

EAGLE BANCORP INC  
Form 10-K  
March 14, 2014

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

**For the fiscal year ended December 31, 2013**

**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**  
(State or other jurisdiction of  
incorporation or organization)

**52-2061461**  
(I.R.S. Employer Identification Number)

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

**20814**  
(Zip Code)

Registrant's telephone number, including area code: **(301) 986-1800**

Securities registered pursuant to Section 12(b) of the Act:

| <b>Title of class</b>          | <b>Name of each exchange on which registered</b> |
|--------------------------------|--|
| Common Stock, \$0.01 par value | The NASDAQ Capital Market                        |

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Section 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes  No

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

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the outstanding Common Stock held by nonaffiliates as of June 30, 2013 was approximately \$503.0 million.

As of March 12, 2014, the number of outstanding shares of the Common Stock, \$0.01 par value, of Eagle Bancorp, Inc. was 25,953,207.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 15, 2014 are incorporated by reference in part III hereof.

---

**EAGLE BANCORP, INC.  
ANNUAL REPORT ON FORM 10-K**

**TABLE OF CONTENTS**

|                          |   | <b>Page</b>       |
|--------------------------|---|-------------------|
| <b>Part I</b>            |   |                   |
| <u>Item 1.</u>           | <u>Business</u>   | <u>1</u>          |
| <u>Item 1A.</u>          | <u>Risk Factors</u>   | <u>19</u>         |
| <u>Item 1B.</u>          | <u>Unresolved Staff Comments</u>  | <u>29</u>         |
| <u>Item 2.</u>           | <u>Properties</u>   | <u>29</u>         |
| <u>Item 3.</u>           | <u>Legal Proceedings</u>  | <u>31</u>         |
| <u>Item 4.</u>           | <u>Mine Safety Disclosures</u>  | <u>31</u>         |
| <b>Part II</b>           |   |                   |
| <u>Item 5.</u>           | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>32</u>         |
| <u>Item 6.</u>           | <u>Selected Financial Data</u>  | <u>35</u>         |
| <u>Item 7.</u>           | <u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>                         | <u>38</u>         |
| <u>Item 7A.</u>          | <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | <u>74</u>         |
| <u>Item 8.</u>           | <u>Financial Statements and Supplementary Data</u>  | <u>80</u>         |
| <u>Item 9.</u>           | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | <u>137</u>        |
| <u>Item 9A.</u>          | <u>Controls and Procedures</u>  | <u>137</u>        |
| <u>Item 9B.</u>          | <u>Other Information</u>  | <u>139</u>        |
| <b>Part III</b>          |   |                   |
| <u>Item 10.</u>          | <u>Directors, Executive Officers and Corporate Governance</u>   | <u>139</u>        |
| <u>Item 11.</u>          | <u>Executive Compensation</u>   | <u>139</u>        |
| <u>Item 12.</u>          | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>               | <u>139</u>        |
| <u>Item 13.</u>          | <u>Certain Relationships and Related Transactions and Director Independence</u>                                     | <u>140</u>        |
| <u>Item 14.</u>          | <u>Principal Accounting Fees and Services</u>   | <u>140</u>        |
| <b>Part IV</b>           |   |                   |
| <u>Item 15.</u>          | <u>Exhibits, Financial Statement Schedules</u>  | <u>141</u>        |
| <b><u>SIGNATURES</u></b> |   | <b><u>145</u></b> |

Table of Contents

**PART I**

**ITEM 1. BUSINESS**

Eagle Bancorp, Inc. (the "Company"), headquartered in Bethesda, Maryland, was incorporated under the laws of the State of Maryland on October 28, 1997, to serve as the bank holding company for EagleBank (the "Bank"). The Company was formed by a group of local businessmen and professionals with significant prior experience in community banking in the Company's market area, together with an experienced community bank senior management team. The Company has one direct non-banking subsidiary, Eagle Commercial Ventures, LLC ("ECV"), which provides subordinated financing for the acquisition, development and construction of real estate projects.

The Bank, a Maryland chartered commercial bank, which is a member of the Federal Reserve System, is the Company's principal operating subsidiary. It commenced banking operations on July 20, 1998. The Bank operates eighteen banking offices: seven in Montgomery County, Maryland located in Rockville (three), Bethesda, Silver Spring, Potomac and Chevy Chase; five located in the District of Columbia; and six in Northern Virginia located in Tysons Corner, Ballston, Rosslyn, Reston, Merrifield and Alexandria. The Bank may seek additional banking offices consistent with its strategic plan, although there can be no assurance that the Bank will establish any additional offices, or that any branch office will prove to be profitable.

The Bank has two active direct subsidiaries: Bethesda Leasing, LLC and Eagle Insurance Services, LLC. Bethesda Leasing, LLC holds title to and operates real estate owned and acquired through foreclosure. Eagle Insurance Services, LLC facilitates the placement of commercial and retail insurance products through a referral arrangement with The Meltzer Group, a large well known insurance brokerage within the Company's market area.

The Bank operates as a community bank alternative to the super-regional financial institutions, which dominate its primary market area. The cornerstone of the Bank's philosophy is to provide superior, personalized service to its clients. The Bank focuses on relationship banking, providing each client with a number of services, familiarizing itself with, and addressing itself to, client needs in a proactive, personalized fashion. Management believes that the Bank's target market segments, small to medium-sized for profit and non-profit businesses and the consumer base working or living in and near of the Bank's market area, demand the convenience and personal service that a smaller, independent financial institution such as the Bank can offer. It is these themes of convenience and proactive personal service that form the basis for the Bank's business development strategies.

*Description of Services.* The Bank offers a full range of commercial banking services to its business and professional clients, as well as complete consumer banking services to individuals living or working in the service area. The Bank emphasizes providing commercial banking services to sole proprietorships, small and medium-sized businesses, partnerships, corporations, non-profit organizations and associations, and investors living and working in and near the Bank's primary service area. A full range of retail banking services are offered to accommodate the individual needs of both corporate customers as well as the community the Bank serves. The Bank also offers online banking, mobile banking and a remote deposit service, which allows clients to facilitate and expedite deposit transactions through the use of electronic devices.

The Bank provides a variety of commercial and consumer lending products to small to medium-sized businesses and individuals for various business and personal purposes, including (i) commercial loans for a variety of business purposes such as for working capital, equipment purchases, real estate lines of credit, and government contract financing; (ii) asset based lending and accounts receivable financing (on a limited basis); (iii) construction and commercial real estate loans; (iv) business equipment financing; (v) consumer home equity lines of credit, personal lines of credit and term loans; (vi) consumer installment loans such as

Table of Contents

auto and personal loans; (v) personal credit cards offered through an outside vendor; and (vi) residential mortgage loans.

The Bank maintains a loan portfolio consisting primarily of traditional business and real estate secured loans, with a substantial portion having variable and adjustable rates, and where the cash flow of the borrower/borrower's business is the principal source of debt service with a secondary emphasis on collateral. Real estate loans are made generally for commercial purposes and are structured using both variable and fixed rates and renegotiable rates which adjust in three to five years, with maturities of five to ten years.

The Bank's consumer loans portfolio is comprised of home equity lines of credit that are structured with an interest only draw period followed either by a balloon maturity or a fully amortized repayment schedule. The Bank's consumer loan portfolio also includes first lien residential mortgage loans, although the Bank's general practice is to sell conforming first trust loans on a servicing and released to third party investors.

The Bank has also developed significant expertise and commitment as a Small Business Administration ("SBA") lender and has been recognized as a top originator of such loans in our market area.

The direct lending activities in which the Bank engages carry the risk that the borrowers will be unable to perform on their obligations. As such, interest rate policies of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and general economic conditions, nationally and in the Bank's primary market area, have a significant impact on the Bank's and the Company's results of operations. To the extent that economic conditions deteriorate, business and individual borrowers may be less able to meet their obligations to the Bank in full, in a timely manner, resulting in decreased earnings or losses to the Bank. To the extent the Bank makes fixed rate loans or variable rate loans with fixed rate floors, general increases in interest rates will tend to reduce the Bank's spread as the interest rates the Bank must pay for deposits may increase while interest income may be unchanged. Economic conditions may also adversely affect the value of property pledged as security for loans.

The Bank'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 Bank is an approved SBA lender. As a preferred lender under the SBA's Preferred Lender Program, the Bank can originate certain SBA loans in-house without prior SBA approval. SBA loans are made through programs designed by the federal government to assist the small business community in obtaining financing from financial institutions that are given government guarantees as an incentive to make the loans. Under certain circumstances, the Bank attempts to further mitigate commercial term loan losses by using loan guarantee programs offered by the SBA. SBA lending is subject to federal legislation that can affect the availability and funding of the program. From time to time, this dependence on legislative funding causes limitations and uncertainties with regard to the continued funding of such programs, which could potentially have an adverse financial impact on our business.

The composition of the Bank's loan portfolio is heavily weighted toward commercial real estate, both owner occupied and income producing real estate. Owner occupied commercial real estate and owner occupied commercial real estate construction represent 12% of the loan portfolio. At December 31, 2013, non owner occupied commercial real estate and real estate construction represented approximately 57% of

Table of Contents

the loan portfolio. Accordingly, combined owner occupied and commercial real estate loans represent 69% 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 are generally 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 Bank is also an active traditional commercial lender providing loans for a variety of purposes, including cash flow, equipment and account receivable financing. This loan category represents approximately 24% of the Bank's loan portfolio at December 31, 2013 and is 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 1% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the uninsured portion of the credit. The Company generally sells the insured 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.

Approximately 4% of the loan portfolio at December 31, 2013 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

The remaining 3% of the loan portfolio consists of residential home mortgage loans. 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, certain loan terms do not satisfy the requirements of third party investors and are instead maintained in the Bank's portfolio. Portfolio residential loans exhibit minimal credit risk.

Our lending activities are subject to a variety of lending limits imposed by state and federal law. These limits will increase or decrease in response to increases or decreases in the Bank's level of capital. At January 31, 2014, the Bank had a legal lending limit of \$60.6 million. In accordance with internal lending policies, the Bank occasionally sells participations in its loans to other area banks, which allows the Bank to manage risk involved in these loans and to meet the lending needs of its clients. The Bank has also participated loans to the Company until such time as the Bank could accommodate the participation within its internal lending limit or the loan could be participated to another lender. No loan participations to the Company are outstanding at December 31, 2013. The ability of the Company to assist the Bank with these credits has expanded the flexibility and service the Bank can offer its customers

From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, ECV, which under its operating agreement conducts lending only to real estate projects, as to which the Company's directors or lending officers have significant expertise. Such loans may have higher risk characteristics than loans made by the Bank, such as lower priority security interests and/or higher loan to value ratios. The Company seeks an overall financial return on these transactions commensurate with the risks and structure of each individual loan. Certain transactions bear current interest at a rate with a significant premium to normal market rates. Other loan transactions carry a standard rate of current interest, but also earn additional interest based on a fixed rate or a percentage of the profits of the underlying project. Refer to the discussion under "Management's Discussion and Analysis Noninterest Income" at page 49 and "Loan Portfolio" at page 55, for further information on the Company's and ECV's higher risk lending activities. At December 31, 2013, ECV had five outstanding loan transactions totaling \$7.4 million.

The risk of nonpayment (or deferred payment) of loans is inherent in commercial banking. The Bank's marketing focus on small to medium-sized businesses may result in the assumption by the Bank of

Table of Contents

certain lending risks that are different from those attendant to loans to larger companies. The management and director committees of the Bank carefully evaluate all loan applications and attempt to minimize credit risk exposure by use of extensive loan application data, due diligence, and approval and monitoring procedures; however, there can be no assurance that such procedures can significantly reduce such lending risks.

The Bank originates residential mortgage loans primarily as a correspondent lender. With only minor exceptions, the loans are presold to one of the designated investors at the time of application with intentions of immediate sale to that investor on a servicing released basis. This activity is managed by utilizing the available pricing, programs and lock periods, which produce market gains on the sale of the loan. Activity in the residential mortgage loan market is highly sensitive to changes in interest rates and product availability. While the Bank does have delegated underwriting authority from most of its investors, it also employs the services of the investor to underwrite the loans. Because the loans are originated within investor guidelines and designated automated underwriting and product specific requirements as part of the loan application, the loans sold have a limited recourse provision. Most contracts with investors contain recourse periods. In general, the Company may be required to repurchase a previously sold mortgage loan or indemnify the investor if there is non-compliance with defined loan origination or documentation standards, including fraud, negligence or material misstatement in the loan documents. In addition, the Company may have an obligation to repurchase a loan if the mortgagor has defaulted early in the loan term. The potential default repurchase period varies by investor but can be up to approximately twelve months after sale of the loan to the investor. Mortgages subject to recourse are collateralized by single-family residential properties, have loan-to-value ratios of 80% or less, or have private mortgage insurance. In certain instances, the Bank may provide equity loans (second position financing) in combination with residential first mortgage lending for purchase money and refinancing purposes. The Bank also brokers loan transactions with two investors, where the Bank refers, but does not underwrite and does not close the loan transaction. In this situation the Bank has no recourse liability for the loan.

The general terms and underwriting standards for each type of commercial real estate and construction loan are incorporated into the Bank's lending policies. These policies are analyzed periodically by management, and the policies are reviewed and approved by the Board on an annual basis. The Bank's loan policies and practices described in this report are subject to periodic change, and each guideline or standard is subject to waiver or exception in the case of any particular loan, by the appropriate officer or committee, in accordance with the Bank's loan policies. Policy standards are often stated in mandatory terms, such as "shall" or "must", but these provisions are subject to exceptions. Policy requires that loan value not exceed a percentage of "market value" or "fair value" based upon appraisals or evaluations obtained in the ordinary course of the Bank's underwriting practices.

Loans are secured primarily by duly recorded first deeds of trust. In some cases, the Bank may accept a recorded second 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 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 construction contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for certain 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

Table of Contents

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 required to contribute 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.

Loan-to-value ("LTV") ratios, with few exceptions, are maintained consistent with or below supervisory guidelines.

Construction draw requests generally must be presented in writing on American Institute of Architects documents and certified by the contractor, the borrower and the borrower's architect. Each draw request shall also include the borrower's soft cost breakdown certified by the borrower or its 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 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. 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 are generally subject to re-pricing after 5 years and 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.

Personal guarantees are generally received from the principals on commercial real estate loans, and only in instances where the loan-to-value is sufficiently low and the debt service is sufficiently high is consideration given to either limiting or not requiring personal recourse.

Updated appraisals for real estate secured loans are obtained as necessary and appropriate to borrower financial condition, project status, loan terms, and market conditions.

The Company's loan portfolio includes loans made for real estate Acquisition, Development and Construction ("ADC") purposes, including both income producing and owner occupied projects. ADC loans amounted to \$608.8 million at December 31, 2013. The ADC loans containing loan funded interest reserves represent approximately 47% of the outstanding ADC loan portfolio at December 31, 2013. 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: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) 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: (i) 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; (ii) a construction loan administration department independent of the lending function; (iii) third party independent construction loan inspection reports; (iv) 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 (v) quarterly commercial real estate construction



Table of Contents

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.

Despite the less than robust economic recovery to date, the Company has not experienced any significant issues with increased vacancy rates or lower rents for income producing properties financed. The construction loan portfolio has remained solid, particularly in the area of well located residential and multifamily, as the housing market has continued to improve. The Washington, D.C. metropolitan area real estate market has been relatively strong, as compared to other markets in the U.S. However, the potential impact of disruptions in government spending patterns, i.e. sequestration, program cuts or terminations, and changes in geographic distribution of government spending, while very minimal to date, remains of concern. As a result the Company has maintained somewhat higher than pre-recession allocation factors for the allowance for loan losses ("ALLL") for the real estate loan portfolio. As part of its overall risk assessments, management carefully reviews the Bank's loan portfolio and general economic and market conditions on a regular basis and will continue to adjust both the specific and environmental reserve factors as necessary.

Deposit services include business and personal checking accounts, NOW accounts, tiered savings and money market account and time deposits with varying maturity structures and customer options. A complete individual retirement account program is available. The Bank also participates in the Promontory Interfinancial Network, LLC ("Promontory") Certificate of Deposit Account Registry Service ("CDAR's") and its Insured Cash Sweep ("ICS") program, both of which networks function to assure full FDIC insurance. In cooperation with Goldman Sachs Asset Management, the Bank offers a Goldman Sachs Investment Sweep Account, a check writing cash management account that sweeps funds to one of several non-FDIC insured off-balance sheet investment accounts managed by Goldman Sachs.

The Bank offers a full range of on-line banking services for both personal and business accounts and has recently introduced a Mobile Banking application. Other services include cash management services, business sweep accounts, lock box, remote deposit capture, account reconciliation services, merchant card services, safety deposit boxes and Automated Clearing House origination. After-hours depositories and ATM service are also available.

The Bank and Company maintain portfolios of short term investments and investment securities consisting primarily of U.S. Government agency bonds and government sponsored enterprise mortgage backed securities, and municipal bonds. The Company also owns equity investments related to membership in the Federal Reserve System and the Federal Home Loan Bank of Atlanta ("FHLB"). The Company's securities portfolio also consists of equity investments in the form of common stocks of a few local banking companies. These portfolios provide the following objectives: liquidity management, additional income to the Company and Bank in the form of interest and gain on sale opportunities, collateral to facilitate borrowing arrangements and assistance with meeting interest rate risk management objectives.

The Company and Bank have formalized an asset and liability management process and have a standing Asset Liability Committee ("ALCO") consisting both of outside and inside directors and senior management. The ALCO operates under established policies and practices, which are updated and re-approved annually. A typical Committee meeting includes discussion of current economic conditions and strategies, including interest rate trends and volumes positions, the current balance sheet and earnings position, cash flow estimates, liquidity positions and funding alternatives as necessary, interest rate risk position (quarterly), capital positions of the Company and Bank, reviews (and including independent reviews) of the investment portfolio of the Bank and the Company, and the approval of investment transactions. The current Investment Policy limits the Bank to investments of high quality, U.S. Treasury securities, U.S. Government agency securities and high grade municipal securities. High risk investments and non-traditional investments are prohibited. Investment maturities are generally limited to ten to

Table of Contents

fifteen years, except as specifically approved by the ALCO, and mortgage backed pass through securities with average lives generally not to exceed eight years.

The Bank's customer base has benefited from the extensive business and personal contacts of its Directors and Executive Officers. To introduce new customers to the Bank, enhanced reliance is expected on proactively designed officer calling programs, active participation in business organizations, and enhanced referral programs.

*Internet Access to Company Documents.* The Company provides access to its Securities and Exchange Commission ("SEC") filings through its web site at [www.eaglebankcorp.com](http://www.eaglebankcorp.com). After accessing the web site, the filings are available upon selecting "Investor Relations/SEC Filings/Documents." Reports available include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are electronically filed with or furnished to the SEC.

**MARKET AREA AND COMPETITION**

---

The headquarters of the Company is located at 7830 Old Georgetown Road, Bethesda, Maryland 20814. The Bank's main branch office is located at 7815 Woodmont Avenue, Bethesda. The Bank has six additional Maryland offices, located at 110 North Washington Street, Rockville; 8665 Georgia Avenue, Silver Spring; 130 Rollins Avenue, Rockville; 9600 Blackwell Road, Rockville; 15 Wisconsin Circle, Chevy Chase; and 12505 Park Potomac Avenue, Potomac. There are five offices in Washington, D.C., located at 2001 K Street, NW; 1044 Wisconsin Ave, NW; 1228 Connecticut Ave, NW, 1425 K Street, NW; and 700 7<sup>th</sup> Street, NW. The Bank has six offices in Northern Virginia, located at 8601 Westwood Center Drive, Vienna; 4420 N. Fairfax Drive, Arlington; 1919 North Lynn St, Arlington; 12011 Sunset Hills Road, Reston; and 2905 District Avenue, Fairfax and 277 S. Washington Street, Alexandria, Virginia.

The primary service area of the Bank is the Washington, D.C. metropolitan area. With a population of nearly 6,300,000, the region is the 5<sup>th</sup> largest market in the U.S. Total employment in the region is approximately 2,400,000. The region has one of the highest total job creation records of any market in the country with reported new job creation of more than 275,000 jobs since 2001 and 24,100 new jobs created in 2013. The Washington, D.C. metropolitan area contains a substantial federal workforce, as well as supporting a variety of support industries such as attorneys, lobbyists, government contractors, real estate developers and investors, non-profit organizations, tourism and consultants. The Gross Domestic Product ("GDP") for the metropolitan area in 2012 was reported at \$449 billion. Of this amount, approximately \$97 billion or 22% is spending by the government as of 2012. Other significant sectors include professional and business services, education, health and leisure and hospitality. The region also has a very active non-profit sector including trade associations, colleges and universities and major hospitals.

Montgomery County, Maryland, with a total population of approximately 972,000 (2010) and occupying an area of about 500 square miles, borders Washington, D.C. to the north and is roughly 30 miles southwest of Baltimore. Montgomery County represents a diverse and healthy segment of Maryland's economy. Montgomery County is a thriving business center and is Maryland's most populous jurisdiction. Population in the county is expected to grow 4.5% between 2010 and 2015. While the State of Maryland boasts a demographic profile superior to the U.S. economy at large, the economy in and around Montgomery County is among the very best in Maryland. The number of jobs in Montgomery County has been relatively stable in the recent past with the public sector contributing about 20% of the employment. The unemployment rate in Montgomery County is among the lowest in the state at 4.5% (November 2013 preliminary). A very educated population has contributed to favorable median household income of \$96,985 with the number of households totaling 379,003. According to the 2010 census update, approximately 57% of the County's residents (between 2008 and 2012) hold college or advanced degrees, placing the population of Montgomery County among the most educated in the nation. The area boasts a diverse business climate of over 34,000 businesses with 510,000 jobs in addition to a strong federal

Table of Contents

government presence. Major areas of employment include a substantial technology sector, biotechnology, software development, a housing construction and renovation sector, and a legal, financial services and professional services sector. Major private employers include Adventist Healthcare, Lockheed Martin, Giant Food, and Marriott International. The county is also an incubator for firms engaged in biotechnology and the area has traditionally attracted significant amounts of venture capital. Transportation congestion remains the biggest threat to future economic development and the quality of life in the area.

Montgomery County is home to many major federal and private sector research and development and regulatory agencies, including the National Institute of Standards and Technology, the National Institutes of Health, National Oceanic and Atmospheric Administration, Naval Research and Development Center, Naval Surface Warfare Center, Nuclear Regulatory Commission, the Food and Drug Administration and the Walter Reed National Military Medical Center in Bethesda.

Washington, D.C. in addition to being the seat of the Federal Government is a vibrant city with a well-educated, diverse population. According to survey data from the latest U.S. Census, the estimated 2012 population of the District of Columbia is approximately 646,449, up from 601,723 in 2010. Median household income, at \$64,267 between 2008 and 2012, is above the national median level of \$53,046. The growth of residents in the city is due partially to improvements in the city's services and to the many housing options available, ranging from grand old apartment buildings to Federal era town homes to the most modern condominiums. As of 2010, the housing market has grown to over 300,241 units. As of July 2013, the absorption of condominium units in the District has continued at a satisfactory pace. While the Federal Government and its employees are a major factor in the economy, over 100 million square feet of commercial office space support a dynamic business community of more than 20,000 companies. These include law and accounting firms, trade and professional associations, information technology companies, international financial institutions, health and education organizations and research and management companies. Unemployment has declined slightly with the preliminary rate for November 2013 at 7.3%, which was down from 8.2% in November 2012. The disparity between the high level of unemployment among District residents and the strong employment trends reflects the high level of jobs held by residents of the surrounding suburban jurisdictions. The District has a well-educated and highly paid work force. The Federal Government accounts for approximately 30% of the employment and professional and business service firms provide an additional 21%. Other large employers include the many local universities and hospitals. Another significant factor in the economy is the leisure and hospitality industry, as Washington, D.C. remains a popular tourist destination for both national and international travelers.

