other real estate owned	—	—	1,394	1,394
Total assets measured at fair value on a nonrecurring basis as of December 31, 2017	$ —	$ —	$ 19,370	$ 19,370

Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by quoted market price, if one exists.

Quoted market prices, if available, are shown as estimates of fair value. Because no quoted market prices exist for a portion of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the net realizable value could be materially different from the estimates presented below. In addition, the estimates are only indicative of individual financial instrument values and should not be considered an indication of the fair value of the Company taken as a whole.

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The following methods and assumptions were used to estimate the fair value of each category of financial instrument for which it is practicable to estimate value:

Cash due from banks and federal funds sold: For cash and due from banks and federal funds sold the carrying amount approximates fair value.

Interest bearing deposits with other banks: For interest bearing deposits with other banks the carrying amount approximates fair value.

Investment securities: For these instruments, fair values are based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Federal Reserve and Federal Home Loan Bank stock: The carrying amounts approximate the fair values at the reporting date.

Loans held for sale: As the Company has elected the fair value option, the fair value of loans held for sale is the carrying value and is based on commitments outstanding from investors as well as what secondary markets are currently offering for portfolios with similar characteristics for residential mortgage loans held for sale since such loans are typically committed to be sold (servicing released) at a profit. The fair value of multifamily FHA loans held for sale is the carrying value and is based on commitments outstanding from investors as well as what secondary markets are currently offering for portfolios with similar characteristics for multifamily FHA loans held for sale since such loans are typically committed to be securitized and sold (servicing retained) at a profit.

Loans: The loan portfolio is valued using an exit price notion. The present value of cash flows projection is established for each loan in the portfolio projecting contractual payments, default adjusted payments, cash flows in the event of default (including deferred timing of recoveries), and pre-payments. These expected cash flows are then discounted to present value using the note interest rate and an established market rate which, if different from the note rate, allows the Bank to isolate the amount above or below par a potential acquirer would pay to acquire the Bank's portfolio.

Bank owned life insurance: The fair value of bank owned life insurance is the current cash surrender value, which is the carrying value.

Annuity investment: The fair value of the annuity investments is the carrying amount at the reporting date.

Mortgage banking derivatives: The Company enters into interest rate lock commitments with prospective residential mortgage borrowers. These commitments are carried at fair value based on the fair value of the underlying mortgage loans which are based on market data. These commitments are classified as Level 3 in the fair value disclosures, as the valuations are based on market unobservable inputs. The Company hedges the risk of the overall change in the fair value of loan commitments to borrowers by selling forward contracts on securities of GSEs. These forward settling contracts are classified as Level 3, as valuations are based on market unobservable inputs. See Note 4 to the Consolidated Financial Statements for additional detail.

Interest rate swap derivatives: These derivative instruments consist of forward starting interest rate swap agreements, which are accounted for as cash flow hedges. The Company's derivative position is classified within Level 2 of the fair value hierarchy and is valued using models generally accepted in the financial services industry and that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations. The fair value of the derivatives is determined using discounted cash flow models. These models' key assumptions include the contractual terms of the respective contract along with significant observable inputs, including interest rates, yield curves, nonperformance risk and volatility. Derivative contracts are executed with a Credit Support Annex, which is a bilateral ratings-sensitive agreement that requires collateral postings when the market value exceeds certain threshold limits. These agreements protect the interests of the Company and its counterparties should either party suffer a credit rating deterioration.

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Noninterest bearing deposits: The fair value of these deposits is the amount payable on demand at the reporting date, since generally accepted accounting standards do not permit an assumption of core deposit value.

Interest bearing deposits: The fair value of interest bearing transaction, savings, and money market deposits with no defined maturity is the amount payable on demand at the reporting date, since generally accepted accounting standards do not permit an assumption of core deposit value.

Certificates of deposit: The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits with remaining maturities would be accepted.

Customer repurchase agreements: The carrying amount approximate the fair values at the reporting date.

Borrowings: The carrying amount for variable rate borrowings approximate the fair values at the reporting date. The fair value of fixed rate FHLB advances and the subordinated notes are estimated by computing the discounted value of contractual cash flows payable at current interest rates for obligations with similar remaining terms. The fair value of variable rate FHLB advances is estimated to be carrying value since these liabilities are based on a spread to a current pricing index.

Off-balance sheet items: Management has reviewed the unfunded portion of commitments to extend credit, as well as standby and other letters of credit, and has determined that the fair value of such instruments is equal to the fee, if any, collected and unamortized for the commitment made.