Fairfax County, Virginia is a large, affluent jurisdiction with an estimated population of approximately 1,118,602 as of 2012. This county covers about 395 square miles and is located west of Washington, D.C. Fairfax County is one of the leading technology centers in the United States. Ten Fortune 500 companies are headquartered in the county and 29 of the largest 100 technology federal contractors in the Washington metropolitan area are located in Fairfax County. The county has over 114 million square feet of office space and is one of the largest suburban office markets in the United States. The midyear 2013 office vacancy rate was 14.4%, below the national average of 16.9%, as measured in fourth quarter 2013. It is a thriving residential as well as business center with 388,452 households, which is expected to grow at about 3.5% between 2010 and 2015. The county is among the most affluent in the country with average annual household income of \$109,383 per annum between 2008 and 2012. Total employment was over 569,388 as of 2011. Major companies headquartered in the county, which are also major employers, include Capital One Financial, CSC, Gannett, General Dynamics, Hilton Hotels, SAIC and Sallie Mae. The county is also home to several federal agencies including the CIA, Fort Belvoir and a major facility of the Smithsonian Institution.

In 2011, the Company's footprint expanded into Arlington County, Virginia which has an estimated population of over 221,000 as of 2012. The county is made up of 26 square miles and is situated just west of Washington, D.C., directly across the Potomac River. There are approximately 92,992 households with a

Table of Contents

median household income of \$102,459 between 2008 and 2012. There were over 165,649 employees as of June 2013, working predominantly in the public sector. Significant private sector employers include Deloitte, Lockheed Martin Corporation, Virginia Hospital Center and Marriott International, Inc. The preliminary unemployment rate was 3.2% as of November 2013. These numbers compare favorably to the region, the rest of Virginia and the U.S. Arlington County has approximately 39.7 million square feet of office space with a vacancy rate of approximately 16.5% as of January 2013. The population is highly educated, with about 71% of residents over 25 years of age holding at least a bachelor's degree as of 2012.

In early 2013, the Company added a branch to its network in Alexandria, Virginia. Alexandria is a city with an estimated population of 146,294 as of 2012. The city is made up of just over 15 square miles and sits on the west bank of the Potomac River just south of Arlington, Virginia. There are approximately 64,729 households with a median household income of \$83,996 on average between 2008 and 2012. The employment base was approximately 98,674 employees as of July 2013, with 75% working in the private sector and 25% working in government roles. Alexandria has over 8,000 businesses and organizations, located in the more than 20 million square feet of office space and over 7 million square feet of retail space existing in the city as of March 2013. The preliminary unemployment rate was just 4.1% as of November 2013. The population is highly educated, with over 60% of residents over 25 years of age holding at least a bachelor's degree as of 2012.

Throughout the Washington, D.C. metropolitan area, competition is keen from large banking institutions headquartered outside of Maryland. In addition, the Bank competes with other community banks, savings and loan associations, credit unions, mortgage companies, finance companies and others providing financial services. Among the advantages that many of these large institutions have over the Bank are their abilities to finance extensive advertising campaigns, maintain extensive branch networks and technology investments, and to directly offer certain services, such as international banking and trust services, which are not offered directly by the Bank. Further, the greater capitalization of the larger institutions allows for substantially higher lending limits than the Bank. Certain of these competitors have other advantages, such as tax exemption in the case of credit unions, and to some extent lesser regulation in the case of mortgage companies and finance companies, although this regulatory oversight is undergoing dramatic change. As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), enacted in July 2010, regulation of all financial firms has been heightened. Under current law, unlimited interstate *de novo* branching is available to all state and federally chartered banks. As a result, institutions, which previously were ineligible to establish *de novo* branches in the Company's market area may elect to do so.

**EMPLOYEES**

---

At December 31, 2013 the Bank employed 386 persons on a full time basis (nine of whom are executive officers of the Bank) which compares to 393 employees at December 31, 2012. None of the Bank's employees are represented by any collective bargaining group and the Bank believes that its employee relations are good. At December 31, 2013, the Bank provided a benefit program, which included health and dental insurance, a 401(k) plan, life and long term disability insurance. Additionally, the Company maintains an employee stock purchase plan and a stock-based compensation plan for employees of the Bank who meet certain eligibility requirements.

**REGULATION**

---

Our business and operations are subject to extensive federal and state governmental regulation and supervision. The following is a brief summary of certain statutes and rules and regulations that affect or will affect us. This summary is not intended to be an exhaustive description of the statutes or regulations applicable to our business. Supervision, regulation, and examination of the Company by the regulatory

Table of Contents

agencies are intended primarily for the protection of depositors and the deposit insurance fund, rather than our shareholders.

*The Company.* The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, (the "Act") and is subject to regulation and supervision by the Board of Governors of the Federal Reserve Board. The Act and other federal laws subject bank holding companies to restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations and unsafe and unsound banking practices. As a bank holding company, the Company is required to file with the Federal Reserve Board an annual report and such other additional information as the Federal Reserve Board may require pursuant to the Act. The Federal Reserve Board may also examine the Company and each of its subsidiaries. The Company is subject to risk-based and capital requirements adopted by the Federal Reserve Board, which are substantially identical to those applicable to the Bank, and which are described below.

The Act requires approval of the Federal Reserve Board for, among other things, a bank holding company's direct or indirect acquisition of control of more than five percent (5%) of the voting shares, or substantially all the assets, of any bank or the merger or consolidation by a bank holding company with another bank holding company. The Act also generally permits the acquisition by a bank holding company of control or substantially all the assets of any bank located in a state other than the home state of the bank holding company, except where the bank has not been in existence for the minimum period of time required by state law; but if the bank is at least 5 years old, the Federal Reserve Board may approve the acquisition.

With certain limited exceptions, a bank holding company is prohibited from acquiring control of any voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or furnishing services to or performing service for its authorized subsidiaries. A bank holding company may, however, engage in or acquire an interest in, a company that engages in activities which the Federal Reserve Board has determined by order or regulation to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such a determination, the Federal Reserve Board is required to consider whether the performance of such activities can reasonably be expected to produce benefits to the public, such as convenience, increased competition or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve Board is also empowered to differentiate between activities commenced *de novo* and activities commenced by the acquisition, in whole or in part, of a going concern. Some of the activities that the Federal Reserve Board has determined by regulation to be closely related to banking include making or servicing loans, performing certain data processing services, acting as a fiduciary or investment or financial advisor, and making investments in corporations or projects designed primarily to promote community welfare.

Subsidiary banks of a bank holding company are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or any of its subsidiaries, or investments in the stock or other securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. Further, a bank holding company and any subsidiary bank are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit. A subsidiary bank may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that: (i) the customer obtain or provide some additional credit, property or services from or to such bank other than a loan, discount, deposit or trust service; (ii) the customer obtain or provide some additional credit, property or service from or to the Company or any other subsidiary of the Company; or (iii) the customer not obtain some other credit, property or service from competitors, except for reasonable requirements to assure the soundness of credit extended.

Table of Contents

The Gramm Leach-Bliley Act of 1999 (the "GLB Act") allows a bank holding company or other company to certify status as a financial holding company, which allows such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker, underwriting, dealing in or making markets in securities, and engaging in merchant banking under certain restrictions. It also authorizes the Federal Reserve Board to determine by regulation what other activities are financial in nature, or incidental or complementary thereto. The GLB Act allows a wider array of companies to own banks, which could result in companies with resources substantially in excess of the Company's entering into competition with the Company and the Bank. The Company has not elected financial holding company status.

*The Bank.* The Bank, as a Maryland chartered commercial bank which is a member of the Federal Reserve System (a "state member bank") and whose accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum legal limits of the FDIC, is subject to regulation, supervision and regular examination by the Maryland Department of Financial Institutions and the Federal Reserve Board. The regulations of these various agencies govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends and location and number of branch offices.

The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance fund, and not for the purpose of protecting shareholders.

Competition among commercial banks, savings and loan associations, and credit unions has increased following enactment of legislation which greatly expanded the ability of banks and bank holding companies to engage in interstate banking or acquisition activities. As a result of federal and state legislation, banks in the Washington, D.C./Maryland/Virginia area can, subject to limited restrictions, acquire or merge with a bank in another of the jurisdictions, and can branch *de novo* in any of the jurisdictions.

Banking is a business which depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and its other borrowings and the interest received by a bank on loans extended to its customers and securities held in its investment portfolio constitute the major portion of the bank's earnings. Thus, the earnings and growth of the Bank will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve Board, which regulates the supply of money through various means including open market dealings in United States government securities. The nature and timing of changes in such policies and their impact on the Bank cannot be predicted.

*Branching and Interstate Banking.* The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act") by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Such interstate bank mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act. The District of Columbia, Maryland and Virginia have each enacted laws which permit interstate acquisitions of banks and bank branches. The Dodd-Frank Act authorizes national and state banks to establish *de novo* branches in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Although the District of Columbia, Maryland and Virginia had all enacted laws which permitted banks in these jurisdictions to branch freely, the branching provisions of the Dodd-Frank Act could result in banks from a wider variety of states establishing *de novo* branches in the Bank's market area.

Table of Contents

The GLB Act made substantial changes in the historic restrictions on non-bank activities of bank holding companies, and allows affiliations between types of companies that were previously prohibited. The GLB Act also allows banks to engage in a wider array of nonbanking activities through "financial subsidiaries."

*USA Patriot Act.* Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the "USA Patriot Act" or the "Patriot Act," financial institutions are subject to prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum standards specified by the act, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers. The costs or other effects of the compliance burdens imposed by the Patriot Act or future anti-terrorist, homeland security or anti-money laundering legislation or regulation cannot be predicted with certainty.

*Capital Adequacy.* The Federal Reserve Board and the FDIC have adopted risk-based and leverage capital adequacy requirements, pursuant to which they assess the adequacy of capital in examining and supervising banks and bank holding companies and in analyzing bank regulatory applications. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items. Under the Dodd-Frank Act, the Federal Reserve Board is required to apply consolidated capital requirements to depository institution holding companies that are no less stringent than those currently applied to depository institutions. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

State member banks are expected to meet a minimum ratio of total qualifying capital (the sum of core capital (Tier 1) and supplementary capital (Tier 2) to risk weighted assets of 8%. At least half of this amount (4%) should be in the form of core capital.

Tier 1 Capital generally consists of the sum of common shareholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stock which may be included as Tier 1 Capital), less goodwill, without adjustment for changes in the market value of securities classified as "available-for-sale," together with a limited amount of other qualifying interests, including trust preferred securities. The Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock") issued to the Secretary of the Treasury (the "Treasury") pursuant to the Small Business Lending Fund program ("SBLF") is eligible for treatment as Tier 1 capital without limitation. Tier 2 Capital consists of the following: hybrid capital instruments; perpetual preferred stock which is not otherwise eligible to be included as Tier 1 Capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses and excess restricted core capital elements. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no risk-based capital) for assets such as cash, to 100% for the bulk of assets which are typically held by a bank holding company, including certain multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Residential first mortgage loans on one to four family residential real estate and certain seasoned multi-family residential real estate loans, which are not 90 days or more past due or nonperforming and which have been made in accordance with prudent underwriting standards are assigned a 50% level in the risk-weighting system, as are certain privately-issued mortgage-backed securities representing indirect ownership of such loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics. Under guidance adopted by the federal banking regulators, banks which have concentrations in construction, land development or commercial real estate loans (other than loans for

Table of Contents

majority owner occupied properties) would be expected to maintain higher levels of risk management and, potentially, higher levels of capital.

In addition to the risk-based capital requirements, the Federal Reserve Board has established a minimum 3.0% Leverage Capital Ratio (Tier 1 Capital to total adjusted assets) requirement for the most highly-rated banks, with an additional cushion of at least 100 to 200 basis points for all other banks, which effectively increases the minimum Leverage Capital Ratio for such other banks to 4.0% 5.0% or more. The highest-rated banks are those that are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, those which are considered a strong banking organization. A bank having less than the minimum Leverage Capital Ratio requirement shall, within 60 days of the date as of which it fails to comply with such requirement, submit a reasonable plan describing the means and timing by which the bank shall achieve its minimum Leverage Capital Ratio requirement. A bank which fails to file such plan is deemed to be operating in an unsafe and unsound manner, and could subject the bank to a cease-and-desist order. Any insured depository institution with a Leverage Capital Ratio that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the Federal Deposit Insurance Act (the "FDIA") and is subject to potential termination of deposit insurance. However, such an institution will not be subject to an enforcement proceeding solely on account of its capital ratios, if it has entered into and is in compliance with a written agreement to increase its Leverage Capital Ratio and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The capital regulations also provide, among other things, for the issuance of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital or to restore its capital to the minimum capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease-and-desist order.

The capital ratios described above are the minimum levels that the federal banking regulators expect. Our state and federal regulators have the discretion to require us to maintain higher capital levels based upon our concentrations of loans, the risk of our lending or other activities, the performance of our loan and investment portfolios and other factors. Failure to maintain such higher capital expectations could result in a lower composite regulatory rating, which would impact our deposit insurance premiums and could affect our ability to borrow and costs of borrowing, and could result in additional or more severe enforcement actions. In respect of institutions with high concentrations of loans in areas deemed to be higher risk, or during periods of significant economic stress, regulators may require an institution to maintain a higher level of capital, and/or to maintain more stringent risk management measures, than those required by these regulations.

*Changes in Capital Requirements.* In December 2010, the Basel Committee on Banking Supervision released its final framework for strengthening international capital and liquidity regulation ("Basel III"). The regulations adopted by the U.S. federal bank regulatory agencies, when fully phased-in, will require bank holding companies and their bank subsidiaries to maintain more capital, with a greater emphasis on common equity.

The Basel III final capital framework, among other things, (i) introduces as a new capital measure "Common Equity Tier 1" ("CET1"), (ii) specifies that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

When fully phased in, Basel III requires banks to maintain: (i) as a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a "capital conservation buffer" of 2.5%; (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer, or 8.5%; (iii) a minimum ratio of Total (Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0% plus the capital conservation buffer, or 10.5%; and (iv) as a newly



Table of Contents

adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

Basel III also provides for a "countercyclical capital buffer," generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented. The capital conservation buffer is designed to absorb losses during periods of economic stress.

Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) may face constraints on its ability to pay dividends, effect equity repurchases and pay discretionary bonuses to executive officers, which constraints vary based on the amount of the shortfall.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

The federal banking regulators adopted a final rulemaking in July 2013 (the "Basel III Rule") to implement Basel III under regulations substantially consistent with the above. The Basel III Rule also includes, as part of the definition of CET1 capital, a requirement that banking institutions include the amount of Additional Other Comprehensive Income ("AOCI," which primarily consists of unrealized gains and losses on available for sale securities, which are not required to be treated as other-than-temporary impairment, net of tax) in calculating regulatory capital, unless the institution makes a one-time opt-out election from this provision in connection with the filing of its first regulatory reports after applicability of the Basel III Rule to that institution. The Basel III Rule also proposes a 4% minimum leverage ratio.

The Basel III Rule also makes changes to the manner of calculating risk weighted assets. New methodologies for determining risk weighted assets in the general capital rules are included, including revisions to recognition of credit risk mitigation, including a greater recognition of financial collateral and a wider range of eligible guarantors. They also include risk weighting of equity exposures and past due loans; and higher (greater than 100%) risk weighting for certain commercial real estate exposures that have higher credit risk profiles, including higher loan to value and equity components.

As discussed below, the Basel III Rule also integrates the new capital requirements into the prompt corrective action provisions under Section 38 of the FDIA.

In general, the Basel III Rule will become applicable to the Company and Bank on January 1, 2015. We currently expect that the Company and Bank will elect to exclude AOCI in calculating regulatory capital when they file their respective first regulatory reports after applicability of the Basel III Rule to them in January 2015, although we reserve the right to elect to include AOCI in the calculation of regulatory capital. The Company expects that, in general, the higher risk loans made by ECV will be subject to higher risk weightings, and as such require additional capital. Additionally, the Company expects its outstanding subordinated notes will cease to qualify as capital for regulatory purposes when the new capital definitions under the Basel III Rule become applicable to the Company and Bank. The Company expects that it will consider redemption of the subordinated notes. Overall, the Company believes that implementation of the Basel III Rule will not have a material adverse effect on the Company's or Bank's capital ratios, earnings, shareholder's equity, or its ability to pay dividends, effect stock repurchases or pay discretionary bonuses to executive officers.

Table of Contents

*Prompt Corrective Action.* Under Section 38 of the FDIA, each federal banking agency is required to implement a system of prompt corrective action for institutions which it regulates. The federal banking agencies have promulgated substantially similar regulations to implement the system of prompt corrective action established by Section 38 of the FDIA. Under the regulations, a bank shall be deemed to be: (i) "well capitalized" if it has a Total Risk Based Capital Ratio of 10.0% or more, a Tier 1 Risk Based Capital Ratio of 6.0% or more, a Leverage Capital Ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a Total Risk Based Capital Ratio of 8.0% or more, a Tier 1 Risk Based Capital Ratio of 4.0% or more and a Tier 1 Leverage Capital Ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized;" (iii) "undercapitalized" if it has a Total Risk Based Capital Ratio that is less than 8.0%, a Tier 1 Risk based Capital Ratio that is less than 4.0% or a Leverage Capital Ratio that is less than 4.0% (3.0% under certain circumstances); (iv) "significantly undercapitalized" if it has a Total Risk Based Capital Ratio that is less than 6.0%, a Tier 1 Risk Based Capital Ratio that is less than 3.0% or a Leverage Capital Ratio that is less than 3.0%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate federal banking agency within 45 days of the date the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving a capital restoration plan, subject to extensions by the applicable agency.

An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. Such guaranty shall be limited to the lesser of (i) an amount equal to 5.0% of the institution's total assets at the time the institution was notified or deemed to have notice that it was undercapitalized or (ii) the amount necessary at such time to restore the relevant capital measures of the institution to the levels required for the institution to be classified as adequately capitalized. Such a guaranty shall expire after the federal banking agency notifies the institution that it has remained adequately capitalized for each of four consecutive calendar quarters. An institution which fails to submit a written capital restoration plan within the requisite period, including any required performance guaranty, or fails in any material respect to implement a capital restoration plan, shall be subject to the restrictions in Section 38 of the FDIA which are applicable to significantly undercapitalized institutions.

A "critically undercapitalized institution" is to be placed in conservatorship or receivership within 90 days unless the FDIC formally determines that forbearance from such action would better protect the deposit insurance fund. Unless the FDIC or other appropriate federal banking regulatory agency makes specific further findings and certifies that the institution is viable and is not expected to fail, an institution that remains critically undercapitalized on average during the fourth calendar quarter after the date it becomes critically undercapitalized must be placed in receivership. The general rule is that the FDIC will be appointed as receiver within 90 days after a bank becomes critically undercapitalized unless extremely good cause is shown and an extension is agreed to by the federal regulators. In general, good cause is defined as capital which has been raised and is imminently available for infusion into the Bank except for certain technical requirements which may delay the infusion for a period of time beyond the 90 day time period.

Immediately upon becoming undercapitalized, an institution shall become subject to the provisions of Section 38 of the FDIA, which (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution's assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include: requiring the institution to raise additional capital; restricting transactions with affiliates; requiring divestiture of the institution or the sale of the institution to a willing purchaser; and any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

Additionally, under Section 11(c)(5) of the FDIA, a conservator or receiver may be appointed for an institution where: (i) an institution's obligations exceed its assets; (ii) there is substantial dissipation of the institution's assets or earnings as a result of any violation of law or any unsafe or unsound practice; (iii) the institution is in an unsafe or unsound condition; (iv) there is a willful violation of a cease-and-desist order; (v) the institution is unable to pay its obligations in the ordinary course of business; (vi) losses or threatened losses deplete all or substantially all of an institution's capital, and there is no reasonable prospect of becoming "adequately capitalized" without assistance; (vii) there is any violation of law or unsafe or unsound practice or condition that is likely to cause insolvency or substantial dissipation of assets or earnings, weaken the institution's condition, or otherwise seriously prejudice the interests of depositors or the insurance fund; (viii) an institution ceases to be insured; (ix) the institution is undercapitalized and has no reasonable prospect that it will become adequately capitalized, fails to become adequately capitalized when required to do so, or fails to submit or materially implement a capital restoration plan; or (x) the institution is critically undercapitalized or otherwise has substantially insufficient capital.

As noted above, the Basel III Rule integrates the new capital requirements into the prompt corrective action category definitions. As of January 1, 2015, the following capital requirements will apply to the Company for purposes of Section 38.

| Capital Category                  | Total<br>Risk-Based<br>Capital Ratio | Tier 1<br>Risk-Based<br>Capital Ratio | Common<br>Equity<br>Tier 1<br>Capital Ratio | Leverage<br>Ratio | Tangible<br>Equity<br>to Assets | Supplemental<br>Leverage<br>Ratio |
|-----------------------------------|--------------------------------------|---------------------------------------|---|-------------------|---------------------------------|-----------------------------------|
| Well Capitalized                  | 10% or greater                       | 8% or greater                         | 6.5% or<br>greater                          | 5% or<br>greater  | n/a                             | n/a                               |
| Adequately Capitalized            | 8% or greater                        | 6% or greater                         | 4.5% or<br>greater                          | 4% or<br>greater  | n/a                             | 3% or greater                     |
| Undercapitalized                  | Less than 8%                         | Less than 6%                          | 4.5%  | 4%                | n/a                             | Less than 3%                      |
| Significantly<br>Undercapitalized | Less than 6%                         | Less than 4%                          | Less than 3%                                | Less than<br>3%   | n/a                             | n/a                               |
| Critically Undercapitalized       | n/a                                  | n/a                                   | n/a   | n/a               | Less than<br>2%                 | n/a                               |

*Regulatory Enforcement Authority.* Federal banking law grants substantial enforcement powers to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

As a result of the volatility and instability in the financial system in recent years, the Congress, the bank regulatory authorities and other government agencies have called for or proposed additional regulation and restrictions on the activities, practices and operations of banks and their holding companies. While many of these proposals relate to institutions that have accepted investments from, or sold troubled assets to, the Department of the Treasury or other government agencies, or otherwise participate in government programs intended to promote financial stabilization, the Congress and the federal banking agencies have broad authority to require all banks and holding companies to adhere to more rigorous or costly operating procedures, corporate governance procedures, or to engage in activities or practices which they would not otherwise elect. Any such requirement could adversely affect the Company's business and results of operations.

*The Dodd-Frank Act.* The Dodd-Frank Act made significant changes to the current bank regulatory structure which affect the lending, deposit, investment, trading and operating activities of financial

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

institutions and their holding companies. The Dodd-Frank Act requires a number of federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. The federal agencies are giving significant discretion in drafting these rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for some time. Although it is not possible to determine the ultimate impact of this statute until the extensive rulemaking is complete and becomes effective, the following provisions are considered to be of greatest significance to the Company:

Expands the authority of the Federal Reserve Board to examine bank holding companies and their subsidiaries, including insured depository institutions.

Requires a bank holding company to be well capitalized and well managed to receive approval of an interstate bank acquisition.

Provides mortgage reform provisions regarding a customer's ability to pay and making more loans subject to provisions for higher-cost loans and new disclosures.

Creates the Consumer Financial Protection Bureau ("CFPB"), which has rulemaking authority for a wide range of consumer protection laws that apply to all banks, and has broad powers to supervise and enforce consumer protection laws.

Creates the Financial Stability Oversight Council ("FSOC") with authority to identify institutions and practices that might pose a systemic risk.

Introduces additional corporate governance and executive compensation requirements on companies subject to the 1934 Act, as amended.

Permits FDIC-insured banks to pay interest on business demand deposits.

Codifies the requirement that holding companies and other companies that directly or indirectly control an insured depository institution to serve as a source of financial strength.

Makes permanent the \$250 thousand limit for federal deposit insurance.

Permits national and state banks to establish interstate branches to the same extent as the branch host state allows establishment of in-state branches.

*Consumer Financial Protection Bureau.* The Dodd-Frank Act created the CFPB, a new, independent federal agency within the Federal Reserve System having broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, the consumer financial privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB, which began operations on July 21, 2011, has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions, including the Bank, are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for compliance with federal consumer protection laws and regulations. The CFPB also has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

The CFPB has proposed or issued a number of important rules affecting a wide range of consumer financial products. Many of these rules took effect in January 2014, which has created significant uncertainty for the financial services industry in general. It is difficult to predict at this

time the specific impact the Dodd-Frank Act and CFPB rulemakings will have on our business. The changes resulting from the Dodd-Frank Act and CFPB rulemakings may impact the profitability of our business activities, limit

Table of Contents

our ability to make, or the desirability of making, certain types of loans, including non-qualified mortgage loans, require us to change certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business or profitability. The changes may also require us to dedicate significant management attention and resources to evaluate and make necessary changes to comply with the new statutory and regulatory requirements.

The CFPB has concentrated much of its rulemaking efforts on reforms related to residential mortgage transactions. In 2013, the CFPB issued final rules related to a borrower's ability to repay and qualified mortgage standards, mortgage servicing standards, loan originator compensation standards, requirements for high-cost mortgages, appraisal and escrow standards and requirements for higher-priced mortgages. In November 2013, the CFPB issued final rules establishing integrated disclosure requirements for lenders and settlement agents in connection with most closed end, real estate secured consumer loans. These rules become effective August 2015, and we continue to analyze their requirements to determine the impact of the rules to our businesses. During 2014, we expect the CFPB to focus its rulemaking efforts on expanding the scope of information lenders must report in connection with mortgage and other housing-related loan applications under the Home Mortgage Disclosure Act. These rules include significant regulatory and compliance changes and are expected to have a broad impact on the financial services industry.

The final rule implementing the Dodd-Frank Act requirement that lenders determine whether a consumer has the ability to repay a mortgage loan, which went into effect on January 10, 2014, establishes certain minimum requirements for creditors when making ability to pay determinations, and establishes certain protections from liability for mortgages meeting the definition of "qualified mortgages." Generally, the rule applies to all consumer-purpose, closed-end loans secured by a dwelling including home-purchase loans, refinances and home equity loans whether first or subordinate lien. The rule does not cover, among other things, home equity lines of credit or other open-end credit; temporary or "bridge" loans with a term of 12 months or less, such as a loan to finance the initial construction of a dwelling; a construction phase of 12 months or less of a construction-to-permanent loan; and business-purpose loans, even if secured by a dwelling. The rule affords greater legal protections for lenders making qualified mortgages that are not "higher priced." Qualified mortgages must generally satisfy detailed requirements related to product features, underwriting standards, and a points and fees requirement whereby the total points and fees on a mortgage loan cannot exceed specified amounts or percentages of the total loan amount. Mandatory features of a qualified mortgage include: (1) a loan term not exceeding 30 years; and (2) regular periodic payments that do not result in negative amortization, deferral of principal repayment, or a balloon payment. Further, the rule clarifies that qualified mortgages do not include "no-doc" loans and loans with negative amortization, interest-only payments, or balloon payments. The rule creates special categories of qualified mortgages originated by certain smaller creditors. Our business strategy, product offerings, and profitability may change as the rule is interpreted by the regulators and courts.

The final rule adopting new mortgage servicing standards, which took effect January 2014, imposes new requirements regarding force-placed insurance, mandates certain notices prior to rate adjustments on adjustable rate mortgages, and establishes requirements for periodic disclosures to borrowers. These requirements will affect notices to be given to consumers as to delinquency, foreclosure alternatives, modification applications, interest rate adjustments and options for avoiding "force-placed" insurance. Servicers will be prohibited from processing foreclosures when a loan modification is pending, and must wait until a loan is more than 120 days delinquent before initiating a foreclosure action. Servicers must provide direct and ongoing access to its personnel, and provide prompt review of any loss mitigation application. Servicers must maintain accurate and accessible mortgage records for the life of a loan and until one year after the loan is paid off or transferred. These new standards are expected to increase the cost and compliance risks of servicing mortgage loans. While the Bank has a general practice of selling the residential mortgage loans it originates in the secondary market, it continues to engage in servicing activities for the loans it maintains in its portfolio. We cannot predict the ultimate outcome of these

Table of Contents

inquiries, actions, or regulatory changes or the impact that they could have on our financial condition, results of operations, or business.

*FDIC Insurance Premiums.* The FDIC maintains a risk-based assessment system for determining deposit insurance premiums. Four risk categories (I-IV), each subject to different premium rates, are established based upon an institution's status as well capitalized, adequately capitalized or undercapitalized, and the institution's supervisory rating. An insured institution is required to pay deposit insurance premiums on its assessment base in accordance with its risk category. There are three adjustments that can be made to an institution's initial base assessment rate: (1) a potential decrease for long-term unsecured debt, including senior and subordinated debt and, for small institutions, a portion of Tier 1 capital; (2) a potential increase for secured liabilities above a threshold amount; and (3) for non-Risk Category I institutions, a potential increase for brokered deposits above a threshold amount. The FDIC may also impose special assessments from time to time.

The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions and credit unions to \$250,000 per depositor. The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are now based on a financial institution's average consolidated total assets less tangible equity capital. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act eliminated the statutory prohibition against the payment of interest on business checking accounts.

**ITEM 1A. RISK FACTORS**

*An investment in our common stock involves a high degree of risk. Before making an investment decision, you should carefully read and consider the risk factors described below as well as the other information included in this report and other documents we file with the SEC, as the same may be updated from time to time. Any of these risks, if they actually occur, could materially adversely affect our business, financial condition, and results of operations. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect us. In any such case, you could lose all or a portion of your original investment.*

**The price of our common stock may fluctuate significantly, which may make it difficult for investors to resell shares of common stock at time or prices they find attractive.**

Our stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond our control. These factors include:

Actual or anticipated quarterly fluctuations in our operating results and financial condition;

Changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to us or other financial institutions;

Reports in the press or investment community generally or relating to our reputation or the financial services industry;

Strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;

Fluctuations in the stock price and operating results of our competitors;

Future sales of our equity or equity-related securities;

Proposed or adopted regulatory changes or developments;

Anticipated or pending investigations, proceedings, or litigation that involve or affect us;

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Domestic and international economic factors unrelated to our performance; and

General market conditions and, in particular, developments related to market conditions for the financial services industry.



Table of Contents

In addition, in recent years, the stock market in general has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies, including for reasons unrelated to their operating performance. These broad market fluctuations may adversely affect our stock price, notwithstanding our operating results. We expect that the market price of our common stock will continue to fluctuate and there can be no assurances about the levels of the market prices for our common stock.

**Trading in the common stock has been moderate. As a result, shareholders may not be able to quickly and easily sell their common stock, particularly in large quantities.**

Although our common stock is listed for trading on the NASDAQ Capital Market and a number of brokers offer to make a market in the common stock on a regular basis, trading volume to date has been limited, averaging approximately 76,351 shares per day during 2013, and there can be no assurance that a continuously active and liquid market for the common stock can be maintained. As a result, shareholders may find it difficult to sell a significant number of shares at the prevailing market price.

**Our ability to pay dividends on the common stock, or repurchase shares of common stock may be limited.**

Under the terms of the our Series B Preferred Stock issued to the Treasury under the SBLF, our ability to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of common stock is subject to restrictions. No repurchases of common stock may be effected, and no dividends may be declared or paid on the common stock during the current quarter and for the next three quarters following the failure to declare and pay dividends on the Series B Preferred Stock.

Additionally, under the terms of the Series B Preferred Stock, the Company may only declare and pay a dividend on the common stock, or repurchase shares of any such class or series of stock, if, after payment of such dividend, the dollar amount of the Company's Tier 1 Capital would be at least 90% of the Signing Date Tier 1 Capital, as set forth in the Articles Supplementary relating to the Series B Preferred Stock, excluding any subsequent net charge-offs and any redemption of the Series B Preferred Stock (the "Tier 1 Dividend Threshold"). The Tier 1 Dividend Threshold is subject to reduction, beginning on the second anniversary of issuance and ending on the tenth anniversary, by 10% for each one percent increase in QSBL over the baseline level. See "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Common Equity" at page 32 for additional information on limitations of our ability to pay dividends.

**We may issue additional equity securities, or engage in other transactions which dilute our book value or affect the priority of the common stock, which may adversely affect the market price of our common stock.**

Our board of directors may determine from time to time that we need to raise additional capital by issuing additional shares of our common stock or other securities. We are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future offerings, or the prices at which such offerings may be affected. Such offerings could be dilutive to common shareholders. New investors also may have rights, preferences and privileges that are senior to, and that adversely affect, our then current common shareholders. Additionally, if we raise additional capital by making additional offerings of debt or preferred equity securities, upon liquidation, holders of our debt securities and shares of preferred stock, and lenders with respect to other borrowings, will receive distributions of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing

Table of Contents

shareholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

**We expect that we will issue additional securities in order to obtain a portion of the funds required to redeem outstanding securities.**

We currently expect that we will seek to redeem all of the outstanding shares of Series B Preferred Stock from the Treasury before the dividend rate automatically adjusts, in December 2015, to 9%. The aggregate redemption price of the Series B Preferred Stock is \$56.6 million plus accrued but unpaid dividends to the date of redemption. Additionally, we have \$9.3 million of subordinated notes outstanding, which will cease to qualify as capital for regulatory purposes on January 1, 2015, the date on which the new capital definitions implementing Basel III become applicable to the Company and Bank. The Company expects that it will consider redemption of the subordinated notes. While the Company expects that it will be able to fund an as yet undetermined portion of the redemption price of the Series B Preferred Stock and the subordinated notes from the earnings of the Bank, we expect that we will have to issue additional debt or equity securities to fund the balance of the purchase price. The amount to be funded through the sale of securities, and the type and terms of such securities, will be dependent, in part, on our earnings, rate of growth, capital requirements, market conditions and regulatory requirements.

**Directors and executive officers of the Company own approximately 12.4% of the outstanding common stock. As a result of their combined ownership, they could make it more difficult to obtain approval for some matters submitted to shareholder vote, including acquisitions of the Company. The results of a vote may be contrary to the desires or interests of some public shareholders.**

Directors and executive officers of the Company and their affiliates own approximately 12.4% of the outstanding shares of common stock, excluding shares which may be acquired upon the exercise of options. By voting against a proposal submitted to shareholders, the directors and officers, as a group, may be able to make approval more difficult for proposals requiring a vote of shareholders, such as some mergers, share exchanges, asset sales, and amendments to the articles of incorporation.

**Substantial regulatory limitations on changes of control and anti-takeover provisions of Maryland law may make it more difficult for you to receive a change in control premium.**

With certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be "acting in concert" from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve Board. There are comparable prior approval requirements for changes in control under Maryland law. Also, Maryland corporate law contains several provisions that may make it more difficult for a third party to acquire control of the Company without the approval of the Company's board of directors, and may make it more difficult or expensive for a third party to acquire a majority of our outstanding common stock.

**The economic environment continues to pose significant challenges for us and could adversely affect our financial condition and results of operations.**

The Company is operating in a challenging and uncertain economic environment. Financial institutions continue to be affected by softness in the real estate market and constrained financial markets, highlighted by historically low market interest rates. There have been dramatic declines in the housing market, with falling home prices, and high levels of foreclosures and weak employment statistics in many parts of the country. While conditions have improved since the depths of the financial crisis, generally and in the Company's market area, should declines in real estate values, home sales volumes, and financial stress on borrowers as a result of the uncertain economic environment re-emerge, such events could have

Table of Contents

an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations. A worsening of these conditions would likely exacerbate the adverse effects on the Company and others in the financial institutions industry. For example, deterioration in local economic conditions in our market could drive losses beyond that which is provided for in our allowance for loan losses. The Company may also face the following risks in connection with these events:

Economic conditions that negatively affect housing prices and the job market have resulted and may continue to result in a deterioration in credit quality of our loan portfolio, and such deterioration in credit quality has had, and could continue to have, a negative impact on our business;

Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities;

A reduction in the size, spending or employment levels of the federal, state and/or local governments in the Washington, D.C. metropolitan area could have a negative effect on the economy in the region, on our customers and on real estate prices;

The methodologies we use to establish our allowance for loan losses may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation;

Volatility in the market, and lower levels of confidence in the banking system, could require the Bank to pay higher interest rates to obtain deposits to meet the needs of its depositors and borrowers, resulting in reduced margin and net interest income. If conditions worsen significantly, it is possible that banks such as the Bank may be unable to meet the needs of their depositors and borrowers, which could, in the worst case, result in the Bank being placed into receivership; and

Compliance with increased regulation of the banking industry may increase our costs, limit our ability to pursue business opportunities, and divert management efforts.

If these conditions or similar ones continue to exist or worsen, the Company could experience continuing or increased adverse effects on its financial condition.

**Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance for loan losses.**

Historically, we have enjoyed a relatively low level of nonperforming assets and net charge-offs, both in absolute dollars, as a percentage of loans and as compared to many of our peer institutions. As a result of this historical experience, we have incurred a relatively lower loan loss provision expense, which has positively impacted our earnings. However, experience in the banking industry indicates that a portion of our loans will become delinquent, that some of our loans may only be partially repaid or may never be repaid and we may experience other losses for reasons beyond our control. Despite our underwriting criteria and historical experience, we may be particularly susceptible to losses due to: (1) the geographic concentration of our loans; (2) the concentration of higher risk loans, such as commercial real estate, construction and commercial and industrial loans; (3) the relative lack of seasoning of certain of our loans. As a result, we may not be able to maintain our relatively low levels of nonperforming assets and charge-offs. Although we believe that our allowance for loan losses is maintained at a level adequate to absorb any inherent losses in our loan portfolio, these estimates of loan losses are necessarily subjective and their accuracy depends on the outcome of future events. If we need to make significant and unanticipated increases in our loss allowance in the future, our results of operations and financial condition would be materially adversely affected at that time.

While we strive to carefully monitor credit quality and to identify loans that may become nonperforming, at any time there are loans included in the portfolio that will result in losses, but that have

Table of Contents

not been identified as nonperforming or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become nonperforming assets, or that we will be able to limit losses on those loans that are identified. As a result, future additions to the allowance may be necessary.

Economic conditions and uncertainty in the financial markets could adversely affect our ability to accurately assess our allowance for credit losses. Our ability to assess the creditworthiness of our customers or to estimate the values of our assets and collateral for loans will be reduced if the models and approaches we use become less predictive of future behaviors, valuations, assumptions or estimates. We estimate losses inherent in our credit exposure, the adequacy of our allowance for loan losses and the values of certain assets by using estimates based on difficult, subjective, and complex judgments, including estimates as to the effects of economic conditions and how these economic conditions might affect the ability of our borrowers to repay their loans or the value of assets.

**Changes in accounting standards could impact reported earnings.**

From time to time there are changes in the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can materially impact how we record and report our financial condition and results of operations. In some instances, we could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements.

**Our continued growth depends on our ability to meet minimum regulatory capital levels. Growth and shareholder returns may be adversely affected if sources of capital are not available to help us meet them.**

As we grow, we will have to maintain our regulatory capital levels at or above the required minimum levels, including the new capital requirements under Basel III. If earnings do not meet our current estimates, if we incur unanticipated losses or expenses, or if we grow faster than expected, we may need to obtain additional capital sooner than expected or we may be required to reduce our level of assets or reduce our rate of growth in order to maintain regulatory compliance. Under those circumstances net income and the rate of growth of net income may be adversely affected. Additional issuances of equity securities could have a dilutive effect on existing shareholders.

**Our results of operations, financial condition and the value of our shares may be adversely affected if we are not able to maintain our historical growth rate.**

Since opening for business in 1998, our asset level has increased rapidly, including an 11% increase in 2013. Over the past five fiscal years (2009 - 2013), our net income has increased at a compounded annual rate of 45%, with an increase in net income of 33% in 2013. We may not be able to achieve comparable results in future years. As our asset size and earnings increase, it may become more difficult to achieve high rates of increase in assets and earnings. Additionally, it may become more difficult to achieve continued improvements in our expense levels and efficiency ratio. We may not be able to maintain the relatively low levels of nonperforming assets that we have experienced. Declines in the rate of growth of income or assets or deposits, and increases in operating expenses or nonperforming assets may have an adverse impact on the value of the common stock.

**We are subject to liquidity risk in our operations.**

Liquidity risk is the possibility of being unable to meet obligations as they come due, pay deposits when withdrawn, and fund loan and investment opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. If a financial institution is unable to meet its payment obligations on a daily basis, it is subject to being placed into receivership, regardless of its capital levels. Our largest source of liquidity is customer deposit accounts, including noninterest bearing demand deposit accounts, which at December 31, 2013, constituted 26% of our total deposits. If we are unable to increase customer deposits in an amount

Table of Contents

sufficient to fund loan growth, we may be required to rely on other, potentially more expensive, sources of liquidity, such as FHLB borrowings, brokered deposits and repurchase agreements, to fund loan growth, which could adversely affect our earnings, or reduce our rate of growth, which could adversely affect our earnings and stock price.

We also have a significant amount of deposits which are in excess of the maximum FDIC insurance coverage limits. At any time, customers who have uninsured deposits may decide to move their deposits to institutions which are perceived as safer, sounder, or "too big to fail" or could elect to use other non-deposit funding products, such as repurchase agreements, that would require the Bank to pay higher interest and to provide securities as collateral for the Bank's repurchase obligation. At December 31, 2013, the Bank had approximately \$636 million of deposits in noninterest bearing demand accounts that would be uninsured deposits, or 20% of our total deposits.

While we believe that our strong earnings, capital position, relationship banking model and reputation as a safe and sound institution mitigate the risk of losing deposits, there can be no assurance that we will not have to replace a significant amount of deposits with alternative funding sources, such as repurchase agreements, federal funds lines, certificates of deposit, brokered deposits, other categories of interest bearing deposits and FHLB borrowings, all of which are more expensive than noninterest bearing deposits, and can be more expensive than other categories of deposits. While we believe that we would be able to maintain adequate liquidity at reasonable cost, the loss of a significant amount of deposits, particularly noninterest bearing deposits, could have a material adverse affect on our earnings, net interest margin, rate of growth and stock price.

**We may not be able to successfully manage continued growth.**

We intend to seek further growth in the level of our assets and deposits and selectively in the number of our branches, both within our existing footprint and possibly to expand our footprint in the Maryland and Virginia suburbs, and in Washington, D.C., although no additional branches are currently anticipated in 2014. We may not be able to manage increased levels of assets and liabilities, and an expanded branch system, without increased expenses and higher levels of nonperforming assets. We may be required to make additional investments in equipment and personnel to manage higher asset levels and loan balances and a larger branch network, which may adversely impact earnings, shareholder returns and our efficiency ratio. Increases in operating expenses or nonperforming assets may have an adverse impact on the value of our common stock.

**We may face risks with respect to future expansion or acquisition activity.**

We selectively seek to expand our banking operations through limited *de novo* branching or opportunistic acquisition activities, and expect to continue to explore such opportunities. We cannot be certain that any expansion activity, through *de novo* branching, acquisition of branches of another financial institution or a whole institution, or acquisition of nonbanking financial service companies, will prove profitable or will increase shareholder value. The success of any acquisition will depend, in part, on our ability to realize the estimated cost savings and revenue enhancements from combining the businesses of the Company and the target company. Our ability to realize increases in revenue will depend, in part, on our ability to retain customers and employees, and to capitalize on existing relationships for the provision of additional products and services. If our estimates turn out to be incorrect or we are not able to successfully combine companies, the anticipated cost savings and increased revenues may not be realized fully or at all, or may take longer to realize than expected. It is possible that the integration process could result in the loss of key employees, the disruption of each company's ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients and employees or to achieve the anticipated benefits of the merger. As with any combination of banking institutions, there also may be disruptions that cause us to lose customers or cause customers to withdraw their deposits from our bank. Customers may not readily accept changes to their banking

Table of Contents

arrangements that we make as part of or following an acquisition. Additionally, the value of an acquisition to the Company is dependent on our ability to successfully identify and estimate the magnitude of any asset quality issues of acquired companies.

**Our concentrations of loans may create a greater risk of loan defaults and losses.**

A substantial portion of our loans are secured by real estate in the Washington, D.C. metropolitan area and substantially all of our loans are to borrowers in that area. We also have a significant amount of real estate construction loans and land related loans for residential and commercial developments. At December 31, 2013, 79.9% of our loans were secured by real estate, primarily commercial real estate. Management believes that the commercial real estate concentration risk is mitigated by diversification among the types and characteristics of real estate collateral properties, sound underwriting practices, and ongoing portfolio monitoring and market analysis. Of these loans, \$608.8 million, or 21% of portfolio loans were construction and land development loans. An additional \$694.4 million, or 24% of portfolio loans, were commercial and industrial loans which are generally not secured by real estate. The repayments of these loans often depends on the successful operation of a business or the sale or development of the underlying property and as a result, are more likely to be adversely affected by adverse conditions in the real estate market or the economy in general. While we believe that our loan portfolio is well diversified in terms of borrowers and industries, these concentrations expose us to the risk that adverse developments in the real estate market, or in the general economic conditions in the Washington, D.C. metropolitan area, could increase the levels of nonperforming loans and charge-offs, and reduce loan demand. In that event, we would likely experience lower earnings or losses. Additionally, if, for any reason, economic conditions in our market area deteriorate, or there is significant volatility or weakness in the economy or any significant sector of the area's economy, our ability to develop our business relationships may be diminished, the quality and collectability of our loans may be adversely affected, the value of collateral may decline and loan demand may be reduced.

Commercial, commercial real estate and construction loans tend to have larger balances than single family mortgages loans and other consumer loans. Because the loan portfolio contains a significant number of commercial and commercial real estate and construction loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in nonperforming assets. An increase in nonperforming loans could result in: a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, which could have an adverse impact on our results of operations and financial condition.

Additionally, through ECV, we provide subordinated financing for the acquisition, development and construction of real estate or other projects, the primary financing for which may be provided by the Bank. These subordinated financings and the business of ECV will generally entail a higher risk profile (including lower lien priority and higher loan to value ratios) than loans made by the Bank. A portion of the amount which the Company expects to receive for such loans will be payments based on the success, sale or completion of the underlying project, and as such the income of the Company may be more volatile from period to period, based on the status of such projects. The Company may not be able to successfully operate or manage the business of providing higher loan to value financing.

**Our concentrations of loans may require us to maintain higher levels of capital.**

Under guidance adopted by the federal banking regulators, banks which have concentrations in construction, land development or commercial real estate loans (other than loans for majority owner occupied properties) would be expected to maintain higher levels of risk management and, potentially, higher levels of capital. Although not currently anticipated, we may be required to maintain higher levels of capital than we would otherwise be expected to maintain as a result of our levels of construction, development and commercial real estate loans, which may require us to obtain additional capital sooner than we would otherwise seek it, which may reduce shareholder returns.

Table of Contents

**Our Residential Lending department may not continue to provide us with significant noninterest income.**

During 2013, the Bank's Residential Lending division, which originates residential mortgage loans on a pre-sold servicing released basis, for secondary market sale, saw decreased originations as market interest rates increased beginning in the second quarter of 2013. The volume of loans originated in 2013 declined to \$983 million, as compared to \$1.5 billion of loans originated in 2012 and \$816 million in 2011. The residential mortgage business is highly competitive, and highly susceptible to changes in market interest rates, consumer confidence levels, employment statistics, the capacity and willingness of secondary market purchasers to acquire and hold or securitize loans, and other factors beyond our control. Additionally, in many respects, the mortgage origination business is relationship based, and dependent on the services of individual mortgage loan officers. The loss of services of one or more loan officers could have the effect of reducing the level of our mortgage production, or the rate of growth of production. As a result of these factors we cannot be certain that we will not be able to continue to increase the volume or percentage of revenue or net income produced by the residential mortgage business.

**Our financial condition, earnings and asset quality could be adversely affected if we are required to repurchase loans originated for sale by our Residential Lending department.**

The Bank originates residential mortgage loans for sale to secondary market investors, subject to contractually specified and limited recourse provisions. In 2013, the Bank originated \$983 million and sold \$1.2 billion of loans to investors, as compared to \$1.5 billion originated and \$1.4 billion sold to investors in 2012 and \$816 million originated and \$725 million sold in 2011. Because the loans are intended to be originated within investor guidelines, designated automated underwriting and product specific requirements as part of the loan application, the loans sold have a limited recourse provision. In general, the Bank may be required to repurchase a previously sold mortgage loan or indemnify the investor if there is non-compliance with defined loan origination or documentation standards, including fraud, negligence, material misstatement in the loan documents or noncompliance with applicable law. In addition, the Company may have an obligation to repurchase a loan if the mortgagor has defaulted early in the loan term. The potential mortgagor early default repurchase period is up to approximately twelve months after sale of the loan to the investor. The recourse period for fraud, material misstatement, breach of representations and warranties, noncompliance with law, or similar matters could be as long as the term of the loan. Mortgages subject to recourse are collateralized by single-family residential properties, have loan-to-value ratios of 80% or less, or have private mortgage insurance. Our experience to date has been minimal in the case of loan repurchases due to default, fraud, breach of representations, material misstatement, or legal noncompliance. Should repurchases become a material issue, our earnings and asset quality could be adversely impacted, which could adversely impact our share price.