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The estimated fair values of the Company’s financial instruments at March 31, 2018 and December 31, 2017 are as follows:

			Fair Value Measurements		
(dollars in thousands)	**Carrying Value**	**Fair Value**	**Quoted Prices (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
March 31, 2018					
Assets					
Cash and due from banks	$7,954	$7,954	$—	$ 7,954	$ —
Federal funds sold	29,552	29,552	—	29,552	—
Interest bearing deposits with other banks	167,347	167,347	—	167,347	—
Investment securities	578,317	578,317	—	576,599	1,718
Federal Reserve and Federal Home Loan Bank stock	34,768	34,768	—	34,768	—
Loans held for sale	25,873	25,873	—	25,873	—
Loans (1)	6,536,719	6,564,036	—	—	6,564,036
Bank owned life insurance	61,291	61,291	—	61,291	—
Annuity investment	11,463	11,463	—	11,463	—
Mortgage banking derivatives	51	51	—	—	51
Interst rate swap derivatives	4,788	4,788	—	4,788	—
Liabilities					
Noninterest bearing deposits	1,909,210	1,909,210	—	1,909,210	—
Interest bearing deposits	3,134,707	3,134,707	—	3,134,707	—
Certificates of deposit	1,077,884	1,074,200	—	1,074,200	—
Customer repurchase agreements	48,365	48,365	—	48,365	—
Borrowings	492,003	497,066	—	497,066	—
Mortgage banking derivatives	84	84	—	—	84
December 31, 2017					
Assets					
Cash and due from banks	$7,445	$7,445	$—	$ 7,445	$ —
Federal funds sold	15,767	15,767	—	15,767	—
Interest bearing deposits with other banks	167,261	167,261	—	167,261	—
Investment securities	589,268	589,268	—	587,550	1,718
Federal Reserve and Federal Home Loan Bank stock	36,324	36,324	—	36,324	—
Loans held for sale	25,096	25,096	—	25,096	—
Loans (2)	6,346,770	6,381,213	—	—	6,381,213
Bank owned life insurance	60,947	60,947	—	60,947	—
Annuity investment	11,632	11,632	—	11,632	—
Mortgage banking derivatives	43	43	—	—	43
Interst rate swap derivatives	2,256	2,256	—	2,256	—

Liabilities					
Noninterest bearing deposits	1,982,912	1,982,912	—	1,982,912	—
Interest bearing deposits	3,041,563	3,041,563	—	3,041,563	—
Certificates of deposit	829,509	829,886	—	829,886	—
Customer repurchase agreements	76,561	76,561	—	76,561	—
Borrowings	541,905	533,162	—	533,162	—
Mortgage banking derivatives	10	10	—	—	10

(1) Carrying amount is net of unearned income and the allowance for credit losses. In accordance with the prospective adoption of ASU No. 2016-01, the fair value of loans was measured using an exit price notion.

(2) Carrying amount is net of unearned income and the allowance for credit losses. The fair value of loans was measured using an entry price notion.

Note 13. Supplemental Executive Retirement Plan

The Bank has entered into Supplemental Executive Retirement and Death Benefit Agreements (the “SERP Agreements”) with certain of the Bank’s executive officers other than Mr. Paul, which upon the executive’s retirement, will provide for a stated monthly payment for such executive’s lifetime subject to certain death benefits described below. The retirement benefit is computed as a percentage of each executive’s projected average base salary over the five years preceding retirement, assuming retirement at age 67. The SERP Agreements provide that (a) the benefits vest ratably over six years of service to the Bank, with the executive receiving credit for years of service prior to entering into the SERP Agreement, (b) death, disability and change-in-control shall result in immediate vesting, and (c) the monthly amount will be reduced if retirement occurs earlier than age 67 for any reason other than death, disability or change-in-control. The SERP Agreements further provide for a death benefit in the event the retired executive dies prior to receiving 180 monthly installments, paid either in a lump sum payment or continued monthly installment payments, such that the executive’s beneficiary has received payment(s) sufficient to equate to a cumulative 180 monthly installments.

The SERP Agreements are unfunded arrangements maintained primarily to provide supplemental retirement benefits and comply with Section 409A of the Internal Revenue Code. The Bank financed the retirement benefits by purchasing fixed annuity contracts with four insurance carriers in 2013 totaling $11.4 million that have been designed to provide a future source of funds for the lifetime retirement benefits of the SERP Agreements. The primary impetus for utilizing fixed annuities is a substantial savings in compensation expenses for the Bank as opposed to a traditional SERP Agreement. For the quarter ended March 31, 2018, the annuity contracts accrued $27 thousand of income, which was included in other noninterest income on the Consolidated Statement of Operations. The cash surrender value of the annuity contracts was $11.5 million and $11.6 million at March 31, 2018 and December 31, 2017, respectively and is included in other assets on the Consolidated Balance Sheet. For the three months ended March 31, 2018 and 2017, the Company recorded benefit expense accruals of $100 thousand and $103 thousand for this post retirement benefit.