**Changes in interest rates and other factors beyond our control could have an adverse impact on our financial performance and results.**

Our operating income and net income depend to a great extent on our net interest margin, i.e., the difference between the interest yields we receive on loans, securities and other interest bearing assets and the interest rates we pay on interest bearing deposits and other liabilities. Net interest margin is affected by changes in market interest rates, because different types of assets and liabilities may react differently, and at different times, to market interest rate changes. When interest bearing liabilities mature or re-price more quickly than interest earning assets in a period, an increase in market rates of interest could reduce net interest income. Similarly, when interest earning assets mature or re-price more quickly than interest bearing liabilities, falling interest rates could reduce net interest income. These rates are highly sensitive to many factors beyond our control, including competition, general economic conditions and monetary and fiscal policies of various governmental and regulatory authorities, including the Federal Reserve Board.

Table of Contents

We attempt to manage our risk from changes in market interest rates by adjusting the rates, maturity, re-pricing, and balances of the different types of interest earning assets and interest bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on our net interest margin and results of operations. At December 31, 2013, our cumulative net asset sensitive twelve month gap position was 9.02% of total assets, which includes loans currently at their floor rates. As such, we expect modest decreases of approximately minus 2.1% and minus 7.2%, respectively, in projected net interest income and net income over a twelve month period resulting from a 100 basis point increase in rates, as loans currently at floor rates which are above the calculated contractual rate do not adjust upon a rate increase, and our residential mortgage origination and sale volume could decline as interest rates increase. The results of our interest rate sensitivity simulation model depend upon a number of assumptions, which may not prove to be accurate. There can be no assurance that we will be able to successfully manage our interest rate risk.

Adverse changes in the real estate market in our market area could also have an adverse affect on our cost of funds and net interest margin, as we have a large amount of noninterest bearing deposits related to real estate sales and development. While we expect that we would be able to replace the liquidity provided by these deposits, the replacement funds would likely be more costly, negatively impacting earnings.

**We may not be able to successfully compete with others for business.**

The Washington, D.C. metropolitan area in which we operate is considered highly attractive from an economic and demographic viewpoint, and is a highly competitive banking market. We compete for loans, deposits, and investment dollars with numerous regional and national banks, online divisions of out-of-market banks, and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, and private lenders. Many competitors have substantially greater resources than us, and some operate under less stringent regulatory environments. The differences in resources and regulations may make it harder for us to compete profitably, reduce the rates that we can earn on loans and investments, increase the rates we must offer on deposits and other funds, and adversely affect our overall financial condition and earnings.

The Company has been very successful in developing new customer relationships. These new relationships have resulted in significant increases in both loans and deposits, and have contributed to increased earnings. As the economy improves and competition increases, we are subject to the risk that we may not be able to retain the loans and deposits produced by these new relationships. While we believe that our relationship banking model will enable us to keep a significant percentage of these new relationships, there can be no assurance that we will be able to do so, that we would be able to maintain favorable pricing, margins and asset quality, or that we will be able to grow at the same rate we did when such alternative financing was not widely available.

**Government regulation will significantly affect the Bank's business, and may result in higher costs and lower shareholder returns.**

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance fund and depositors, not shareholders. The Company and Bank are regulated and supervised by the Maryland Department of Financial Regulation, the Federal Reserve Board and the FDIC. The Bank is also subject to regulations promulgated by the CFPB. The burden imposed by federal and state regulations puts banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies and leasing companies. Changes in the laws, regulations and regulatory practices affecting the banking industry may increase our costs of doing business or otherwise adversely affect us and create competitive advantages for others. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition.



Table of Contents

Federal economic and monetary policy may also affect our ability to attract deposits and other funding sources, make loans and investments, and achieve satisfactory interest spreads.

**New or changed legislation or regulation and regulatory initiatives could subject us to increased regulation, increase our costs of doing business and adversely affect us.**

Changes in federal and state legislation and regulation may affect our operations. New and modified regulation, such as the Dodd-Frank Act and Basel III, may have unforeseen or unintended consequences on our industry. The Dodd-Frank Act has implemented, and is expected to further implement, significant changes to the U.S. financial system, including the creation of new regulatory agencies (such as the FSOC to oversee systemic risk and the CFPB to develop and enforce rules for consumer financial products), changes in retail banking regulations, and changes to deposit insurance assessments. Additionally, proposed rules to implement Basel III would revise risk-based and leverage capital requirements and also limit capital distributions and certain discretionary bonuses if a banking organization does not hold a "capital conservation buffer." This additional regulation could increase our compliance costs and otherwise adversely affect our operations. The potential also exists for additional federal or state laws or regulations, or changes in policy or interpretations, affecting many of our operations, including capital levels, lending and funding practices, insurance assessments, and liquidity standards. The effect of any such changes and their interpretation and application by regulatory authorities cannot be predicted, may increase the Company's cost of doing business and otherwise affect our operations, may significantly affect the markets in which the Company does business, and could have a materially adverse effect on the Company.

In addition, recent government responses to the condition of the global financial markets and the banking industry has, among other things, increased our costs and may further increase our costs for items such as federal deposit insurance. The FDIC insures deposits at FDIC-insured institutions, such as the Bank, up to applicable limits. The FDIC charges the insured financial institutions premiums to maintain the Deposit Insurance Fund at a certain level. Increases in deposit insurance premiums to increase the coverage ratio to required levels, or to pay depositors of additional failed institutions could adversely affect the Company's net income.

While the full impact of the Dodd-Frank Act and the CFPB rulemakings cannot be assessed until all implementing regulations are released, become effective and are interpreted by regulators and the courts, the Dodd-Frank Act's extensive requirements may have a significant effect on the financial markets, and may affect the availability or terms of financing from our lender counterparties and the availability or terms of mortgage-backed securities, both of which may have an adverse effect on our financial condition and results of operations. The CFPB's rules are likely to result in increased compliance costs and fees, along with possible restrictions on our operations, any of which may have a material adverse effect on our operating results and financial condition.

**Our customers, and businesses in the Washington, D.C. metropolitan area in general, may be adversely impacted as a result of changes in government spending.**

The Washington, D.C. metropolitan area is characterized by a significant number of businesses that are federal government contractors or subcontractors, or which depend on such businesses for a significant portion of their revenues. While the Company does not have a significant level of loans to federal government contractors or their subcontractors, the impact of a decline in federal government spending, a reallocation of government spending to different industries or different areas of the country, or a delay in payments to such contractors, could have a ripple effect. Temporary layoffs, salary reductions or furloughs of government employees or government contractors could have adverse impacts on other businesses in the Company's market and the general economy of the greater Washington D.C. metropolitan area, and may indirectly lead to a loss of revenues by the Company's customers, including vendors and lessors to the federal government and government contractors or to their employees, as well as a wide variety of commercial and retail businesses. Accordingly, such potential changes in federal government activities could lead to increases in past due loans, nonperforming loans, loan loss reserves, and charge-offs, and a decline in liquidity.

Table of Contents

**We rely upon independent appraisals to determine the value of the real estate which secures a significant portion of our loans, and the values indicated by such appraisals may not be realizable if we are forced to foreclose upon such loans.**

A significant portion of our loan portfolio consists of loans secured by real estate, 79.9% at December 31, 2013. We rely upon independent appraisers to estimate the value of such real estate. Appraisals are only estimates of value and the independent appraisers may make mistakes of fact or judgment which adversely affect the reliability of their appraisals. In addition, events occurring after the initial appraisal may cause the value of the real estate to increase or decrease. As a result of any of these factors, the real estate securing some of our loans may be more or less valuable than anticipated at the time the loans were made. If a default occurs on a loan secured by real estate that is less valuable than originally estimated, we may not be able to recover the outstanding balance of the loan and will suffer a loss.

**We are exposed to risk of environmental liabilities with respect to properties to which we take title.**

In the course of our business we may foreclose and take title to real estate, potentially becoming subject to environmental liabilities associated with the properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs or we may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. Costs associated with investigation or remediation activities can be substantial. If the Bank is the owner or former owner of a contaminated site, it may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. These costs and claims could adversely affect our business.

**Our operations rely on certain external vendors.**

Our business is dependent on the use of outside service providers that support our day-to-day operations including data processing and electronic communications. Our operations are exposed to risk that a service provider may not perform in accordance with established performance standards required in our agreements for any number of reasons including equipment or network failure, a change in their senior management, their financial condition, their product line or mix and how they support existing customers, or a simple change in their strategic focus. While we have comprehensive policies and procedures in place to mitigate risk at all phases of service provider management from selection, to performance monitoring and renewals, the failure of a service provider to perform in accordance with contractual agreements could be disruptive to our business, which could have a material adverse effect on our financial conditions and results of our operations.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None

**ITEM 2. PROPERTIES**

All properties out of which the Company operates are leased properties. As of December 31, 2013, the Company and its subsidiaries operated out of 23 leased facilities; 18 of which are leased for branch

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

offices in the Washington, D.C. metro area: seven in Montgomery County, Maryland; six located in Northern Virginia; and five in the District of Columbia.

#### **Maryland Branch Locations:**

Bethesda Office  
7815 Woodmont Avenue  
Bethesda, Maryland 20814

Chevy Chase Office  
15 Wisconsin Circle  
Chevy Chase, Maryland 20815

Park Potomac Office  
12505 Park Potomac Avenue  
Potomac, Maryland 20854

Rockville Office  
110 North Washington Street  
Rockville, Maryland 20850

Rollins Avenue Office  
130 Rollins Avenue  
Rockville, Maryland 20852

Shady Grove Office  
9600 Blackwell Road  
Rockville, Maryland 20850

Silver Spring Office  
8665-B Georgia Avenue  
Silver Spring, Maryland 20910

#### **Virginia Branch Locations:**

Alexandria Office  
277 S. Washington Street  
Alexandria, Virginia 22314

Ballston Office  
4420 N. Fairfax Drive  
Arlington, Virginia 22203

Merrifield Office  
2905 District Avenue  
Fairfax, Virginia 22201

Reston Office  
12011 Sunset Hills Road  
Reston, Virginia 20190

Rosslyn Office  
1919 N. Lynn Street  
Arlington, Virginia 22209

Tysons Corner Office  
8601 Westwood Center Drive  
Vienna, Virginia 22182

#### **Washington, D.C. Branch Locations:**

Dupont Circle Office  
1228 Connecticut Avenue, NW  
Washington, D.C. 20036

Gallery Place Office  
700 7th Street, NW  
Washington, D.C. 20001

Georgetown Office  
1044 Wisconsin Avenue, NW  
Washington, D.C. 20007

K Street Office  
2001 K Street, NW  
Washington, D.C. 20006

McPherson Square Office  
1425 K Street, NW  
Washington, D.C. 20005

The Bank leases an office facility in Bethesda at 7809 Woodmont Avenue, consisting of 6,406 square feet under a nine year lease (with options) which expires in April 2018. This facility is currently under sub-lease arrangements. Additionally, the Bank leases a 2,550 square foot office facility in Anne Arundel

Table of Contents

County Maryland, previously used for a Residential Mortgage production office, and which is being marketed for sub-lease. The lease expires in January 2017.

**Other Properties:**

Executive Offices and Lending Center  
7830 Old Georgetown Road  
Bethesda, Maryland 20814

Reston Corporate/Lending Center  
11911 Freedom Drive  
Reston, Virginia 20190

Operations Center  
11961 Tech Road  
Silver Spring, Maryland 20904

K Street Corporate/Lending Center  
2001 K Street, NW  
Washington, D.C. 20006

Residential Lending operates out of two offices as follows:

**Residential Lending:**

Park Potomac Office Fifth Floor  
12505 Park Potomac Avenue  
Potomac, Maryland 20854

Reston Office Residential Lending  
12011 Sunset Hills Drive  
Reston, Virginia 20190

**ITEM 3. LEGAL PROCEEDINGS**

From time to time the Company is a participant in various legal proceedings incidental to its business. In the opinion of management, the liabilities (if any) resulting from such legal proceedings will not have a material effect on the financial position of the Company.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF COMMON EQUITY**

*Market for Common Stock.* The Company's common stock is listed for trading on the NASDAQ Capital Market under the symbol "EGBN." Over the twelve month period ended December 31, 2013, the average daily trading volume amounted to approximately 76,351 shares, an increase from approximately 53,810 shares over the twelve month period ended December 31, 2012. No assurance can be given that a highly active trading market will develop or can be maintained. The following table sets forth the high and low sale prices for the common stock during each calendar quarter during the last two fiscal years, as adjusted for a 10% stock dividend paid on June 14, 2013. No cash dividends for common shareholders were declared during such periods. As of March 1, 2014, there were 25,947,555 shares of common stock outstanding, held by approximately 8,158 beneficial shareholders, including approximately 809 shareholders of record.

| Quarter | 2013     |          | 2012     |          |
|---------|----------|----------|----------|----------|
|         | High     | Low      | High     | Low      |
| First   | \$ 20.91 | \$ 18.18 | \$ 16.06 | \$ 13.32 |
| Second  | \$ 23.21 | \$ 18.13 | \$ 16.31 | \$ 13.96 |
| Third   | \$ 28.45 | \$ 22.29 | \$ 16.53 | \$ 14.28 |
| Fourth  | \$ 33.25 | \$ 26.04 | \$ 19.60 | \$ 15.25 |

*Dividends.* The Company has not paid a cash dividend on the common stock since the second quarter of 2008.

The payment of a cash dividend on common stock will depend largely upon the ability of the Bank, the Company's principal operating business, to declare and pay dividends to the Company. Payment of dividends on the common stock will also depend upon the Bank's earnings, financial condition, and need for funds, as well as governmental policies and regulations applicable to the Company and the Bank.

Regulations of the Federal Reserve Board and Maryland law place limits on the amount of dividends the Bank may pay to the Company without prior approval. Prior regulatory approval is required to pay dividends which exceed the Bank's net profits for the current year plus its retained net profits for the preceding two calendar years, less required transfers to surplus. Under Maryland law, dividends may only be paid out of retained earnings. State and federal bank regulatory agencies also have authority to prohibit a bank from paying dividends if such payment is deemed to be an unsafe or unsound practice, and the Federal Reserve Board has the same authority over bank holding companies. At December 31, 2013 the Bank could pay dividends to the Company to the extent of its earnings so long as it maintained required capital ratios.

The Federal Reserve Board has established requirements with respect to the maintenance of appropriate levels of capital by registered bank holding companies. Compliance with such standards, as presently in effect, or as they may be amended from time to time, could possibly limit the amount of dividends that the Company may pay in the future. In 1985, the Federal Reserve Board issued a policy statement on the payment of cash dividends by bank holding companies. In the statement, the Federal Reserve Board expressed its view that a holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income, or which could only be funded in ways that weaken the holding company's financial health, such as by borrowing. As a depository institution, the deposits of which are insured by the FDIC, the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due the FDIC. The Bank currently is not in default under any of its obligations to the FDIC.

Table of Contents

The Company's ability to pay dividends on the common stock is also restricted by the provisions of the Series B Preferred Stock issued under the SBLF. Under the Series B Preferred Stock, no repurchases may be effected, and no dividends may be declared or paid on preferred shares ranking *pari passu* with the Series B Preferred Stock, junior preferred shares, or other junior securities (including the common stock) during the current quarter and for the next three quarters following the failure to declare and pay dividends on the Series B Preferred Stock, except that, in any such quarter in which the dividend is paid, dividend payments on shares ranking *pari passu* may be paid to the extent necessary to avoid any resulting material covenant breach. The Company at December 31, 2013 was not in default of any obligations to declare and pay dividends on the Series B Preferred Stock.

Under the terms of the Series B Preferred Stock, the Company may only declare and pay a dividend on the common stock or other stock junior to the Series B Preferred Stock, or repurchase shares of any such class or series of stock, if, after payment of such dividend, the dollar amount of the Company's Tier 1 Capital would be at least 90% of the Signing Date Tier 1 Capital, as set forth in the Articles Supplementary relating to the Series B Preferred Stock, excluding any subsequent net charge-offs and any redemption of the Series B Preferred Stock (the "Tier 1 Dividend Threshold"). The Tier 1 Dividend Threshold is subject to reduction, beginning on the second anniversary of issuance and ending on the tenth anniversary, by 10% for each one percent increase in QSBL over the baseline level.

*Issuer Repurchase of Common Stock.* No shares of the Company's Common Stock were repurchased by or on behalf of the Company during 2013 or 2012.

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters for "Securities Authorized for Issuance Under Equity Compensation Plans."

Table of Contents

*Stock Price Performance.* The following table compares the cumulative total return on a hypothetical investment of \$100 in the Company's common stock on December 31, 2008 through December 31, 2013, with the hypothetical cumulative total return on the NASDAQ Stock Market Index (U.S. Companies) and the NASDAQ Bank Index for the comparable period, including reinvestment of dividends.

**Total Return Performance**

| Index                                      | Year Ending |          |          |          |          |          |
|--|-------------|----------|----------|----------|----------|----------|
|  | 12/31/08    | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 | 12/31/13 |
| Eagle Bancorp, Inc.                        | 100.00      | 182.09   | 250.96   | 252.87   | 347.30   | 585.97   |
| NASDAQ Stock Market Index-(U.S. Companies) | 100.00      | 145.36   | 171.74   | 170.38   | 200.63   | 281.22   |
| NASDAQ Bank Index                          | 100.00      | 83.70    | 95.55    | 85.52    | 101.50   | 143.84   |
| S&P 500                                    | 100.00      | 126.46   | 145.51   | 148.59   | 172.37   | 228.19   |

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The following table shows selected historical consolidated financial data for the Company. It should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes included elsewhere in this report.

*Use of Non-GAAP Financial Measures*

The information set forth below contains certain financial information determined by methods other than in accordance with generally accepted accounting principles in the United States ("GAAP"). These non-GAAP financial measures are "tangible common equity," and "tangible book value per common share." Our management uses these non-GAAP measures in its analysis of our performance because it believes these measures are material and will be used as a measure of our performance by investors.

These disclosures should not be considered in isolation or as a substitute for results determined in accordance with GAAP, and are not necessarily comparable to non-GAAP performance measures which may be presented by other bank holding companies. Management compensates for these limitations by providing detailed reconciliations between GAAP information and the non-GAAP financial measures. A reconciliation table is set forth below following the selected historical consolidated financial data.

|  | Year Ended December 31, |            |            |            |            |
|--|-------------------------|------------|------------|------------|------------|
| (dollars in thousands except per share data) | 2013                    | 2012       | 2011       | 2010       | 2009       |
| <b>Balance Sheets</b>                        |                         |            |            |            |            |
| <i>Period End</i>                            |                         |            |            |            |            |
| Securities                                   | \$ 389,405              | \$ 310,514 | \$ 324,053 | \$ 237,576 | \$ 245,644 |
| Loans held for sale                          | 42,030                  | 226,923    | 176,826    | 80,571     | 1,550      |
| Loans  | 2,945,158               | 2,493,095  | 2,056,256  | 1,675,500  | 1,399,311  |
| Allowance for credit losses                  | 40,921                  | 37,492     | 29,653     | 24,754     | 20,619     |
| Intangible assets, net                       | 3,510                   | 3,785      | 4,145      | 4,188      | 4,379      |
| Total assets                                 | 3,771,503               | 3,409,441  | 2,831,255  | 2,089,370  | 1,805,504  |
| Deposits                                     | 3,225,414               | 2,897,222  | 2,392,095  | 1,726,798  | 1,460,274  |
| Borrowings                                   | 119,771                 | 140,638    | 152,662    | 146,884    | 150,090    |
| Total liabilities                            | 3,377,640               | 3,059,465  | 2,564,544  | 1,884,654  | 1,617,183  |
| Preferred shareholders' equity               | 56,600                  | 56,600     | 56,600     | 22,582     | 22,612     |
| Common shareholders' equity                  | 337,263                 | 293,376    | 210,111    | 182,134    | 165,709    |
| Total shareholders' equity                   | 393,863                 | 349,976    | 266,711    | 204,716    | 188,321    |
| Tangible common equity(1)                    | 333,753                 | 289,591    | 205,966    | 177,946    | 161,330    |
| <b>Statements of Operations</b>              |                         |            |            |            |            |
| Interest income                              | \$ 157,294              | \$ 141,943 | \$ 119,124 | \$ 96,658  | \$ 84,338  |
| Interest expense                             | 12,504                  | 14,414     | 20,077     | 19,832     | 24,809     |
| Provision for credit losses                  | 9,602                   | 16,190     | 10,983     | 9,308      | 7,669      |
| Noninterest income                           | 24,716                  | 21,364     | 13,501     | 9,242      | 7,297      |
| Noninterest expense                          | 84,579                  | 76,531     | 63,276     | 51,005     | 42,773     |
| Income before taxes                          | 75,325                  | 56,172     | 38,289     | 25,755     | 16,384     |
| Income tax expense                           | 28,318                  | 20,883     | 13,731     | 9,098      | 5,965      |
| Net income                                   | 47,007                  | 35,289     | 24,558     | 16,657     | 10,419     |
| Preferred dividends                          | 566                     | 566        | 1,511      | 1,299      | 2,307      |
| Net income available to common shareholders  | 46,441                  | 34,723     | 23,047     | 15,358     | 8,112      |



Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

|   | Year Ended December 31, |            |            |            |            |
|---|-------------------------|------------|------------|------------|------------|
| (dollars in thousands except per share data)                | 2013                    | 2012       | 2011       | 2010       | 2009       |
| <b>Per Common Share Data(2)</b>                             |                         |            |            |            |            |
| Net income, basic   | \$ 1.81                 | \$ 1.50    | \$ 1.05    | \$ 0.71    | \$ 0.50    |
| Net income, diluted   | 1.76                    | 1.46       | 1.04       | 0.70       | 0.50       |
| Book value  | 13.03                   | 11.62      | 9.57       | 8.41       | 7.71       |
| Tangible book value(3)                                      | 12.89                   | 11.47      | 9.38       | 8.21       | 7.51       |
| Common shares outstanding                                   | 25,885,863              | 25,250,378 | 21,948,128 | 21,670,426 | 21,487,649 |
| Weighted average common shares outstanding                  | 25,726,062              | 23,135,886 | 21,819,087 | 21,613,450 | 16,107,623 |
| <b>Ratios</b>   |                         |            |            |            |            |
| Net interest margin(4)                                      | 4.30%                   | 4.32%      | 3.99%      | 4.09%      | 3.85%      |
| Efficiency ratio(5)   | 49.90%                  | 51.40%     | 56.22%     | 59.26%     | 64.01%     |
| Return on average assets(4)                                 | 1.37%                   | 1.18%      | 0.97%      | 0.86%      | 0.65%      |
| Return on average common equity                             | 14.60%                  | 14.14%     | 11.71%     | 8.74%      | 6.52%      |
| Total capital (to risk weighted assets)                     | 13.01%                  | 12.20%     | 11.84%     | 11.64%     | 13.57%     |
| Tier 1 capital (to risk weighted assets)                    | 11.53%                  | 10.80%     | 10.33%     | 9.91%      | 11.82%     |
| Tier 1 capital (to average assets)                          | 10.93%                  | 10.44%     | 8.21%      | 9.32%      | 10.29%     |
| <b>Asset Quality</b>  |                         |            |            |            |            |
| Nonperforming assets and loans 90+ past due                 | \$ 33,927               | \$ 35,983  | \$ 36,019  | \$ 31,988  | \$ 27,131  |
| Nonperforming assets and loans 90+ past due to total assets | 0.90%                   | 1.06%      | 1.27%      | 1.53%      | 1.50%      |
| Allowance for credit losses to loans                        | 1.39%                   | 1.50%      | 1.44%      | 1.48%      | 1.47%      |
| Allowance for credit losses to nonperforming assets         | 120.61%                 | 104.19%    | 82.33%     | 77.39%     | 76.00%     |
| Net charge-offs   | \$ 6,173                | \$ 8,351   | \$ 6,084   | \$ 5,173   | \$ 5,453   |
| Net charge-offs to average loans                            | 0.23%                   | 0.37%      | 0.32%      | 0.35%      | 0.42%      |

- (1) Tangible common shareholders' equity, a non-GAAP financial measure, is defined as total common shareholders' equity reduced by goodwill and other intangible assets.
- (2) Presented giving retroactive effect to the 10% stock dividend paid on the common stock on June 14, 2013.
- (3) Tangible book value per common share, a non-GAAP financial measure, is defined as tangible common shareholders' equity divided by total common share outstanding.

|  | Year Ended December 31, |                   |                   |                   |                   |
|--|-------------------------|-------------------|-------------------|-------------------|-------------------|
| (dollars in thousands except per share data) | 2013                    | 2012              | 2011              | 2010              | 2009              |
| <b>GAAP Reconciliation</b>                   |                         |                   |                   |                   |                   |
| Common shareholders' equity                  | \$ 337,263              | \$ 293,376        | \$ 210,111        | \$ 182,134        | \$ 165,709        |
| Less: Intangible assets                      | (3,510)                 | (3,785)           | (4,145)           | (4,188)           | (4,379)           |
| <b>Tangible common equity</b>                | <b>\$ 333,753</b>       | <b>\$ 289,591</b> | <b>\$ 205,966</b> | <b>\$ 177,946</b> | <b>\$ 161,330</b> |

Book value per common share \$ 13.03 \$ 11.62 \$ 9.57 \$ 8.41 \$ 7.71

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|  |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|
| Less: Intangible book value per common share | (0.14) | (0.15) | (0.19) | (0.20) | (0.20) |
|--|--------|--------|--------|--------|--------|

|   |          |          |         |         |         |
|---|----------|----------|---------|---------|---------|
| <b>Tangible book value per common share</b> | \$ 12.89 | \$ 11.47 | \$ 9.38 | \$ 8.21 | \$ 7.51 |
|---|----------|----------|---------|---------|---------|

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

**GAAP Reconciliation (Unaudited)**

| (dollars in thousands except per share data) | December 31, 2013 | December 31, 2012 |
|--|-------------------|-------------------|
| Common shareholders' equity                  | \$ 337,263        | \$ 293,376        |
| Less: Intangible assets                      | (3,510)           | (3,785)           |
| <b>Tangible common equity</b>                | <b>\$ 333,753</b> | <b>\$ 289,591</b> |

|  |          |          |
|--|----------|----------|
| Book value per common share                  | \$ 13.03 | \$ 11.62 |
| Less: Intangible book value per common share | (0.14)   | (0.15)   |

|   |                 |                 |
|---|-----------------|-----------------|
| <b>Tangible book value per common share</b> | <b>\$ 12.89</b> | <b>\$ 11.47</b> |
|---|-----------------|-----------------|

|                         |              |              |
|-------------------------|--------------|--------------|
| Total assets            | \$ 3,771,503 | \$ 3,409,441 |
| Less: Intangible assets | (3,510)      | (3,785)      |

|                        |                     |                     |
|------------------------|---------------------|---------------------|
| <b>Tangible assets</b> | <b>\$ 3,767,993</b> | <b>\$ 3,405,656</b> |
|------------------------|---------------------|---------------------|

|                                     |              |              |
|-------------------------------------|--------------|--------------|
| <b>Tangible common equity ratio</b> | <b>8.86%</b> | <b>8.50%</b> |
|-------------------------------------|--------------|--------------|

(4)

The reported figure includes the effect of a \$618 million deposit received on September 13, 2011 in connection with a class action settlement, which was disbursed by year end. The deposit was invested in excess reserves at the Federal Reserve Bank. As the magnitude of the deposit (the "settlement deposit") distorts the operational results of the Company, we present, in the GAAP reconciliation below and in Management's Discussion and Analysis of Financial Condition and Results of Operations, certain performance ratios excluding the effect of this deposit, notably the net interest margin and the return on average assets which resulted in approximately \$326,000 of interest income and \$170,000 of income, net of tax, during the twelve month period ended December 31, 2011. We believe this information is important to enable shareholders and other interested parties to assess the core operational performance of the Company.

| GAAP Reconciliation (Unaudited)<br>(dollars in thousands except per<br>share data) | Year Ended December 31, |            |                       |                    |            |                       |
|--|-------------------------|------------|-----------------------|--------------------|------------|-----------------------|
|  | 2012                    |            |                       | 2011               |            |                       |
|  | Average<br>Balance      | Interest   | Average<br>Yield/Rate | Average<br>Balance | Interest   | Average<br>Yield/Rate |
| Total earning assets   | \$ 2,953,417            | \$ 141,943 | 4.81%                 | \$ 2,482,625       | \$ 119,124 | 4.80%                 |
| Less: settlement deposit   |                         |            |                       | (117,990)          | (326)      | (0.28)%               |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                                    |              |            |              |              |            |              |
|------------------------------------|--------------|------------|--------------|--------------|------------|--------------|
| Adjusted earning assets            | \$ 2,953,417 | \$ 141,943 | 4.81%        | \$ 2,364,635 | \$ 118,798 | 5.02%        |
| Total interest bearing liabilities | \$ 1,903,453 | \$ 14,414  | 0.76%        | \$ 1,679,855 | \$ 20,077  | 1.20%        |
| <b>Adjusted interest spread</b>    |              |            | <b>4.05%</b> |              |            | <b>3.82%</b> |
| <b>Adjusted interest margin</b>    |              |            | <b>4.32%</b> |              |            | <b>4.17%</b> |

|  | Years Ended<br>December 31, |                  |
|--|-----------------------------|------------------|
|  | 2012                        | 2011             |
| Net income                               | \$ 35,289                   | \$ 24,558        |
| Less: settlement deposit                 |                             | (170)            |
| <b>Adjusted net income</b>               | <b>\$ 35,289</b>            | <b>\$ 24,388</b> |
| Average total assets                     | \$ 2,997,994                | \$ 2,523,592     |
| Less: settlement deposit                 |                             | (117,990)        |
| Adjusted average total assets            | \$ 2,997,994                | \$ 2,405,602     |
| <b>Adjusted return on average assets</b> | <b>1.18%</b>                | <b>1.01%</b>     |

(5) Computed by dividing noninterest expense by the sum of net interest income and noninterest income.

Table of Contents

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of the Company. The Company's primary subsidiaries are the Bank, Bethesda Leasing, LLC, Eagle Insurance Services, LLC, and Eagle Commercial Ventures ("ECV"). This discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report.

*Caution About Forward Looking Statements.* This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, objectives, expected operating results and the assumptions upon which those statements are based. Forward looking statements include without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and are typically identified with words such as "may," "could," "should," "will," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," or words or phrases of similar meaning. These forward looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Actual results, performance or achievements could differ materially from those contemplated, expressed, or implied by the forward looking statements.

The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward looking statements:

The strength of the United States economy in general and the strength of the local economies in which we conduct operations;

Geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad;

The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board, inflation, interest rate, market and monetary fluctuations;

The timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;

The willingness of users to substitute competitors' products and services for our products and services;

The impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;

The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the Securities and Exchange Commission (the "SEC"), the Public Company Accounting Oversight Board or the Financial Accounting Standards Board;

Technological and social media changes;

The effect of acquisitions we may make, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;

The growth and profitability of noninterest or fee income being less than expected;

Changes in the level of our nonperforming assets and charge-offs;

Table of Contents

Changes in consumer spending and savings habits; and

Unanticipated regulatory or judicial proceedings.

If one or more of the factors affecting our forward looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward looking information and statements contained in this report. You should not place undue reliance on our forward looking information and statements. We will not update the forward looking statements to reflect actual results or changes in the factors affecting the forward looking statements.

**GENERAL**

---

The Company is a growth oriented, one-bank holding company headquartered in Bethesda, Maryland, which is currently celebrating fifteen 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 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 eighteen branch offices, including seven in Montgomery County, Maryland, five in Washington, D.C. and six in Northern Virginia.

The Company 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 Company 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 delivery commitments by the investors to purchase the loans subject to compliance with pre-established investor criteria. The Company 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. 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 a referral program with a third party. ECV, a subsidiary of the Company, provides subordinated financing for the acquisition, development and/or construction of real estate projects. ECV lending involves higher levels of risk, together with commensurate expected returns.

Throughout 2013, economic conditions in both the U.S. economy and worldwide were quite mixed as monthly reports fluctuated from generally good to weak with sub-par economic growth being a persistent theme. Actual GDP growth in 2013 in the U.S. was below expectations. U.S. unemployment levels were lower at year-end 2013 but were impacted significantly by a much lower job participation level, which weighed heavily on Federal Reserve monetary policy. The first half of 2013 witnessed significant levels of residential mortgage refinancing, but as market interest rates began a steady rise beginning in late May 2013, the volume of residential lending subsided dramatically for the remainder of the year. Overall, real

Table of Contents

estate values were stable to increasing in 2013 as job creation was fairly anemic and personal income levels rising only slightly, if at all. Additionally, significant continued political gridlock in Washington D.C. politics over concerns of public debt and deficits, tax policy and spending levels persisted in 2013, which resulted in a partial government shutdown and added a heightened level of business uncertainty to everyday economic activity. Such uncertainty kept private investment weak throughout 2013 and average liquidity very high. As we moved through 2013, average interest rates increased in each quarter of 2013, in part due to the market's sense of certainty over the Federal Reserve's starting to decrease the quantitative easing programs involving large purchases of U.S. Treasury and mortgage backed securities. The first steps to reduce quantitative easing actually occurred in January 2014. These open market purchases served in part to keep residential mortgage interest rates at historical lows during 2013, in the hope that more homeowners might benefit from refinancing existing home mortgages. Even considering the partial federal government shutdown during 2013 and pressure to reduce federal spending, the Company's primary market, the Washington, D.C. metropolitan area, has been relatively less impacted by recessionary type forces than other parts of the country, due in part to the significant economic impact of the federal government, a highly educated work force and a diverse economy.

During 2013, the Company enhanced its marketplace positioning by remaining proactive in growing client relationships, expanding its branch presence in the Northern Virginia area by opening its Alexandria Office in March, and by the continued addition of experienced lending and sales personnel. The Company has had the financial resources and has remained committed to meeting the credit needs of its community, resulting in substantial growth in its loan portfolio during 2013. Furthermore, the Company's capital position was enhanced in 2013 by very strong and consistent earnings. The Company believes its strategies of remaining growth oriented and seeking quality lending and deposit relationships during the difficult economic times of the past few years have proven successful and is evidenced in its financial and performance ratios. Additionally, the Company believes such focus and strategy of relationship building has fostered future growth opportunities.

Operating in this less than ideal economic environment, the Company was able to produce good growth in deposits and loans in 2013, grow its net interest spread earnings substantially, maintain a solid position regarding asset quality and further leverage its cost of operations due to its seasoned and professional staff. The Company increased net income in each quarter of 2013, continuing a trend of consecutive quarters of increasing net earnings dating to the first quarter of 2009.

**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.

The fair values and the information used to record valuation adjustments for investment securities available-for-sale are based either on quoted market prices or are provided by other third-party sources, when available. The Company's investment portfolio is categorized as available-for-sale with unrealized



Table of Contents

gains and losses net of income tax being a component of shareholders' equity and accumulated other comprehensive income.

The allowance for credit losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two principles of accounting: (a) ASC Topic 450, "*Contingencies*," which requires that losses be accrued when they are probable of occurring and are estimable and (b) ASC Topic 310, "*Receivables*," which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, can be determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows, or values observable in the secondary markets.

Three components comprise our allowance for credit losses: a specific allowance, a formula allowance and a nonspecific or environmental factors allowance. Each component is determined based on estimates that can and do change when actual events occur.

The specific allowance allocates a reserve to identified impaired loans. Impaired loans are assigned specific reserves based on an impairment analysis. Under ASC Topic 310, "*Receivables*," a loan for which reserves are individually allocated may show deficiencies in the borrower's overall financial condition, payment record, support available from financial guarantors and for the fair market value of collateral. When a loan is identified as impaired, a specific reserve is established based on the Company's assessment of the loss that may be associated with the individual loan.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as requiring specific reserves. The portfolio of unimpaired loans is stratified by loan type and risk assessment. Allowance factors relate to the type of loan and level of the internal risk rating, with loans exhibiting higher risk and loss experience receiving a higher allowance factor.

The environmental allowance is also used to estimate the loss associated with pools of non-classified loans. These non-classified loans are also stratified by loan type, and environmental allowance factors are assigned by management based upon a number of conditions, including delinquencies, loss history, changes in lending policy and procedures, changes in business and economic conditions, changes in the nature and volume of the portfolio, management expertise, concentrations within the portfolio, quality of internal and external loan review systems, competition, and legal and regulatory requirements.

The allowance captures losses inherent in the loan portfolio, which have not yet been recognized. Allowance factors and the overall size of the allowance may change from period to period based upon management's assessment of the above described factors, the relative weights given to each factor, and portfolio composition.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including in connection with the valuation of collateral, a borrower's prospects of repayment, and in establishing allowance factors on the formula and environmental components of the allowance. The establishment of allowance factors involves a continuing evaluation, based on management's ongoing assessment of the global factors discussed above and their impact on the portfolio. The allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors can have a direct impact on the amount of the provision, and a related after tax effect on net income. Errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. Alternatively, errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance being in excess of amounts necessary to cover losses in the portfolio, and may result in lower provisions in the future. For additional information regarding the provision for credit losses, refer to the discussion under the caption "Provision for Credit Losses" below.

Table of Contents

The Company follows the provisions of ASC Topic 718, "Compensation," which requires the expense recognition for the fair value of share based compensation awards, such as stock options, restricted stock awards, and performance based shares. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. The accounting standard also allows for the use of alternative option pricing models which may impact fair value as determined. The Company's practice is to utilize reasonable and supportable assumptions.

## RESULTS OF OPERATIONS

---

### Overview

For the year ended December 31, 2013, the Company's net income was \$47.0 million, a 33% increase over the \$35.3 million for the year ended December 31, 2012. Net income available to common shareholders was \$46.4 million (\$1.81 per basic common share and \$1.76 per diluted common share), as compared to \$34.7 million (\$1.50 per basic common share and \$1.46 per diluted common share) for the year ended December 31, 2012, a 34% increase. Per share amounts for all prior periods have been adjusted to reflect the 10% stock dividend distributed on June 14, 2013.

For the three months ended December 31, 2013, the Company reported net income of \$12.0 million, an 18% increase over the \$10.2 million net income for the three months ended December 31, 2012. Net income available to common shareholders for the three months ended December 31, 2013 increased 18% to \$11.9 million (\$0.46 per basic common share and \$0.45 per diluted common share), as compared to \$10.1 million (\$0.40 per basic common share and \$0.39 per diluted common share) for the same period in 2012.

For the twelve months ended December 31, 2013, the Company reported a return on average assets ("ROAA") of 1.37% as compared to 1.18% for the twelve months of 2012, while the return on average common equity ("ROAE") was 14.60% in 2013, as compared to 14.14% for the same twelve month period in 2012. The higher ROAA and ROAE ratios for the twelve months of 2013 as compared to 2012 was primarily due to improved credit quality, lower provision expense, higher noninterest income, and strong cost management. Contributing to the growth in ROAA and ROAE was solid growth in net interest income and a favorable net interest margin.

For the three months ended December 31, 2013, the Company reported an annualized ROAA of 1.33% as compared to 1.25% for the three months ended December 31, 2012. The annualized ROAE for the quarter ended December 31, 2013 was 14.07%, as compared to 13.95% for the quarter ended December 31, 2012. The higher ROAA and ROAE ratios for fourth quarter of 2013 as compared to 2012 was due primarily to a combination of higher net interest margin, improved credit quality resulting in lower provision expense, and strong cost management.

The Company's earnings are largely dependent on net interest income, the difference between interest income and interest expense, which represented 85% and 86% of total revenue (defined as net interest income plus noninterest income) for the full year in 2013 and 2012, respectively.

For the twelve months ended December 31, 2013, the net interest margin, net interest income as a percentage of earning assets, was 4.30% as compared to 4.32%, for the twelve months ended December 31, 2012. For the year of 2013, the Company was able to maintain a strong net interest margin due to disciplined loan pricing practices, and has been able to reduce its cost of funds, while maintaining a favorable deposit mix, largely resulting from ongoing efforts to increase and expand client relationships. The slightly lower net interest margin for the year ended December 31, 2013 as compared to the 2012 was due to a lower mix of average noninterest deposits, as the net interest spread was higher in 2013 (4.11%) versus 2012 (4.05%). For the year 2013 as compared to 2012, average loan yields declined by 17 basis points (from 5.68% to 5.51%), average investment yields increased by 18 basis points (from 2.06% to

Table of Contents

2.24%), and average earning asset yields declined by 14 basis points (from 4.81% to 4.67%) as compared to a decline of 20 basis points (from 0.76% to 0.56%) in the cost of interest bearing liabilities. The net interest spread was 4.11% for the year ended December 31, 2013, as compared to 4.05% for the same period in 2012, an increase of 6 basis points. The benefit of noninterest sources funding earning assets declined from 27 basis points for the year ended December 31, 2012 to 19 basis points for same period in 2013. The combination of a 6 basis point increase in the net interest spread and 8 basis points decrease in the value of noninterest sources resulted in the 2 basis point decrease in the net interest margin.

For the three months ended December 31, 2013 and 2012, average interest bearing liabilities were 66% and 63%, respectively, of average earning assets, as more earning assets were funded by interest bearing sources in the most recent three month period as compared to the same three month period in 2012. For the three months ended December 31, 2013 average loan yields declined by 27 basis points from 5.67% to 5.40% and average investment yields increased by 32 basis points from 1.98% to 2.30%. Additionally, due to an increase in the mix of higher yielding earning assets in the three months ended December 31, 2013, as compared to the same period in 2012, the average rate on earning assets for the three months ended December 31, 2012 remained the same at 4.74%. The cost of interest bearing liabilities for the three months ended December 31, 2013 as compared to 2012 decreased by 16 basis points from 0.67% to 0.51%, resulting in an increase in the net interest spread of 16 basis points from 4.07% for the three months ended December 31, 2012 to 4.23% for the three months ended December 31, 2013. The net interest margin increased 9 basis points from 4.31% for the three months ended December 31, 2012 to 4.40% for the three months ended December 31, 2013. The benefit of noninterest sources funding earning assets decreased from 24 basis points for the three months ended December 31, 2012 to 17 basis points for same period in 2013. The combination of a 16 basis point increase in the net interest spread and 7 basis points decrease in the value of noninterest sources resulted in the 9 basis point increase in the net interest margin.

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 (at 85%) represents the most significant component of the Company's revenues.

In order to fund significant growth in the average balance of loans of 16% over the twelve months ended December 31, 2013 as compared to 2012, the Company has relied primarily upon core deposit growth, while decreasing the use of brokered and wholesale deposits. The major component of the growth in core deposits has been growth in money market accounts and noninterest deposits primarily as a result of effectively building new and enhanced client relationships. Growth of average total deposits was 15% for the twelve months ended December 31, 2013 as compared to 2012.

In terms of the average balance sheet composition or mix, loans, which generally have higher yields than securities and other earning assets, increased from 77% of average earning assets for the year ended December 31, 2012 to 78% of average earning assets in 2013. The higher growth of average funding sources as compared to average loan growth added average liquidity to the balance sheet for the year ended December 31, 2013 compared to the year 2012. The increase in average loans for the year ended December 31, 2013 as compared to the same period in 2012 is primarily attributable to growth in loans for both commercial and income producing commercial real estate loans. For the year ended December 31, 2013, as compared to the same period in 2012, average loans held for sale decreased \$50 million, a 36% decrease. Increases in average deposits for the year ended December 31, 2013, as compared to the same period in 2012, is attributable primarily to growth in money market accounts. Average investment securities for the year ended December 31, 2013 and 2012 amounted to 10% and 11% of average earning assets, respectively. The combination of federal funds sold, interest bearing deposits with other banks and loans held for sale, comprised 11% and 12% of average earning assets for the year ended December 31, 2013 and 2012, respectively.

Table of Contents

For the three months ended December 31, 2013, average loans were 82% of average earning assets as compared to 76% for the same period in 2012. Average loans increased \$426 million (17%) and average deposits increased \$290 million (11%), for the three months ended December 31, 2013 as compared to the same quarter of 2012. The increase in average loans in the fourth quarter of 2013 as compared to the fourth quarter of 2012 is primarily attributable to growth in income producing commercial real estate loans. Increases in average deposits in the fourth quarter of 2013, as compared to the fourth quarter of 2012, is attributable to growth in money market accounts. Average investment securities for the three months ended December 31, 2013 and 2012 amounted to 11% and 10% of average earning assets, respectively. The combination of federal funds sold, interest bearing deposits with other banks and loans held for sale, averaged 7% of average earning assets for the three months ended December 31, 2013 as compared to 14% for the same period in 2012, as the level of loans held for sale declined significantly in 2013.

The provision for credit losses was \$9.6 million for the year of 2013 as compared to \$16.2 million in 2012. The lower provisioning is due to a combination of lower net charge-offs, a lower level of nonperforming loans and overall improvement in asset quality. For the three months ended December 31, 2013, the provision for credit losses was \$2.5 million for the three months ended December 31, 2013 as compared to \$4.1 million for the three months ended December 31, 2012.

Total noninterest income for the year of 2013 was \$24.7 million compared to \$21.4 million in 2012, an increase of 15.7%. Total noninterest income for the three months ended December 31, 2013 decreased 29% to \$4.3 million from \$6.1 million for the three months ended December 31, 2012.

Total noninterest expenses increased 11% for the year 2013 to \$84.6 million as compared to \$76.5 million for 2012. Total noninterest expenses totaled \$21.5 million for the three months ended December 31, 2013, as compared to \$20.3 million for the three months ended December 31, 2012, a 6% increase.

The ratio of common equity to total assets increased from 8.60% at December 31, 2012 to 8.94% at December 31, 2013 due to a decrease in balance sheet leverage, primarily reflecting the increase in retained earnings from 2013 earnings. As discussed below, 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, loans held for sale, investment securities, and interest bearing deposits with banks. The cost of funds comprises interest expense on deposits, customer repurchase agreements and other borrowings, which are federal funds purchased and advances from the FHLB. Noninterest bearing deposits and capital are other components representing funding sources. 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. Net interest income in 2013 was \$144.8 million compared to \$127.5 million in 2012 and \$99.0 million in 2011. For the three months ended December 31, 2013, net interest income was \$38.7 million as compared to \$34.7 million and \$28.3 million for the same periods in 2012 and 2011, respectively.

For the year ended December 31, 2013, net interest income increased 14% over the same period for 2012. Average loans increased \$364 million and average deposits increased by \$373 million. The net interest margin was 4.30% for the year ended December 31, 2013, as compared to 4.32% for the same period in 2012. The Company has been able to maintain its loan yields in 2013 relatively close to 2012 levels due to loan pricing practices, and has been able to reduce its funding costs while maintaining a favorable deposit mix; much of which has occurred from sales efforts to increase and deepen client relationships. The Company believes its net interest margin remains favorable to peer banking companies.

Table of Contents

Net interest income increased 11% for the three months ended December 31, 2013 over the same period for 2012. Average loans increased \$426 million and average deposits increased by \$290 million. For the three months ended December 31, 2013 the net interest margin was 4.40% as compared to 4.31% for the same three months in 2012.