Upon death of a named executive, the annuity contract related to such executive terminates. The Bank has purchased additional bank owned life insurance contracts, which would effectively finance payments (up to a 15 year certain amount) to the executives’ named beneficiaries.

Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides information about the results of operations, and financial condition, liquidity, and capital resources of the Company and its subsidiaries as of the dates and periods indicated. This discussion and analysis should be read in conjunction with the unaudited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report and the Management Discussion and Analysis in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

This report contains forward looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In some cases, forward- looking statements can be identified by use of such words as “may,” “will,” “anticipate,” “believes,” “expects,” “plans,” “estimates,” “potential,” “continue,” “should,” and similar words or phrases. These statements are based upon current and anticipated economic conditions, nationally and in the Company’s market, interest rates and interest rate policy, competitive factors and other conditions, which by their nature are not susceptible to accurate forecast, and are subject to significant uncertainty. For details on factors that could affect these expectations, see the risk factors and other cautionary language included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 and in other periodic and current reports filed by the Company with the Securities and Exchange Commission. Because of these uncertainties and the assumptions on which this discussion and the forward-looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward looking statements.

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GENERAL

The Company is a growth-oriented, one-bank holding company headquartered in Bethesda, Maryland, which is currently celebrating twenty years of successful operations. The Company provides general commercial and consumer banking services through the Bank, its wholly owned banking subsidiary, a Maryland chartered bank which is a member of the Federal Reserve System. The Company was organized in October 1997, to be the holding company for the Bank. The Bank was organized in 1998 as an independent, community oriented, full service banking alternative to the super regional financial institutions, which dominate the Company's primary market area. The Company's philosophy is to provide superior, personalized service to its customers. The Company focuses on relationship banking, providing each customer with a number of services and becoming familiar with and addressing customer needs in a proactive, personalized fashion. The Bank currently has a total of twenty branch offices, including nine in Northern Virginia, six in Suburban Maryland, and five in Washington, D.C.

The Bank offers a broad range of commercial banking services to its business and professional clients as well as full service consumer banking services to individuals living and/or working primarily in the Bank's market area. The Bank emphasizes providing commercial banking services to sole proprietors, small and medium-sized businesses, non-profit organizations and associations, and investors living and working in and near the primary service area. These services include the usual deposit functions of commercial banks, including business and personal checking accounts, "NOW" accounts and money market and savings accounts, business, construction, and commercial loans, residential mortgages and consumer loans, and cash management services. The Bank is also active in the origination and sale of residential mortgage loans and the origination of SBA loans. The residential mortgage loans are originated for sale to third-party investors, generally large mortgage and banking companies, under best efforts and mandatory delivery commitments with the investors to purchase the loans subject to compliance with pre-established criteria. The Bank generally sells the guaranteed portion of the SBA loans in a transaction apart from the loan origination generating noninterest income from the gains on sale, as well as servicing income on the portion participated. The Company originates multifamily FHA loans through the Department of Housing and Urban Development's Multifamily Accelerated Program ("MAP"). The Company securitizes these loans through the Government National Mortgage Association ("Ginnie Mae") MBS I program and sells the resulting securities in the open market to authorized dealers in the normal course of business and generally retains the servicing rights. Bethesda Leasing, LLC, a subsidiary of the Bank, holds title to and manages other real estate owned ("OREO") assets. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Additionally, the Bank offers investment advisory services through referral programs with third parties.

CRITICAL ACCOUNTING POLICIES

The Company's Consolidated Financial Statements are prepared in accordance with GAAP and follow general practices within the banking industry. Application of these principles requires management to make estimates,

assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the Consolidated Financial Statements; accordingly, as this information changes, the Consolidated Financial Statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or a valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility.

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RESULTS OF OPERATIONS

Earnings Summary

For the three months ended March 31, 2018, the Company's net income was $35.7 million, a 32% increase over the $27.0 million for the three months ended March 31, 2017. Net income per basic common and diluted share for the three months ended March 31, 2018 was $1.04 compared to $0.79 for the same period in 2017, a 32% increase.

The increase in net income for the three months ended March 31, 2018 can be attributed primarily to an increase in total revenue (i.e. net interest income plus noninterest income) of 11% over the same period in 2017 and to the reduction in the federal corporate tax rate from 35% to 21% pursuant to The Tax Cuts and Jobs Act of 2017. Net interest income grew 13% for the three months ended March 31, 2018 as compared to the same period in 2017 due to average earning asset growth of 13%.

For the three months ended March 31, 2018, the Company reported an annualized Return on Average Assets ("ROAA") of 1.91% as compared to 1.62% for the three months ended March 31, 2017. The annualized Return on Average Common Equity ("ROACE") for the three months ended March 31, 2018 was 14.99% as compared to 12.74% for the three months ended March 31, 2017.

The net interest margin increased 3 basis points to 4.17% for the three months ended March 31, 2018 from 4.14% for the three months ended March 31, 2017. Average earning asset yields were 4.90% for the three months ended March 31, 2018 and 4.70% for the same period in 2017. The average cost of interest bearing liabilities increased by 29 basis points (to 1.18% from 0.89%) for the three months ended March 31, 2018 as compared to the same period in 2017. Combining the change in the yield on earning assets and the costs of interest bearing liabilities, the net interest spread decreased by 9 basis points for the three months ended March 31, 2018 as compared to 2017 (3.72% versus 3.81%).

The benefit of noninterest sources funding earning assets increased by 12 basis points to 45 basis points from 33 basis points for the three months ended March 31, 2018 versus the same period in 2017. The combination of a 9 basis point decrease in the net interest spread and a 12 basis point increase in the value of noninterest sources resulted in the 3 basis point increase in the net interest margin for the three months ended March 31, 2018 as compared to the same period in 2017.

The Company believes it has effectively managed its net interest margin and net interest income over the past twelve months as market interest rates (on average) have remained relatively low. This factor has been significant to overall earnings performance over the past twelve months as net interest income represents 93% of the Company's total revenue for the three months ended March 31, 2018.

For the first quarter of 2018, total loans grew 3% over December 31, 2017, and averaged 13% higher in the first three months of 2018 as compared to the first three months of 2017. For the first three months of 2018, total deposits increased 5% over December 31, 2017, and averaged 9% higher for the first three months of 2018 compared with the first three months of 2017.

In order to fund growth in average loans of 13% over the three months ended March 31, 2018 as compared to the same period in 2017, as well as sustain significant liquidity, the Company has relied on both core deposit growth and brokered or wholesale deposits. The major component of the growth in core deposits has been growth in noninterest bearing accounts primarily as a result of effectively building new and enhanced client relationships.

In terms of the average asset composition or mix, loans, which generally have higher yields than securities and other earning assets, represented 87.3% of average earning assets for both the first three months of 2018 and 2017. For the first three months of 2018, as compared to the same period in 2017, average loans, excluding loans held for sale, increased $728.5 million, a 13% increase, due primarily to growth in income producing - commercial real estate, commercial, and owner occupied- commercial real estate loans. The mix of average investment securities for both the three months ended March 31, 2018 and 2017 amounted to 8% of average earning assets. The combination of federal funds sold, interest bearing deposits with other banks and loans held for sale averaged 4% of average earning assets for the first three months of 2018 and 5% of average earning assets for the first three months of 2017. The average combination of federal funds sold, interest bearing deposits with other banks and loans held for sale increased $18.8 million for the three months ended March 31, 2018 as compared to the same period in 2017.

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The provision for credit losses was $2.0 million for the three months ended March 31, 2018 as compared to $1.4 million for the three months ended March 31, 2017. The higher provisioning in the first quarter of 2018, as compared to the first quarter of 2017, is due to higher loan growth coupled with higher net charge-offs. Net charge-offs of $920 thousand in the first quarter of 2018 represented an annualized 0.06% of average loans, excluding loans held for sale, as compared to $623 thousand, or an annualized 0.04% of average loans, excluding loans held for sale, in the first quarter of 2017. Net charge-offs in the first quarter of 2018 were attributable primarily to commercial loans ($981 thousand) and commercial real estate loans ($61 thousand) offset by a net recovery in consumer loans ($120 thousand).

At March 31, 2018 the allowance for credit losses represented 1.00% of loans outstanding, as compared to 1.01% at December 31, 2017 and 1.03% at March 31, 2017. The decrease in the allowance for credit losses as a percentage of total loans at March 31, 2018, as compared to March 31, 2017, is the result of loan growth. The allowance for credit losses represented 492% of nonperforming loans at March 31, 2018, as compared to and 489% at December 31, 2017 and 417% at March 31, 2017.

Total noninterest income for the three months ended March 31, 2018 decreased to $5.3 million from $6.1 million for the three months ended March 31, 2017, a 13% decrease, due substantially to lower net investment gains in the first quarter of 2018 as compared to 2017 and due to lower gains on the sale of residential mortgage loans ($1.4 million versus $2.0 million) resulting from lower volume. Residential mortgage loans closed were $100 million for the first quarter of 2018 versus $150 million for the first quarter of 2017. Net investment gains were $42 thousand for the three months ended March 31, 2018 compared to $505 thousand for the same period in 2017.