The tables below present the average balances and rates of the various categories of the Company's assets and liabilities for the years and three months ended December 31, 2013, 2012 and 2011. Included in the tables 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 expense 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. Margin includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

**Consolidated Average Balances, Interest Yields And Rates (Unaudited)**

| (dollars in thousands)  | Year Ended December 31, |          |                    |                 |          |                    |                 |          |                    |
|---|-------------------------|----------|--------------------|-----------------|----------|--------------------|-----------------|----------|--------------------|
|   | 2013                    |          |                    | 2012            |          |                    | 2011            |          |                    |
|   | Average Balance         | Interest | Average Yield/Rate | Average Balance | Interest | Average Yield/Rate | Average Balance | Interest | Average Yield/Rate |
| <b>Assets</b>   |                         |          |                    |                 |          |                    |                 |          |                    |
| Interest earning assets:  |                         |          |                    |                 |          |                    |                 |          |                    |
| Interest bearing deposits with other banks and other short-term investments |                         |          |                    |                 |          |                    |                 |          |                    |
|   | \$ 280,399              | \$ 689   | 0.25%              | \$ 186,157      | \$ 475   | 0.26%              | \$ 206,894      | \$ 513   | 0.25%              |
| Loans held for sale   | 90,161                  | 3,140    | 3.48%              | 140,167         | 4,945    | 3.53%              | 63,198          | 2,458    | 3.89%              |
| Loans(1)(2)   | 2,644,892               | 145,661  | 5.51%              | 2,281,027       | 129,655  | 5.68%              | 1,895,268       | 109,862  | 5.80%              |
| Investment securities available for sale(2)                                 |                         |          |                    |                 |          |                    |                 |          |                    |
|   | 348,143                 | 7,792    | 2.24%              | 330,670         | 6,824    | 2.06%              | 266,758         | 6,181    | 2.32%              |
| Federal funds sold  | 6,871                   | 12       | 0.17%              | 15,396          | 44       | 0.29%              | 50,507          | 110      | 0.22%              |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Total interest earning assets   | 3,370,466               | 157,294  | 4.67%              | 2,953,417       | 141,943  | 4.81%              | 2,482,625       | 119,124  | 4.80%              |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Noninterest earning assets  | 107,844                 |          |                    | 77,827          |          |                    | 67,882          |          |                    |
| Less: allowance for credit losses   | 39,207                  |          |                    | 33,250          |          |                    | 26,915          |          |                    |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Total noninterest earning assets  | 68,637                  |          |                    | 44,577          |          |                    | 40,967          |          |                    |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Total Assets  | \$ 3,439,103            |          |                    | \$ 2,997,994    |          |                    | \$ 2,523,592    |          |                    |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| <b>Liabilities and Shareholders' Equity</b>                                 |                         |          |                    |                 |          |                    |                 |          |                    |
| Interest bearing liabilities:   |                         |          |                    |                 |          |                    |                 |          |                    |
| Interest bearing transaction  |                         |          |                    |                 |          |                    |                 |          |                    |
|   | \$ 103,763              | \$ 298   | 0.29%              | \$ 94,848       | \$ 289   | 0.30%              | \$ 64,849       | \$ 236   | 0.36%              |
| Savings and money market  | 1,516,699               | 5,765    | 0.38%              | 1,183,402       | 5,946    | 0.50%              | 869,971         | 8,488    | 0.98%              |
| Time deposits   | 481,576                 | 4,551    | 0.95%              | 481,661         | 5,822    | 1.21%              | 579,346         | 8,524    | 1.47%              |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Total interest bearing deposits   | 2,102,038               | 10,614   | 0.50%              | 1,759,911       | 12,057   | 0.69%              | 1,514,166       | 17,248   | 1.14%              |
| Customer repurchase agreements and federal funds purchased                  |                         |          |                    |                 |          |                    |                 |          |                    |
|   | 94,566                  | 254      | 0.27%              | 96,141          | 325      | 0.34%              | 116,367         | 685      | 0.59%              |
| Other short-term borrowings   | 30                      |          |                    | 697             | 3        |                    | 22              |          |                    |
| Long-term borrowings  | 39,300                  | 1,636    | 4.11%              | 46,704          | 2,029    | 4.27%              | 49,300          | 2,144    | 4.35%              |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Total interest bearing liabilities  | 2,235,934               | 12,504   | 0.56%              | 1,903,453       | 14,414   | 0.76%              | 1,679,855       | 20,077   | 1.20%              |
| <br>  |                         |          |                    |                 |          |                    |                 |          |                    |
| Noninterest bearing liabilities:  |                         |          |                    |                 |          |                    |                 |          |                    |
| Noninterest bearing demand  |                         |          |                    |                 |          |                    |                 |          |                    |
|   | 811,757                 |          |                    | 781,240         |          |                    | 599,351         |          |                    |
| Other liabilities   | 16,709                  |          |                    | 11,067          |          |                    | 9,044           |          |                    |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                                       |         |         |         |
|---------------------------------------|---------|---------|---------|
| Total noninterest bearing liabilities | 828,466 | 792,307 | 608,395 |
|---------------------------------------|---------|---------|---------|

|                      |         |         |         |
|----------------------|---------|---------|---------|
| Shareholders' equity | 374,703 | 302,234 | 235,342 |
|----------------------|---------|---------|---------|

|  |              |              |              |
|--|--------------|--------------|--------------|
| Total Liabilities and Shareholders' Equity | \$ 3,439,103 | \$ 2,997,994 | \$ 2,523,592 |
|--|--------------|--------------|--------------|

|                     |            |            |           |
|---------------------|------------|------------|-----------|
| Net interest income | \$ 144,790 | \$ 127,529 | \$ 99,047 |
|---------------------|------------|------------|-----------|

|                     |       |       |       |
|---------------------|-------|-------|-------|
| Net interest spread | 4.11% | 4.05% | 3.60% |
| Net interest margin | 4.30% | 4.32% | 3.99% |

(1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled \$7.9 million, \$5.5 million and \$4.3 million for the year ended December 31, 2013, 2012, and 2011 respectively.

(2) Interest and fees on loans and investments exclude tax equivalent adjustments.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

**Consolidated Average Balances, Interest Yields And Rates (Unaudited)**

| (dollars in thousands)  | Three Months Ended December 31, |               |                    |                     |               |                    |                     |               |                    |
|---|---------------------------------|---------------|--------------------|---------------------|---------------|--------------------|---------------------|---------------|--------------------|
|   | 2013                            |               |                    | 2012                |               |                    | 2011                |               |                    |
|   | Average Balance                 | Interest      | Average Yield/Rate | Average Balance     | Interest      | Average Yield/Rate | Average Balance     | Interest      | Average Yield/Rate |
| <b>Assets</b>   |                                 |               |                    |                     |               |                    |                     |               |                    |
| Interest earning assets:  |                                 |               |                    |                     |               |                    |                     |               |                    |
| Interest bearing deposits with other banks and other short-term investments |                                 |               |                    |                     |               |                    |                     |               |                    |
|   | \$ 204,320                      | \$ 125        | 0.24%              | \$ 258,577          | \$ 177        | 0.27%              | \$ 539,924          | \$ 341        | 0.25%              |
| Loans held for sale   | 27,767                          | 282           | 4.06%              | 186,122             | 1,600         | 3.44%              | 177,116             | 1,724         | 3.89%              |
| Loans(1)(2)   | 2,867,955                       | 39,040        | 5.40%              | 2,442,418           | 34,839        | 5.67%              | 2,030,986           | 29,583        | 5.78%              |
| Investment securities available for sale(2)                                 | 380,562                         | 2,203         | 2.30%              | 310,851             | 1,545         | 1.98%              | 301,517             | 1,427         | 1.88%              |
| Federal funds sold  | 4,942                           | 2             | 0.16%              | 5,494               | 3             | 0.22%              | 22,360              | 16            | 0.28%              |
| <b>Total interest earning assets</b>  | <b>3,485,546</b>                | <b>41,652</b> | <b>4.74%</b>       | <b>3,203,462</b>    | <b>38,164</b> | <b>4.74%</b>       | <b>3,071,903</b>    | <b>33,091</b> | <b>4.27%</b>       |
| <b>Noninterest earning assets</b>   | <b>131,249</b>                  |               |                    | <b>80,580</b>       |               |                    | <b>68,745</b>       |               |                    |
| Less: allowance for credit losses   | 40,080                          |               |                    | 36,544              |               |                    | 28,696              |               |                    |
| <b>Total noninterest earning assets</b>                                     | <b>91,169</b>                   |               |                    | <b>44,036</b>       |               |                    | <b>40,049</b>       |               |                    |
| <b>Total Assets</b>   | <b>\$ 3,576,715</b>             |               |                    | <b>\$ 3,247,498</b> |               |                    | <b>\$ 3,111,952</b> |               |                    |
| <b>Liabilities and Shareholders' Equity</b>                                 |                                 |               |                    |                     |               |                    |                     |               |                    |
| Interest bearing liabilities:   |                                 |               |                    |                     |               |                    |                     |               |                    |
| Interest bearing transaction  | \$ 104,466                      | \$ 71         | 0.27%              | \$ 110,688          | \$ 93         | 0.33%              | \$ 73,577           | \$ 73         | 0.39%              |
| Savings and money market  | 1,621,712                       | 1,471         | 0.36%              | 1,312,792           | 1,528         | 0.46%              | 1,031,079           | 2,085         | 0.80%              |
| Time deposits   | 448,838                         | 950           | 0.84%              | 471,591             | 1,306         | 1.10%              | 570,624             | 1,969         | 1.37%              |
| <b>Total interest bearing deposits</b>                                      | <b>2,175,016</b>                | <b>2,492</b>  | <b>0.45%</b>       | <b>1,895,071</b>    | <b>2,927</b>  | <b>0.61%</b>       | <b>1,675,280</b>    | <b>4,127</b>  | <b>0.98%</b>       |
| Customer repurchase agreements and federal funds purchased                  | 87,084                          | 57            | 0.26%              | 97,622              | 75            | 0.31%              | 134,332             | 152           | 0.45%              |
| Other short-term borrowings   | 25                              |               |                    | 603                 | 1             |                    |                     |               |                    |
| Long-term borrowings  | 39,300                          | 389           | 3.86%              | 39,300              | 424           | 4.22%              | 49,300              | 541           | 4.29%              |
| <b>Total interest bearing liabilities</b>                                   | <b>2,301,425</b>                | <b>2,938</b>  | <b>0.51%</b>       | <b>2,032,596</b>    | <b>3,427</b>  | <b>0.67%</b>       | <b>1,858,912</b>    | <b>4,820</b>  | <b>1.03%</b>       |
| Noninterest bearing liabilities:  |                                 |               |                    |                     |               |                    |                     |               |                    |
| Noninterest bearing demand  | 863,933                         |               |                    | 853,496             |               |                    | 977,427             |               |                    |



Edgar Filing: EAGLE BANCORP INC - Form 10-K

|  |              |              |              |
|--|--------------|--------------|--------------|
| Other liabilities                          | 20,321       | 18,005       | 10,780       |
| Total noninterest bearing liabilities      | 884,254      | 871,501      | 988,207      |
| Shareholders' equity                       | 391,036      | 343,401      | 264,833      |
| Total Liabilities and Shareholders' Equity | \$ 3,576,715 | \$ 3,247,498 | \$ 3,111,952 |
| Net interest income                        | \$ 38,714    | \$ 34,737    | \$ 28,271    |
| Net interest spread                        | 4.23%        | 4.07%        | 3.24%        |
| Net interest margin                        | 4.40%        | 4.31%        | 3.65%        |

- (1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled \$2.3 million, \$1.7 million and \$1.2 million for the three months ended December 31, 2013, 2012, and 2011 respectively.
- (2) Interest and fees on loans and investments exclude tax equivalent adjustments.

Table of Contents**Rate/Volume Analysis of Net Interest Income**

The rate/volume table below presents the composition of the change in net interest income for the periods indicated, as allocated between the change in net interest income due to changes in the volume of average earning assets and interest bearing liabilities, and the changes in net interest income due to changes in interest rates. As the table shows, the increase in net interest income in 2013 as compared to 2012 was a function of an increase in the volume of earning assets, and lower funding costs offsetting the decrease in interest income on earning assets. For 2012 over 2011, the change is due to an increase in the volume of earning assets, and lower funding costs offsetting the decrease in interest income on earning assets.

| (dollars in thousands)         | 2013 compared with 2012 |                    |                           | 2012 compared with 2011 |                    |                           |
|--------------------------------|-------------------------|--------------------|---------------------------|-------------------------|--------------------|---------------------------|
|                                | Change Due to Volume    | Change Due to Rate | Total Increase (Decrease) | Change Due to Volume    | Change Due to Rate | Total Increase (Decrease) |
| <b>Interest earned on</b>      |                         |                    |                           |                         |                    |                           |
| Loans                          | \$ 20,682               | \$ (4,676)         | \$ 16,006                 | \$ 22,361               | \$ (2,568)         | \$ 19,793                 |
| Loans held for sale            | (1,764)                 | (41)               | (1,805)                   | 2,994                   | (507)              | 2,487                     |
| Investment securities          | 361                     | 607                | 968                       | 1,481                   | (838)              | 643                       |
| Interest bearing bank deposits | 240                     | (26)               | 214                       | (51)                    | 13                 | (38)                      |
| Federal funds sold             | (24)                    | (8)                | (32)                      | (76)                    | 10                 | (66)                      |
| <b>Total interest income</b>   | <b>19,495</b>           | <b>(4,144)</b>     | <b>15,351</b>             | <b>26,709</b>           | <b>(3,890)</b>     | <b>22,819</b>             |
| <b>Interest paid on</b>        |                         |                    |                           |                         |                    |                           |
| Interest bearing transaction   | 27                      | (18)               | 9                         | 109                     | (56)               | 53                        |
| Savings and money market       | 1,675                   | (1,856)            | (181)                     | 3,058                   | (5,600)            | (2,542)                   |
| Time deposits                  | (1)                     | (1,270)            | (1,271)                   | (1,437)                 | (1,265)            | (2,702)                   |
| Customer repurchase agreements | (5)                     | (66)               | (71)                      | (119)                   | (241)              | (360)                     |
| Other borrowings               | (325)                   | (71)               | (396)                     | (113)                   | 1                  | (112)                     |
| <b>Total interest expense</b>  | <b>1,371</b>            | <b>(3,281)</b>     | <b>(1,910)</b>            | <b>1,498</b>            | <b>(7,161)</b>     | <b>(5,663)</b>            |
| <b>Net interest income</b>     | <b>\$ 18,124</b>        | <b>\$ (863)</b>    | <b>\$ 17,261</b>          | <b>\$ 25,211</b>        | <b>\$ 3,271</b>    | <b>\$ 28,482</b>          |

**Provision for Credit Losses**

The provision for credit losses represents the amount of expense charged to current earnings to fund the allowance for credit losses. The amount of the allowance for credit losses is based on many factors which reflect management's assessment of the risk in the loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company and Bank.

Management has developed a comprehensive analytical process to monitor the adequacy of the allowance for credit losses. This process and guidelines were developed utilizing among other factors, the guidance from federal banking regulatory agencies. The results of this process, in combination with conclusions of the Bank's outside loan review consulting firm, support management's assessment as to the adequacy of the allowance at the balance sheet date. Please refer to the discussion under the caption "Critical Accounting Policies" for an overview of the methodology management employs on a quarterly basis to assess the adequacy of the allowance and the provisions charged to expense. Also,

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

refer to the table under "Allowance for Credit Losses" at page 59, which reflects the comparative charge-offs and recoveries.

During the year of 2013, the allowance for credit losses increased \$3.4 million reflecting \$9.6 million in provision for credit losses and \$6.2 million in net charge-offs during the period. The provision for credit

Table of Contents

losses was \$9.6 million for 2013 as compared to \$16.2 million in 2012. The lower provisioning is due to a combination of lower net charge-offs, a lower level of nonperforming loans and overall improvement in asset quality. Net charge-offs totaled \$6.2 million (0.23% of average loans) at December 31, 2013 compared to \$8.4 million (0.37% of average loans) at December 31, 2012, a dollar decline of 26%. Net charge-offs in 2013 were attributable to charge-offs of commercial and industrial loans (\$3.5 million), construction loans (\$1.3 million), the unguaranteed portion of SBA loans (\$659 thousand), commercial real estate loans (\$602 thousand) and home equity and consumer loans (\$135 thousand).

The provision for credit losses was \$2.5 million for the three months ended December 31, 2013 as compared to \$4.1 million for the three months ended December 31, 2012. The lower provisioning in the fourth quarter of 2013, as compared to the fourth quarter of 2012, is due to a combination of lower net charge-offs, and overall improved asset quality in the loan portfolio. Net charge-offs of \$1.3 million in the fourth quarter of 2013 represented 0.18% of average loans, excluding loans held for sale, as compared to \$2.2 million or 0.37% of average loans, excluding loans held for sale, in the fourth quarter of 2012. Net charge-offs in the fourth quarter of 2013 were attributable primarily to commercial and industrial loans (\$831 thousand), and commercial real estate loans (\$375 thousand). The lower provisioning in the fourth quarter of 2013, as compared to the fourth quarter of 2012, is due to a combination of lower net charge-offs, and overall improved asset quality in the loan portfolio. At December 31, 2013 the allowance for credit losses represented 1.39% of loans outstanding, as compared to 1.50% and 1.42% at December 31, 2012 and September 30, 2013, respectively. The allowance for credit losses represented 166% of nonperforming loans at December 31, 2013, as compared to 122% at December 31, 2012 and 144% at September 30, 2013.

As part of its comprehensive loan review process, the Bank's Board of Directors and Loan Committee or Bank's Credit Review Committee carefully evaluate loans which are past due 30 days or more. The Committees make a thorough assessment of the conditions and circumstances surrounding each delinquent loan. The Bank's loan policy requires that loans be placed on nonaccrual if they are ninety days past due, unless they are well secured and in the process of collection. Additionally, Credit Administration specifically analyzes the status of development and construction projects, sales activities and utilization of interest reserves in order to carefully and prudently assess the potential for increased levels of risk requiring additional reserves.

The maintenance of a high quality loan portfolio, with an adequate allowance for possible credit losses, will continue to be a primary management objective for the Company.

**Noninterest Income**

Total noninterest income includes service charges on deposits, gain on sale of loans, gain on sale of investments, loss on early extinguishment of debt, income from bank owned life insurance ("BOLI") and other income.

Total noninterest income for the year of 2013 was \$24.7 million compared to \$21.4 million in 2012, an increase of 15.7%. This increase was due primarily to a \$1.7 million increase in gains realized on the sale of SBA loans, offset by a \$1.0 million decrease in gains realized on the sale of residential loans, a \$670 thousand increase on service charges on deposit accounts and a \$1.9 million increase in other noninterest income due primarily to increased loan related fees and income on new annuity investments. Additionally, BOLI income increased \$328 thousand due to new investments. Net gain on sale of investment securities were \$19 thousand in 2013 and \$690 thousand in 2012. A \$529 thousand loss on the early extinguishment of debt was recorded in September of 2012 due to the restructuring of a FHLB advance. Excluding investment securities gains and the loss on the early extinguishment of debt, total noninterest income was \$24.7 million for the year of 2013, as compared to \$21.2 million for 2012, a 17% increase, which represented 15% of total revenue for the year of 2013 as compared to 14% for the year of 2012.

Table of Contents

Total noninterest income for the three months ended December 31, 2013 decreased to \$4.3 million from \$6.1 million for the three months ended December 31, 2012, a 29% decrease. This decrease was primarily due to lower gains on the sale of residential mortgage loans of \$3.0 million, offset by a combination of an increase in service charges income of \$221 thousand, higher income from BOLI of \$202 thousand, higher loan fees and insurance income of \$405 thousand, and higher income from sales of SBA loans of \$148 thousand. There were \$4 thousand of investment securities losses recorded for the fourth quarter of 2013, as compared to investment securities losses of \$75 thousand for the fourth quarter of 2012. Excluding investment securities losses, total noninterest income was \$4.3 million for the fourth quarter of 2013, as compared to \$6.1 million for the fourth quarter of 2012, a decrease of 30%.

For the year ended December 31, 2013, service charges on deposit accounts increased \$670 thousand from \$3.9 million, an increase of 17% over 2012. For the three months ended December 31, 2013, service charges on deposit accounts increased \$221 thousand to \$1.3 million compared to the same period in 2012, an increase of 21%. This increase in service charges for year 2013 and the three months ended December 31, 2013 was primarily related to growth in the number of accounts.

Gain on sale of loans consists of SBA and residential mortgage loans. For the year ended December 31, 2013, gain on sale of loans increased from \$13.9 million to \$14.6 million compared to the same period in 2012 or 5%. For the three months ended December 31, 2013, gain on sale of loans decreased from \$4.1 million to \$1.2 million compared to the same period in 2012. The lower amount of gains in the fourth quarter of 2013 is due substantially to a decrease in the gains realized on the sale of residential mortgage loans as a result of reduced refinancing activity due to higher market interest rates beginning the second quarter of 2013.

The Company originates residential mortgage loans on a pre-sold basis, servicing released. Sales of these mortgage loans yielded gains of \$12.5 million for the year of 2013 compared to \$13.5 million in the same period in 2012. For the three months ended December 31, 2013, gains on the sale of residential mortgage loans were \$1.0 million as compared to \$4.0 million for the same three months of 2012. Loans sold are subject to repurchase in circumstances where documentation is deficient or the underlying loan becomes delinquent. Additionally, premiums received on loans sold are subject to refund if the mortgage loan pays off within a specified period following loan funding and sale. The Bank considers these potential recourse provisions to be a minimal risk, but has established a reserve under generally accepted accounting principles for possible repurchases. There were no repurchases due to fraud by the borrower during the year of 2013. The reserve amounted to \$57 thousand at December 31, 2013 and is included in Other liabilities on the Consolidated Balance Sheets. The Bank does not originate "sub-prime" loans and has no exposure to this market segment.

The Company is an originator of SBA loans and its current practice is to sell the insured portion of those loans at a premium. Income from this source was \$2.1 million for the year ended December 31, 2013 compared to \$443 thousand for the year ended December 31, 2012. For the three months ended December 31, 2013, gains on the sale of SBA loans amounted to \$202 thousand as compared to \$54 thousand for the same period in 2012. Activity in SBA loan sales to secondary markets can vary widely from quarter to quarter.

Other income totaled \$4.8 million for the year ended 2013 as compared to \$2.9 million for the same period in 2012, an increase of 63%. ATM fees increased from \$963 thousand for the year ended 2012 to \$1.1 million for the year ended 2013, an 11% increase. SBA service fees decreased from \$208 thousand for the year ended December 31, 2012 to \$74 thousand for the year ended 2013, a 65% decrease. Noninterest loan fees increased from \$1.3 million for the year ended 2012 to \$2.5 million for the same period in 2013, an 88% increase. Other noninterest fee income was \$1.2 million for the year 2013 compared to \$456 thousand for the same period in 2012, a 163% increase. Other income totaled \$1.5 million for the three months ended December 31, 2013 as compared to \$927 thousand for the same period in 2012, the increase is primarily due to annuity income on new investments during 2013, an increase of 65%.

Table of Contents

The increase in the cash surrender value of BOLI for the year ended December 31, 2013, as compared to December 31, 2012 is due primarily to new investments of approximately \$25 million during 2013. At December 31, 2013 this asset amounted to \$39.7 million as compared to \$14.1 million at December 31, 2012.

Net investment gains amounted to \$19 thousand for the year ended December 31, 2013 compared to \$690 thousand for the year ended December 31, 2012. For the three months ended December 31, 2013 net investment losses amounted to \$4 thousand compared to \$75 thousand for the same period in 2012. Gains were realized during the year 2013 to take advantage of strong fixed income market in bullet U.S. agency securities. Losses were realized during the year 2013 in selling higher coupon mortgaged backed securities in order to mitigate prepayment risk and resulting negative yields.

**Noninterest Expense**

Total noninterest expense consists of salaries and employee benefits, premises and equipment expenses, marketing and advertising, data processing, legal, accounting and professional fees, FDIC insurance premiums and other expenses.

Total noninterest expenses were \$84.6 million for the year of 2013, as compared to \$76.5 million for 2012, an 11% increase. For the three months ended December 31, 2013, total noninterest expenses were \$21.5 million, as compared to \$20.3 million for 2012, a 6% increase.

Salaries and employee benefits were \$47.5 million for the year ended 2013, as compared to \$43.7 million for 2012, a 9% increase. For the three months ended December 31, 2013, salaries and employee benefits amounted to \$12.8 million versus \$12.2 million for the same period in 2012, a 5% increase. Cost increases for salaries and benefits for both the year and three month periods were primarily due to merit increases, incentive compensation and benefits increases, and net staffing increases primarily as a result of growth in the commercial lending and branch personnel, partially offset by staff reductions in the residential lending department during the last half of 2013. At December 31, 2013, the Company's staff numbered 386, as compared to 393 at December 31, 2012 and 338 at December 31, 2011.

Premises and equipment expenses amounted to \$11.9 million for the year ended December 31, 2013 as compared to \$10.2 million for the same period in 2012, a 17% increase. Premises and equipment expenses amounted to \$3.0 million for the three months ended December 31, 2013 as compared to \$2.7 million for the same period in 2012, an 11% increase. For both the year and three month periods, premises and equipment expenses were higher due primarily to the cost of new branch offices and normal increases in leasing costs. For the year and three months ended December 31, 2013, the Company recognized \$57 thousand and \$20 thousand respectively of sublease revenue as compared to \$99 thousand and \$26 thousand for the same period in 2012. The sublease revenue is a direct offset of premises and equipment expenses.

Marketing and advertising expenses decreased from \$1.8 million for the year ended December 31, 2012 to \$1.7 million for 2013, a decrease of 4%. The primary reasons for the decrease for the full year was due to additional advertising expenses incurred in 2012 for general branding purposes, such as online advertisements, as well as increased print advertising for residential mortgage lending and other business lines. Marketing and advertising expenses increased from \$419 thousand for the three months ended December 31, 2012 to \$519 thousand for the same period in 2013, a 24% increase. The primary reasons for the increase for the three month period ended December 31, 2013, was due to creative, account and deliverable costs associated with the retention of a new full service marketing agency.

Data processing expenses increased from \$4.4 million for the year ended December 31, 2012 to \$5.9 million for 2013, an increase of 34%. Data processing expenses increased from \$1.1 million for the three months ended December 31, 2012 to \$1.4 million for the same period in 2013, a 27% increase. The

Table of Contents

increase in expense for the year and three months ended December 31, 2013 as compared to the same period in 2012 was due to system enhancements and increased customer transaction volume.

Legal, accounting and professional fees were \$3.4 million for the year ended December 31, 2013, as compared to \$4.3 million for 2012, a decrease of 19%. Legal, accounting and professional fees were \$863 thousand for the three months ended December 31, 2013, as compared to \$938 thousand in 2012, an 8% decrease. The decrease for the year and three months ended December 31, 2013 as compared to the same period in 2012 was due primarily to the decline in collection costs related to the resolution of problem loans.

FDIC insurance premiums increased to \$2.3 million for the year ended December 31, 2013 as compared to \$2.1 million for 2012, an increase of 8% due to average asset growth. For the three months ended December 31, 2013, FDIC insurance premiums amounted to \$483 thousand as compared to \$536 thousand for the same period in 2012, a 10% decrease due to average asset growth offset by year-end accrual adjustments.

Other expenses increased to \$11.9 million for the year ended December 31, 2013 from \$10.1 million for the same period in 2012, an increase of 17%. For the three months ended December 31, 2013, other expenses amounted to \$2.5 million as compared to \$2.4 million for the same period in 2012, an increase of 1%. The major components of cost in this category include insurance expenses, deposit fees, telephone, OREO expenses and other losses. The increase for the year ended December 31, 2013 compared to the same period in 2012, was primarily due to an increase of \$1.1 million of other losses related to a nonrecurring expense earlier in 2013 and an increase of \$1.6 million in expenses for the operations of OREO properties partially offset by a decrease of \$738 thousand in deposit fees and a decrease of \$359 thousand in telephone expense. The increase for the three month period ended December 31, 2013 compared to the same period in 2012 was primarily due to \$476 thousand of expenses for the operations of OREO properties offset by a \$201 thousand decrease in other losses and a decrease of \$149 thousand in deposit fees.

The efficiency ratio improved to 49.90% for the year of 2013 from 51.40% for 2012. As a percentage of average assets, total noninterest expenses improved to 2.46% for the year of 2013 from 2.55% for the year 2012. Cost control remains a significant operating objective of the Company.

**Income Tax Expense**

The Company recorded income tax expense of \$28.3 million in 2013 compared to \$20.9 million in 2012 and \$13.7 million in 2011, resulting in an effective tax rate of 37.6%, 37.2% and 35.9%, respectively. The higher effective tax rate for the year 2013 relates to a higher level of taxable income relative to income exempt from taxation.

**BALANCE SHEET ANALYSIS**

---

**Overview**

At December 31, 2013, total assets were \$3.77 billion, compared to \$3.41 billion at December 31, 2012, an 11% increase. As compared to September 30, 2013, total assets at December 31, 2013 increased by \$266.6 million, or 8%. Total loans (excluding loans held for sale) were \$2.95 billion at December 31, 2013 compared to \$2.49 billion at December 31, 2012, an 18% increase. As compared to September 30, 2013, total loans at December 31, 2013 increased by \$148.3 million, a 5% increase. Total deposits were \$3.23 billion at December 31, 2013, compared to deposits of \$2.90 billion at December 31, 2012, an 11% increase. As compared to September 30, 2013, total deposits at December 31, 2013 increased by \$241.3 million, an 8% increase. The level of deposit gains in 2013 was impacted by the previously reported loss of \$130.0 million of trustee deposits in March 2013 related to the expiration of the transaction account guarantee ("TAG") program. Loans held for sale amounted to \$42.0 million at December 31, 2013 as

Table of Contents

compared to \$226.9 million at December 31, 2012, an 82% decrease. As compared to September 30, 2013 loans held for sale increased by \$3.0 million, a 7% increase.

The investment portfolio totaled \$378.1 million at December 31, 2013, a 26% increase from the \$299.8 million balance at December 31, 2012. As compared to September 30, 2013, the investment portfolio at December 31, 2013 increased by \$22.3 million, a 6% increase. Total borrowed funds (excluding customer repurchase agreements) were \$39.3 million at December 31, 2013, December 31, 2012 and September 30, 2013, respectively. Total shareholders' equity increased to \$393.9 million at December 31, 2013, compared to \$350.0 million and \$382.1 million at December 31, 2012 and September 30, 2013, respectively, primarily reflecting growth in retained earnings. The Company's capital position remains substantially in excess of regulatory requirements for well capitalized status, with a total risk based capital ratio of 13.01% at December 31, 2013, as compared to a total risk based capital ratio of 12.20% at December 31, 2012. In addition, the tangible common equity ratio (tangible common equity to tangible assets) increased to 8.86% at December 31, 2013, from 8.50% at December 31, 2012.

**Investment Securities Available-for-Sale ("AFS") and Short-Term Investments**

The tables below and Note 3 to the Consolidated Financial Statements provide additional information regarding the Company's investment securities categorized as "available-for-sale" ("AFS"). The Company classifies all its investment securities as AFS. This classification requires that investment securities be recorded at their fair value with any difference between the fair value and amortized cost (the purchase price adjusted by any discount accretion or premium amortization) reported as a component of shareholders' equity (accumulated other comprehensive income), net of deferred income taxes. At December 31, 2013, the Company had a net unrealized loss in AFS securities of \$5.5 million with a deferred tax asset of \$2.2 million, as compared to a net unrealized gain in AFS securities of \$9.1 million at December 31, 2012, with a deferred income tax liability of \$3.6 million, respectively.

The AFS portfolio is comprised of U.S. Government agency securities (12% of AFS securities) with an average duration of 2.1 years, seasoned mortgage backed securities that are 100% agency issued (60% of AFS securities) which have an average expected life of 4.4 years with contractual maturities of the underlying mortgages of up to thirty years, municipal bonds (27% of AFS securities) which have an average duration of 6.6 years, and equity investments which comprise less than 1% of AFS securities. The equity investment consists of common stock of three community banking companies which have an estimated fair value of \$384 thousand. Ninety nine percent (99.9%) of the investment securities which are debt instruments are rated AAA or AA or have the implicit guarantee of the U.S. Treasury.

At December 31, 2013, the investment portfolio amounted to \$378.1 million as compared to a balance of \$299.8 million at December 31, 2012, an increase of 26%. The investment portfolio is managed to achieve goals related to income, liquidity, interest rate risk management and to provide collateral for customer repurchase agreements and other borrowing relationships.

The following table provides information regarding the composition of the Company's investment securities portfolio at the dates indicated. As earlier noted, amounts are reported at estimated fair value. The change in composition of the portfolio at December 31, 2013 as compared to 2012 was due principally to Asset Liability Committee decisions to increase the mix of municipal bonds, which was believed to present attractive valuation and to increase holdings of structured residential mortgage backed securities issued by U.S. Government agencies or government sponsored enterprises which are believed to well position the Company in the current interest rate environment. The decrease in holdings of U.S. Government agency securities was the result of decisions to sell certain issues in order to realize gains that would otherwise mature at par in the next few years. During the twelve months ended December 31, 2013, the investment portfolio balances increased as compared to balances at December 31, 2012, as cash flow from significant declines in loans held for sale has been deployed into a combination of higher yielding loans, and higher average investments. Cash flows from mortgage backed securities and sales of U.S.



Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

agency securities were reinvested primarily into a combination of structured mortgage backed securities and additional investments have been made in high quality municipal bonds.

| (dollars in thousands)                 | December 31, |                  |            |                  |            |                  |
|--|--------------|------------------|------------|------------------|------------|------------------|
|  | 2013         |                  | 2012       |                  | 2011       |                  |
|  | Balance      | Percent of Total | Balance    | Percent of Total | Balance    | Percent of Total |
| U. S. Government agency securities     | \$ 47,335    | 12.5%            | \$ 49,082  | 16.4%            | \$ 103,753 | 33.1%            |
| Residential mortgage backed securities | 228,674      | 60.5%            | 173,083    | 57.7%            | 147,978    | 47.2%            |
| Municipal bonds                        | 101,740      | 26.9%            | 77,313     | 25.8%            | 61,773     | 19.6%            |
| Other equity investments               | 384          | 0.1%             | 342        | 0.1%             | 307        | 0.1%             |
|  | \$ 378,133   | 100%             | \$ 299,820 | 100%             | \$ 313,811 | 100%             |

The decrease in the investment portfolio in 2012 over 2011 was due in large part to higher average loans held for sale, as well as maintaining high average liquidity levels in 2012.

The following table provides information, on an amortized cost basis, regarding the contractual maturity and weighted-average yield of the investment portfolio at December 31, 2013. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Yields on tax exempt securities have not been calculated on a tax equivalent basis.

At December 31, 2013, there were no issuers, other than the U.S. Government and its agencies, whose securities owned by the Company had a book or fair value exceeding 10% of the Company's shareholders' equity.

| (dollars in thousands)                 | One Year or Less        |                        | After One Year Through Five Years |                        | After Five Years Through Ten Years |                        | After Ten Years         |                        | Total                   |                        |
|--|-------------------------|------------------------|-----------------------------------|------------------------|------------------------------------|------------------------|-------------------------|------------------------|-------------------------|------------------------|
|  | Weighted Amortized Cost | Weighted Average Yield | Weighted Amortized Cost           | Weighted Average Yield | Weighted Amortized Cost            | Weighted Average Yield | Weighted Amortized Cost | Weighted Average Yield | Weighted Amortized Cost | Weighted Average Yield |
| U. S. Government agency securities     | \$ 19,025               | 1.69%                  | \$ 27,615                         | 1.64%                  | \$                                 |                        | \$                      |                        | \$ 46,640               | 1.66%                  |
| Residential mortgage backed securities | 5,240                   | 2.94%                  | 147,211                           | 2.00%                  | 81,755                             | 2.03%                  |                         |                        | 234,206                 | 2.02%                  |
| Municipal bonds                        | 2,513                   | 3.31%                  | 23,205                            | 3.08%                  | 74,597                             | 3.00%                  | 2,108                   | 4.06%                  | 102,423                 | 3.05%                  |
| Other equity investments               |                         |                        |                                   |                        |                                    |                        |                         |                        | 396                     |                        |
|  | \$ 26,778               | 2.09%                  | \$ 198,031                        | 2.08%                  | \$ 156,352                         | 2.49%                  | \$ 2,108                | 4.06%                  | \$ 383,665              | 2.25%                  |

The Company also has a portfolio of short-term investments utilized for asset liability management needs which consist from time-to-time of discount notes, commercial paper, money market investments, and other bank certificates of deposit. This portfolio amounted to \$10.3 million at December 31, 2013 and 2012, respectively.

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

Federal funds sold amounted to \$5.7 million at December 31, 2013 as compared to \$7.9 million at December 31, 2012. These funds represent excess daily liquidity which is invested on an unsecured basis with well capitalized banks, in amounts generally limited both in the aggregate and to any one bank.

Interest bearing deposits with banks and other short-term investments amounted to \$291.7 million at December 31, 2013 as compared to \$324.0 million at December 31, 2012. These overnight funds represents daily liquidity held at the Federal Reserve to meet future loan demand, to fund future increases in investment securities and to meet other general liquidity needs of the Company.

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

#### **Loan Portfolio**

In its lending activities, the Company seeks to develop substantial relationships with clients whose businesses and individual banking needs will grow with the Bank. There has been a significant effort to grow the loan portfolio and to be responsive to the lending needs in the markets served, while maintaining sound asset quality.

Loan growth over the past year has been favorable, with loans outstanding reaching \$2.95 billion at December 31, 2013, an increase of \$452.1 million or 18% as compared to \$2.49 billion at December 31, 2012, and increased \$436.8 million or 21% as compared to \$2.06 billion at December 31, 2011.

The loan growth in 2013 was predominantly in the commercial and income producing commercial real estate segments, along with significant percentage increases in the residential real estate mortgage and commercial and residential construction. Despite an increased level of competition for business, the Bank has been able to continue to grow its commercial real estate portfolio and attract new customers. Commercial real estate leasing in the Bank's market area has held up far better than in other parts of the country and values have generally held up well with upward price pressure in prime pockets. Meanwhile, multi-family properties in a number of sub-markets within the Bank's market area are experiencing normalized to declining vacancy rates, with upward pressure on rents. Construction lending picked up in 2013 on both the commercial and residential fronts. The housing market saw an uptick in demand, and tract development has returned in certain suburban markets. Commercial loan growth was strong in 2013 and was reflective of both expansion among existing customers and growth in new banking relationships. Consumer loan balances, including home equity lines of credit, saw modest growth last year.

Owner occupied commercial real estate and owner occupied commercial real estate construction represent 12% of the loan portfolio. The Bank has a large portion of its loan portfolio related to real estate, with 69% consisting of commercial real estate and real estate construction loans. When owner occupied commercial real estate is excluded, the percentage of total loans represented by commercial real estate decreases to 57%. Real estate also serves as collateral for loans made for other purposes, resulting in 79.9% of loans being secured by real estate.

The following table shows the trends in the composition of the loan portfolio over the past five years.

|   | Year Ended December 31, |             |                     |             |                     |             |                     |             |                     |             |
|---|-------------------------|-------------|---------------------|-------------|---------------------|-------------|---------------------|-------------|---------------------|-------------|
|   | 2013                    |             | 2012                |             | 2011                |             | 2010                |             | 2009                |             |
| (dollars in thousands)                  | Amount                  | %           | Amount              | %           | Amount              | %           | Amount              | %           | Amount              | %           |
| Commercial                              | \$ 694,350              | 24%         | \$ 545,070          | 22%         | \$ 478,886          | 23%         | \$ 411,744          | 26%         | \$ 346,692          | 25%         |
| Income producing commercial real estate | 1,119,800               | 38%         | 914,638             | 37%         | 756,645             | 37%         | 619,714             | 37%         | 499,501             | 36%         |
| Owner occupied commercial real estate   | 317,491                 | 11%         | 297,857             | 12%         | 250,174             | 12%         | 223,986             | 13%         | 196,433             | 14%         |
| Real estate mortgage residential        | 90,418                  | 3%          | 61,871              | 3%          | 39,552              | 2%          | 15,977              | 1%          | 9,236               | 1%          |
| Construction commercial and residential | 574,167                 | 19%         | 533,722             | 21%         | 395,267             | 19%         | 298,272             | 18%         | 249,058             | 18%         |
| Construction C&I (owner occupied)       | 34,659                  | 1%          | 28,808              | 1%          | 34,402              | 2%          | 9,809               |             | 3,637               |             |
| Home equity                             | 110,242                 | 4%          | 106,844             | 4%          | 97,103              | 5%          | 89,885              | 5%          | 87,283              | 6%          |
| Other consumer                          | 4,031                   |             | 4,285               |             | 4,227               |             | 6,113               |             | 7,471               |             |
| <b>Total loans</b>                      | <b>2,945,158</b>        | <b>100%</b> | <b>2,493,095</b>    | <b>100%</b> | <b>2,056,256</b>    | <b>100%</b> | <b>1,675,500</b>    | <b>100%</b> | <b>1,399,311</b>    | <b>100%</b> |
| Less: Allowance for credit losses       | (40,921)                |             | (37,492)            |             | (29,653)            |             | (24,754)            |             | (20,619)            |             |
| <b>Net loans</b>                        | <b>\$ 2,904,237</b>     |             | <b>\$ 2,455,603</b> |             | <b>\$ 2,026,603</b> |             | <b>\$ 1,650,746</b> |             | <b>\$ 1,378,692</b> |             |

As noted above, a significant portion of the loan portfolio consists of commercial, construction and commercial real estate loans, primarily made in the Washington, D.C. metropolitan area and secured by real estate or other collateral in that market. Although these loans are made to a diversified pool of unrelated borrowers across numerous businesses, adverse developments in the Washington, D.C. metropolitan real estate market could have an adverse impact on this portfolio of loans and the Company's

Table of Contents

income and financial position. While our basic market area is the Washington, D.C. metropolitan area, the Bank has made loans outside that market area where the nature and quality of such loans was consistent with the Bank's lending policies. At present, the Company believes that commercial real estate values are stable to improving in those sub-markets of the Washington, D.C. metropolitan market in which the Company has its most significant real estate exposure.

The federal banking regulators have issued guidance for those institutions which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land which represent in total 100% or more of an institutions total risk-based capital; or (2) total commercial real estate loans representing 300% or more of the institution's total risk-based capital and the institution's commercial real estate loan portfolio has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans, and the Company has experienced significant growth in its commercial real estate portfolio in recent years. Commercial real estate loans and construction, land and land development loans represent 409% and 154%, respectively, of total risk based capital. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened portfolio monitoring and reporting, and strong underwriting criteria with respect to its commercial real estate portfolio. The Company is well capitalized. Nevertheless, the Company could be required to maintain higher levels of capital as a result of our commercial real estate concentration, which could require us to obtain additional capital, and may adversely affect shareholder returns.

At December 31, 2013, the Company had no other concentrations of loans in any one industry exceeding 10% of its total loan portfolio. An industry for this purpose is defined as a group of businesses that are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

The Company has directly made higher risk real estate loans that entail additional risks as compared to loans made following normal underwriting practices. These higher risk loan transactions, representing financing subordinated to loans made by the Bank or other parties, and occasionally referred to in this report as "subordinated financings" are currently made through the Company's subsidiary, ECV. This activity is limited as to real estate individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. Transactions are structured to provide ECV with returns commensurate to the risk through the requirement of additional interest following payoff of all loans, which additional interest is recorded as a component of noninterest income. At December 31, 2013, ECV has \$7.4 million of loans outstanding for higher risk loan transaction relating to five real estate projects. The loans are expected to be outstanding throughout 2014, with marketing and sales continuing during the year. For the years ended December 31, 2013, 2012 and 2011, ECV recorded \$968 thousand, \$553 thousand and \$203 thousand of interest income. Noninterest income of \$274 thousand was recognized for the year ended December 31, 2013, and no noninterest income was recognized for years ended December 31, 2012 and 2011.

Although the Company carefully underwrites each higher risk loan transaction and expects these transactions to provide additional revenues, there can be no assurance that any higher risk loan transaction, or the related loans made by the Bank, will prove profitable for the Company and Bank, that the Company will be able to receive any additional interest payments with respect to these loans, that any additional interest payments will be significant, or that the Company and Bank will not incur losses with respect to these transactions.

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

### **Loan Maturity**

The following table sets forth the time to contractual maturity of the loan portfolio as of December 31, 2013.

| (dollars in thousands)                  | Total               | One Year or<br>Less | Due In<br>Over One to<br>Five Years | Over Five to<br>Ten Years | Over Ten<br>Years |
|---|---------------------|---------------------|-------------------------------------|---------------------------|-------------------|
| Commercial                              | \$ 694,350          | \$ 287,493          | \$ 300,371                          | \$ 94,869                 | \$ 11,617         |
| Income producing commercial real estate | 1,119,800           | 320,260             | 645,887                             | 152,329                   | 1,324             |
| Owner occupied commercial real estate   | 317,491             | 18,739              | 165,457                             | 76,780                    | 56,515            |
| Real estate mortgage residential        | 90,418              | 4,463               | 65,316                              | 6,982                     | 13,657            |
| Construction commercial and residential | 574,167             | 269,004             | 257,410                             | 47,267                    | 486               |
| Construction C&I (owner occupied)       | 34,659              | 485                 | 9,224                               | 21,574                    | 3,376             |
| Home equity                             | 110,242             | 3,685               | 1,030                               | 57,953                    | 47,574            |
| Other consumer                          | 4,031               | 800                 | 2,128                               | 304                       | 799               |
| <b>Total loans</b>                      | <b>\$ 2,945,158</b> | <b>\$ 904,929</b>   | <b>\$ 1,446,823</b>                 | <b>\$ 458,058</b>         | <b>\$ 135,348</b> |
| Loans with:                             |                     |                     |                                     |                           |                   |
| Predetermined fixed interest rate       | \$ 1,282,580        | \$ 181,371          | \$ 866,296                          | \$ 180,296                | \$ 54,617         |
| Floating interest rate                  | 1,662,578           | 723,558             | 580,527                             | 277,762                   | 80,731            |
| <b>Total loans</b>                      | <b>\$ 2,945,158</b> | <b>\$ 904,929</b>   | <b>\$ 1,446,823</b>                 | <b>\$ 458,058</b>         | <b>\$ 135,348</b> |

Loans are shown in the period based on final contractual maturity. Demand loans, having no contractual maturity and overdrafts, are reported as due in one year or less.

### **Allowance for Credit Losses**

The provision for credit losses represents the amount of expense charged to current earnings to fund the allowance for credit losses. The amount of the allowance for credit losses is based on many factors which reflect management's assessment of the risk in the loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company and Bank.

Management has developed a comprehensive analytical process to monitor the adequacy of the allowance for credit losses. This process and guidelines were developed utilizing, among other factors, the guidance from federal banking regulatory agencies. The results of this process, in combination with conclusions of the Bank's outside loan review consulting firm, support management's assessment as to the adequacy of the allowance at December 31, 2013. During 2013, a provision for credit losses was made in the amount of \$9.6 million and net charge-offs amounted to \$6.2 million. A full discussion of the accounting for allowance for credit losses is contained in Note 1 to the Consolidated Financial Statements and activity in the allowance for credit losses is contained in Note 4 to the Consolidated Financial Statements. Also, please refer to the discussion under the caption, "Critical Accounting Policies" within Management's Discussion and Analysis of Financial Condition and Results of Operation for further discussion of the methodology which management employs to maintain an adequate allowance for credit losses, as well as the discussion under the caption "Provision for Credit Losses."

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

The allowance for credit losses represented 1.39% of total loans at December 31, 2013 as compared to 1.50% at December 31, 2012. At December 31, 2013, the allowance represented 166% of nonperforming loans as compared to 122% at December 31, 2012. The increase in the coverage ratio was due substantially to the level of nonperforming loans declining by \$6.0 million, or approximately 19%, at December 31, 2013 as compared to December 31, 2012.

Table of Contents

As part of its comprehensive loan review process, the Bank's Board of Directors, Directors' Loan Committee or Credit Review Committee carefully evaluate loans which are past due 30 days or more. The Committees make a thorough assessment of the conditions and circumstances surrounding each delinquent loan. The Bank's loan policy requires that loans be placed on nonaccrual if they are 90 days past due, unless they are well secured and in the process of collection. Additionally, Credit Administration specifically analyzes the status of development and construction projects, sales activities and utilization of interest reserves in order to carefully and prudently assess potential increased levels of risk which may require additional reserves.

At December 31, 2013, the Company had \$24.7 million of loans classified as nonperforming, and \$10.7 million of potential problem loans, as compared to \$30.7 million of nonperforming loans and \$42.4 million of potential problem loans at December 31, 2012. Please refer to Note 1 to the Consolidated Financial Statements under the caption "Loans" for a discussion of the Company's policy regarding impairment of loans. Please refer to "Nonperforming Assets" at page 60 for a discussion of problem and potential problem assets.