The efficiency ratio, which measures the ratio of noninterest expense to total revenue, was 38.38% for the first quarter of 2018, as compared to 40.06% for the first quarter of 2017. Noninterest expenses totaled $31.1 million for the three months ended March 31, 2018, as compared to $29.2 million for the three months ended March 31, 2017, a 6% increase. Cost increases for salaries and benefits were $181 thousand, due primarily to increased staff and merit increases. Data processing expense increased by $276 thousand due primarily to increased vendor fees associated with higher volumes and rates. Legal, accounting and professional fees increased $2.0 million, a significant portion of which was due to independent consulting and professional services associated with the internet event late in 2017. FDIC expenses increased $131 thousand due to a higher assessment base resulting from growth in total assets. Other expenses decreased $795 thousand, due primarily to a net loss on the sale of Other Real Estate Owned (“OREO”) in the first quarter of 2017 ($361 thousand), lower business development expenses ($172 thousand), and lower costs to maintain OREO properties pending sale ($90 thousand).

The ratio of common equity to total assets increased to 12.80% at March 31, 2018 from 12.31% at March 31, 2017, due primarily to an increase of $109.6 million in retained earnings. As discussed later in “Capital Resources and Adequacy,” the regulatory capital ratios of the Bank and Company remain above well capitalized levels.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investment securities. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings. Noninterest bearing deposits and capital are other components representing funding sources (refer to discussion above under Results of Operations). Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

For the three months ended March 31, 2018, net interest income increased 13% over the same period for 2017. Average loans increased by $728.5 million and average deposits increased by $508.6 million. The net interest margin was 4.17% for the three months ended March 31, 2018, as compared to 4.14% for the same period in 2017. The Company believes its net interest margin remains favorable as compared to its peer banking companies.

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The table below presents the average balances and rates of the major categories of the Company's assets and liabilities for the three months ended March 31, 2018 and 2017. Included in the table is a measurement of interest rate spread and margin. Interest rate spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest rate paid on interest bearing liabilities. While the interest rate spread provides a quick comparison of earnings rates versus cost of funds, management believes that margin provides a better measurement of performance. The net interest margin (as compared to net interest spread) includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

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Eagle Bancorp, Inc.

Consolidated Average Balances, Interest Yields And Rates (Unaudited)

(dollars in thousands)

	Three Months Ended March 31,							
	2018				2017			
	Average Balance	Interest	Average Yield/Rate		Average Balance	Interest	Average Yield/Rate	
ASSETS								
Interest earning assets:								
Interest bearing deposits with other banks and other short-term investments	$282,440	$981	1.41	%	$272,131	$483	0.72	%
Loans held for sale (1)	24,960	274	4.39	%	29,378	283	3.85	%
Loans (1) (2)	6,433,730	84,156	5.30	%	5,705,261	72,188	5.13	%
Investment securities available for sale (2)	614,064	3,592	2.37	%	526,210	2,833	2.18	%
Federal funds sold	18,341	46	1.02	%	5,397	7	0.53	%
Total interest earning assets	7,373,535	89,049	4.90	%	6,538,377	75,794	4.70	%
Total noninterest earning assets	289,333				293,094			
Less: allowance for credit losses	65,383				59,307			
Total noninterest earning assets	223,950				233,787			
TOTAL ASSETS	$7,597,485				$6,772,164			
LIABILITIES AND SHAREHOLDERS' EQUITY								
Interest bearing liabilities:								
Interest bearing transaction	$372,893	$464	0.50	%	$331,235	$237	0.29	%
Savings and money market	2,769,722	5,664	0.83	%	2,690,526	3,865	0.58	%
Time deposits	888,083	3,001	1.37	%	737,777	1,728	0.95	%
Total interest bearing deposits	4,030,698	9,129	0.92	%	3,759,538	5,830	0.63	%
Customer repurchase agreements	68,043	50	0.30	%	69,628	38	0.22	%
Other short-term borrowings	238,356	1,111	1.86	%	31,944	53	0.66	%
Long-term borrowings	216,970	2,979	5.49	%	216,571	2,979	5.50	%
Total interest bearing liabilities	4,554,067	13,269	1.18	%	4,077,681	8,900	0.89	%
Noninterest bearing liabilities:								
Noninterest bearing demand	2,032,319				1,794,864			
Other liabilities	44,514				39,840			
Total noninterest bearing liabilities	2,076,833				1,834,704			