As the loan portfolio and allowance for credit losses review process continues to evolve, there may be changes to elements of the allowance and this may have an effect on the overall level of the allowance maintained. Historically, the Bank has enjoyed a high quality loan portfolio with relatively low levels of net charge-offs and low delinquency rates. In 2013, the Company witnessed a decreased level of net charge-offs and believes its level of net charge-offs and problem assets were below those of its peer banking companies. The maintenance of a high quality portfolio will continue to be a high priority for both management and the Board of Directors.

Management, being aware of the significant loan growth experienced by the Company, is intent on maintaining a strong credit review function and risk rating process. The Company has an experienced Credit Administration function, which provides independent analysis of credit requests and the management of problem credits. The Credit Department has developed and implemented analytical procedures for evaluating credit requests, has refined the Company's risk rating system, and has adopted enhanced monitoring of the loan portfolio (in particular the construction loan portfolio) and the adequacy of the allowance for credit losses, including stress test analyses. The loan portfolio analysis process is ongoing and proactive in order to maintain a portfolio of quality credits and to quickly identify any weaknesses before they become more severe.



Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

The following table sets forth activity in the allowance for credit losses for the past five years.

| (dollars in thousands)  | Year Ended December 31, |              |              |              |              |
|---|-------------------------|--------------|--------------|--------------|--------------|
|   | 2013                    | 2012         | 2011         | 2010         | 2009         |
| Balance at beginning of year  | \$ 37,492               | \$ 29,653    | \$ 24,754    | \$ 20,619    | \$ 18,403    |
| Charge-offs:  |                         |              |              |              |              |
| Commercial  | 4,275                   | 3,481        | 4,310        | 2,495        | 3,705        |
| Income producing commercial real estate   | 602                     | 1,189        | 277          | 719          | 488          |
| Owner occupied commercial real estate   |                         | 350          |              | 246          | 239          |
| Real estate mortgage residential  |                         | 300          | 95           |              | 553          |
| Construction commercial and residential   | 2,010                   | 3,033        | 1,366        | 1,698        | 177          |
| Construction C&I (owner occupied)   |                         |              |              |              |              |
| Home equity   | 89                      | 698          | 295          | 43           | 427          |
| Other consumer  | 63                      | 47           | 87           | 21           | 191          |
| <b>Total charge-offs</b>  | <b>7,039</b>            | <b>9,098</b> | <b>6,430</b> | <b>5,222</b> | <b>5,780</b> |
| Recoveries:   |                         |              |              |              |              |
| Commercial  | 161                     | 144          | 28           | 37           | 274          |
| Income producing commercial real estate   |                         | 18           | 126          | 3            |              |
| Owner occupied commercial real estate   |                         |              |              |              |              |
| Real estate mortgage residential  |                         |              | 3            |              | 2            |
| Construction commercial and residential   | 688                     | 510          | 183          | 7            | 2            |
| Construction C&I (owner occupied)   |                         |              |              |              |              |
| Home equity   | 11                      | 73           | 3            | 2            |              |
| Other consumer  | 6                       | 2            | 3            |              | 49           |
| <b>Total recoveries</b>   | <b>866</b>              | <b>747</b>   | <b>346</b>   | <b>49</b>    | <b>327</b>   |
| Net charge-offs   | 6,173                   | 8,351        | 6,084        | 5,173        | 5,453        |
| Additions charged to operations   | 9,602                   | 16,190       | 10,983       | 9,308        | 7,669        |
| Balance at end of year  | \$ 40,921               | \$ 37,492    | \$ 29,653    | \$ 24,754    | \$ 20,619    |
| Ratio of allowance for credit losses to total loans outstanding at year end           | 1.39%                   | 1.50%        | 1.44%        | 1.48%        | 1.47%        |
| Ratio of net charge-offs during the year to average loans outstanding during the year | 0.23%                   | 0.37%        | 0.32%        | 0.34%        | 0.42%        |

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

The following table presents the allocation of the allowance for credit losses by loan category and the percent of loans each category bears to total loans. The allocation of the allowance at December 31, 2013 includes specific reserves of \$6.5 million against impaired loans of \$32.6 million as compared to specific reserves of \$8.1 million against impaired loans of \$46.0 million at December 31, 2012. The allocation of the allowance to each category is not necessarily indicative of future losses or charge-offs and does not restrict the usage of the allowance for any specific loan or category.

| (dollars in thousands)                   | Year Ended December 31, |             |                  |             |                  |             |                  |             |                  |             |
|--|-------------------------|-------------|------------------|-------------|------------------|-------------|------------------|-------------|------------------|-------------|
|  | 2013                    |             | 2012             |             | 2011             |             | 2010             |             | 2009             |             |
|  | Amount                  | %(1)        | Amount           | %(1)        | Amount           | %(1)        | Amount           | %(1)        | Amount           | %(1)        |
| Commercial                               | \$ 9,780                | 24%         | \$ 9,412         | 22%         | \$ 9,609         | 23%         | \$ 8,630         | 26%         | \$ 9,871         | 25%         |
| Income producing commercial real estate  | 10,359                  | 38%         | 9,148            | 37%         | 7,304            | 37%         | 6,668            | 37%         | 3,328            | 36%         |
| Owner occupied commercial real estate    | 3,899                   | 11%         | 2,781            | 12%         | 1,898            | 12%         | 2,064            | 13%         | 3,167            | 14%         |
| Real estate mortgage residential         | 944                     | 3%          | 659              | 3%          | 399              | 2%          | 115              | 1%          | 28               | 1%          |
| Construction commercial and residential  | 13,422                  | 19%         | 12,671           | 21%         | 7,862            | 19%         | 5,562            | 18%         | 3,627            | 18%         |
| Construction C&I (owner occupied)        | 512                     | 1%          | 720              | 1%          | 684              | 2%          | 183              |             | 53               |             |
| Home equity                              | 1,871                   | 4%          | 1,730            | 4%          | 1,528            | 5%          | 1,441            | 5%          | 382              | 6%          |
| Other consumer                           | 134                     |             | 371              |             | 369              |             | 91               |             | 163              |             |
| <b>Total allowance for credit losses</b> | <b>\$ 40,921</b>        | <b>100%</b> | <b>\$ 37,492</b> | <b>100%</b> | <b>\$ 29,653</b> | <b>100%</b> | <b>\$ 24,754</b> | <b>100%</b> | <b>\$ 20,619</b> | <b>100%</b> |

---

(1) Represents the percent of loans in each category to total loans.

### **Nonperforming Assets**

As shown in the table below, the Company's level of nonperforming assets, which are comprised of loans delinquent 90 days or more, nonaccrual loans, restructured loans and OREO, totaled \$33.9 million at December 31, 2013, representing 0.90% of total assets, as compared to \$36.0 million at December 31, 2012, representing 1.06% of total assets. The Company has been highly proactive in addressing existing and potential problem loans resulting from a weaker economy. Management remains attentive to early signs of deterioration in borrowers' financial conditions and to taking the appropriate action to mitigate risk. Furthermore, the Company is diligent in placing loans on nonaccrual status and believes, based on its loan portfolio risk analysis, that its allowance for loan losses at 1.39% of total loans at December 31, 2013, is adequate to absorb potential credit losses in the loan portfolio at that date.

Included in nonperforming assets at December 31, 2013 is OREO of \$9.2 million, consisting of seven foreclosed properties. The Company had eleven OREO properties with a net carrying value of \$5.3 million at December 31, 2012. OREO properties are carried at the lower of cost or appraised value less estimated costs to sell. It is the Company's policy to obtain third party appraisals prior to foreclosure, and to obtain updated third party appraisals on OREO properties not less frequently than annually. Generally, the Company would obtain updated appraisals or evaluations where it has reason to believe, based upon market indications (such as comparable sales, legitimate offers below carrying value, broker indications and similar factors), that the current appraisal does not accurately reflect current value. During the year of 2013, the Company sold eleven foreclosed properties with a net carrying value of \$7.6 million, recording a net loss on sale of \$772 thousand.

Table of Contents

Included in nonperforming assets are loans that we consider impaired. Impaired loans are defined as those which we believe it is probable that we will not collect all amounts due according to the contractual terms of the loan agreement, as well as that portion of loans whose terms have been modified in a troubled debt restructuring ("TDR") which have not shown a period of performance as required under applicable accounting standards. Valuation allowances for those loans determined to be impaired are evaluated in accordance with ASC Topic 310 "Receivables," and updated quarterly. For collateral dependent impaired loans, the carrying amount of the loan is determined by current appraised value less estimated costs to sell the underlying collateral, which may be adjusted downward under certain circumstances for actual events and/or changes in market conditions. For example, current average actual selling prices less average actual closing costs on an impaired multi-unit real estate project may indicate the need for an adjustment in the appraised valuation of the project, which in turn could increase the associated ASC Topic 310 specific reserve for the loan. Generally, all appraisals associated with impaired loans are updated on a not less than annual basis.

Loans are considered to have been modified in a TDR when due to a borrower's financial difficulties the Company makes unilateral concessions to the borrower that it would not otherwise consider. Concessions could include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Alternatively, management, from time-to-time and in the ordinary course of business, implements renewals, modifications, extensions, and/or changes in terms of loans to borrowers who have the ability to repay on reasonable market-based terms, as circumstances may warrant. Such modifications are not considered to be TDR's as the accommodation of a borrower's request does not rise to the level of a concession and/or the borrower is not experiencing financial difficulty. For example, (1) adverse weather conditions may create a short term cash flow issue for an otherwise profitable retail business which suggests a temporary interest only period on an amortizing loan; (2) there may be delays in absorption on a real estate project which reasonably suggests extension of the loan maturity at market terms; or (3) there may be maturing loans to borrowers with demonstrated repayment ability who are not in a position at the time of maturity to obtain alternate long-term financing. The most common change in terms provided by the Company is an extension of an interest only term. The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the change in terms, and the exercise of prudent business judgment. The Company had nine TDR's at December 31, 2013 totaling approximately \$17.2 million. Three of these loans, totaling approximately \$7.9 million, have demonstrated a period of at least six months of performance under the modified terms, and as a result are not disclosed in the table below. During 2013, TDR loans aggregating approximately \$6.1 million were moved to nonperforming status, and one loan of approximately \$2.0 million was moved to OREO after receiving the deed to the underlying collateral, during 2013. At December 31, 2012 the Company had eight TDRs totaling approximately \$16.5 million.

Total nonperforming loans amounted to \$24.7 million at December 31, 2013, representing 0.84% of total loans, compared to \$30.7 million at December 31, 2012, representing 1.23% of total loans. Nonperforming loans decreased by \$6.0 million at December 31, 2013 as compared to 2012, and the ratio of nonperforming loans to total loans decreased due to both a decline in nonperforming loans and an increase in the loan portfolio in 2013.

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

The following table shows the amounts and relevant ratios of nonperforming assets at December 31 for the past five years:

| (dollars in thousands)   | 2013             | 2012             | 2011             | 2010             | 2009             |
|--|------------------|------------------|------------------|------------------|------------------|
| <b>Nonaccrual Loans:</b>   |                  |                  |                  |                  |                  |
| Commercial   | \$ 6,779         | \$ 4,799         | \$ 5,718         | \$ 5,137         | \$ 4,364         |
| Income producing commercial real estate                                  | 2,525            | 3,458            | 7,662            | 3,913            | 1,641            |
| Owner occupied commercial real estate                                    | 5,452            | 2,578            | 282              |                  | 526              |
| Real estate mortgage residential   | 887              | 699              | 1,041            | 760              | 259              |
| Construction commercial and residential                                  | 8,366            | 18,594           | 17,459           | 14,645           | 15,192           |
| Construction C&I (owner occupied)  |                  |                  |                  |                  |                  |
| Home equity  | 623              | 513              | 624              | 297              | 42               |
| Other consumer   | 70               | 43               | 8                | 535              |                  |
| Accrual loans-past due 90 days   |                  |                  |                  |                  |                  |
| <b>Total nonperforming loans(1)</b>                                      | <b>24,702</b>    | <b>30,684</b>    | <b>32,794</b>    | <b>25,287</b>    | <b>22,024</b>    |
| <br>   |                  |                  |                  |                  |                  |
| Other real estate owned  | 9,225            | 5,299            | 3,225            | 6,701            | 5,106            |
| <br>   |                  |                  |                  |                  |                  |
| <b>Total nonperforming assets</b>  | <b>\$ 33,927</b> | <b>\$ 35,983</b> | <b>\$ 36,019</b> | <b>\$ 31,988</b> | <b>\$ 27,130</b> |
| <br>   |                  |                  |                  |                  |                  |
| Coverage ratio, allowance for credit losses to total nonperforming loans | 165.66%          | 122.19%          | 90.42%           | 97.89%           | 93.62%           |
| Ratio of nonperforming loans to total loans                              | 0.84%            | 1.23%            | 1.59%            | 1.51%            | 1.57%            |
| Ratio of nonperforming assets to total assets                            | 0.90%            | 1.06%            | 1.27%            | 1.53%            | 1.50%            |

- (1) As of December 31, 2013, nonaccrual loans reported in the table above included \$7.3 million of loans that migrated from performing "troubled debt restructurings" during 2013.
- (2) Gross interest income that would have been recorded in 2013 if nonaccrual loans shown above had been current and in accordance with their original terms was \$1.8 million, while interest actually recorded on such loans was \$117 thousand. See Note 1 to the Consolidated Financial Statements for a description of the Company's policy for placing loans on nonaccrual status.

Significant variation in the amount of nonperforming loans may occur from period to period because the amount of nonperforming loans depends largely on the condition of a relatively small number of individual credits and borrowers relative to the total loan portfolio.

At December 31, 2013, there were \$10.7 million of performing loans considered potential problem loans, defined as loans which are not included in the 90 day past due, nonaccrual or restructured categories, but for which known information about possible credit problems causes management to be uncertain as to the ability of the borrowers to comply with the present loan repayment terms which may in the future result in disclosure in the past due, nonaccrual or restructured loan categories. The \$10.7 million in potential problem loans at December 31, 2013, compared to \$16.4 million at September 30, 2013, and \$42.4 million at December 31, 2012. There were \$17.7 million of potential problem loans at December 31, 2012, that migrated to nonperforming loan status over the course of 2013. The nonperforming loan balance at December 31, 2013, included \$22.4 million of loans that were considered potential problem loans at December 31, 2012. The Company maintains a conservative posture with respect to its risk ratings, which allows for early intervention in potential problem loan situations. Based upon their status as potential problem loans, these loans receive heightened scrutiny and ongoing intensive risk management. Additionally, the Company's loan loss allowance methodology incorporates increased reserve factors for certain loans considered potential problem loans as compared to the general portfolio. See "Allowance for Credit Losses" on page 57 for a description of the allowance methodology.



Table of Contents

**Other Earning Assets**

Residential mortgage loans held for sale amounted to \$42.0 million at December 31, 2013 compared to \$226.9 million at December 31, 2012. The decrease in loans held for sale in 2013 was effectively due to a rise in market interest rates during the last half of the year, which resulted in a decline in refinancing activity. The Company originates and sells loans only on a "servicing released" basis in order to enhance noninterest income. See "Business" at page 1 for a description of the Bank's mortgage lending and brokerage activities.

Bank owned life insurance is utilized by the Company in accordance with income tax regulations as part of the Company's financing of its benefit programs. At December 31, 2013 this asset amounted to \$39.7 million as compared to \$14.1 million at December 31, 2012, which reflected an increase in cash surrender values and new investments. A portion of the increase in BOLI relates to a newly adopted supplemental retirement benefit adopted for certain executive officers adopted in 2013. Refer to Note 15 of Notes to Consolidated Financial Statements.

**Intangible Assets**

The Company recognizes a servicing asset for the computed value of servicing fees on the sale of the guaranteed portion of SBA loans, which is in excess of a normal servicing fee. Assumptions related to loan term and amortization is made to arrive at the initial recorded value, which is included in intangible assets, net, on the Consolidated Balance Sheets.

For 2013, excess servicing fees of \$339 thousand were recorded, and \$248 thousand was amortized as a reduction of actual service fees collected, which is a component of other income. At December 31, 2013, the balance of excess servicing fees was \$234 thousand. For 2012, excess servicing fees of \$36 thousand were recorded, of which \$72 thousand was amortized as a reduction of actual service fees collected, which is a component of other income. At December 31, 2012, the balance of excess servicing fees was \$143 thousand.

In connection with the acquisition of Fidelity & Trust Financial Corporation ("Fidelity") in 2008 and the purchase during 2011 of the Gallery Place branch office, the Company allocated a portion of the purchase price to core deposit intangibles, based upon an independent evaluation, which are included in Intangible assets, on the Consolidated Balance Sheets. The initial amount recorded for Gallery Place branch office was \$215 thousand. The core deposit intangible relating to the Gallery Place branch acquisition was full amortized at December 31, 2013. The initial amount recorded for the Fidelity acquisition was \$2.3 million. The amount of the core deposit intangible relating to the Fidelity acquisition at December 31, 2013 was \$1.1 million, which is being amortized over its remaining economic life of 2.2 years as a component of other noninterest expense. The amounts amortized in 2012 and 2011 were \$366 thousand and \$324 thousand, respectively. The unamortized assets at December 31, 2013 and 2012 were \$1.1 million and \$1.5 million, respectively.

The Company recorded an unidentified intangible asset (goodwill) incident to the acquisition of Fidelity of \$2.2 million. The Company's testing of potential goodwill impairment (which is required annually), has resulted in no impairment being recorded.

**Deposits and Other Borrowings**

The principal sources of funds for the Bank are core deposits, consisting of demand deposits, NOW accounts, money market accounts and savings accounts. Additionally, the Bank obtains certificates of deposits from the local market areas surrounding the Bank's offices. The deposit base includes transaction accounts, time and savings accounts and accounts which customers use for cash management and which provide the Bank with a source of fee income and cross-marketing opportunities, as well as an attractive source of lower cost funds. To meet funding needs during periods of high loan demand and seasonal

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

variations in core deposits, the Bank utilizes alternative funding sources such as secured borrowings from the FHLB, federal funds purchased lines of credit from correspondent banks and brokered deposits from regional and national brokerage firms and the Promontory.

For the twelve months ended December 31, 2013, noninterest bearing deposits decreased \$32.0 million or 4% to \$849.4 million, as compared to \$881.4 million as of December 31, 2012, while interest bearing deposits increased by \$360.2 million or 18%, during the same period. Within interest bearing deposits, money market and savings accounts collectively amounted to \$1.81 billion at December 31, 2013 or 56% of total deposits, as compared to \$1.37 billion, or 47% of total deposits, at December 31, 2012, a 32% increase. The level of noninterest bearing deposits at December 31, 2013 as compared to December 31, 2012 was negatively impacted by the previously reported loss of \$130.0 million of trustee deposits in March 2013 related to the expiration of the TAG program.

Average total deposits for the year of 2013 were \$2.91 billion, as compared to \$2.54 billion for the same period in 2012, a 15% increase.

Approximately 14% of the Bank's deposits at December 31, 2013 (\$446.3 million) were time deposits, which are generally the most expensive form of deposit because of their fixed rate and term, as compared to 18% at December 31, 2012 (\$527.1 million). This decrease in the percentage of total deposits in the time deposit category at December 31, 2013 as compared to December 31, 2012, was due to sales emphasis on acquiring core money market and demand deposit accounts together with the maturities of brokered deposits.

The following table sets forth the maturities of time deposits with balances of \$100 thousand or more, which represent 6% and 8% of total deposits as of December 31, 2013 and 2012, respectively. See Note 7 to the Consolidated Financial Statements for additional information regarding the maturities of time deposits and the Average Balances Table at page 46 for the average rates paid on interest-bearing deposits. Time deposits of \$100 thousand or more can be more volatile and more expensive than time deposits of less than \$100 thousand. However, because the Bank focuses on relationship banking, and its marketplace demographics are favorable, its historical experience has been that large time deposits have not been more volatile or significantly more expensive than smaller denomination certificates.

| (dollars in thousands)                     | December 31,      |                   |                   |
|--|-------------------|-------------------|-------------------|
|  | 2013              | 2012              | 2011              |
| Three months or less                       | \$ 68,710         | \$ 84,541         | \$ 109,615        |
| More than three months through six months  | 66,240            | 61,698            | 90,094            |
| More than six months through twelve months | 41,384            | 45,545            | 44,764            |
| Over twelve months                         | 27,372            | 41,091            | 87,997            |
| <b>Total</b>                               | <b>\$ 203,706</b> | <b>\$ 232,875</b> | <b>\$ 332,470</b> |

From time to time, when appropriate in order to fund strong loan demand, the Bank accepts brokered time deposits, generally in denominations of less than \$100 thousand, from a regional brokerage firm, and other national brokerage networks, including Promontory. The Bank participates in the Certificates of Deposit Account Registry Service ("CDARS") and the Insured Cash Sweep product ("ICS"), which provides for reciprocal ("two-way") transactions among banks facilitated by Promontory for the purpose of maximizing FDIC insurance. These reciprocal CDARS and ICS funds are classified as brokered deposits, although bank regulators have recognized that these reciprocal deposits have many characteristics of core deposits, and therefore provide for separate identification of such deposits in quarterly Call Report data. The Bank has a commitment at December 31, 2013 from Promontory to place up to \$300 million of brokered deposits from its Insured Network Deposit ("IND") program with the Bank in amounts requested by the Bank, as compared to an actual balance of \$159.3 million at December 31, 2013.

Table of Contents

At December 31, 2013, total deposits included \$418.1 million of brokered deposits (excluding the CDARS and ICS two-way), which represented 13% of total deposits. At December 31, 2012, total time deposits (excluding the CDARS and ICS two-way) included \$474.2 million of brokered deposits, which represented 16% of total deposits. The CDARS and ICS two-way component represented \$318.0 million, or 10% of total deposits and \$92.5 million or 3% of total deposits at December 31, 2013 and 2012, respectively. These sources are believed by the Company to represent a reliable and cost efficient alternative funding source for the Bank.

At December 31, 2013, the Company had \$849.4 million in noninterest bearing demand deposits, representing 26% of total deposits. This compared to \$881.4 million of these deposits at December 31, 2012 or 30% of total deposits. These deposits are primarily business checking accounts. Since July 2011, banks are no longer prohibited from paying interest on demand deposits account, including those from businesses. To date, the Bank has elected not to pay interest on business checking accounts, nor is the payment of such interest a prevalent practice in the Bank's market area at present. It is not clear over the long-term what effect the elimination of this prohibition will have on the Bank's interest expense, allocation of deposits, deposit pricing, loan pricing, net interest margin, ability to compete, ability to establish and maintain customer relationships, or profitability. The Bank is prepared to evaluate options in this area should competition intensify for these deposits, which is not occurring at this time. Payment of interest on these deposits could have a significant negative impact on the Company's net interest income and net interest margin, net income, and the return on assets and equity, although no such effect is currently anticipated.

As an enhancement to the basic noninterest bearing demand deposit account, the Company offers a sweep account, or "customer repurchase agreement," allowing qualifying businesses to earn interest on short-term excess funds, which are not suited for either a certificate of deposit or a money market account. The balances in these accounts were \$80.5 million at December 31, 2013 compared to \$101.3 million at December 31, 2012. Customer repurchase agreements are not deposits and are not insured by the FDIC, but are collateralized by U.S. Government agency securities or U.S. Government agency mortgage backed securities. These accounts are particularly suitable to businesses with significant fluctuation in the levels of cash flows. Attorney and title company escrow accounts are an example of accounts which can benefit from this product, as are customers who may require collateral for deposits in excess of FDIC insurance limits but do not qualify for other pledging arrangements. This program requires the Company to maintain sufficient investment securities for pledging purposes to accommodate the fluctuations in balances which may occur in these customer repurchase agreement accounts.

The Company had no outstanding balances under its federal funds lines of credit provided by correspondent banks at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, the Bank had \$30 million of borrowings outstanding under its credit facility from the FHLB. Outstanding FHLB advances are secured by collateral consisting of a blanket lien on qualifying loans in the Bank's commercial mortgage, residential mortgage and home equity loan portfolios.

The Company has a credit facility with a regional bank, secured by a portion of the stock of the Bank, pursuant to which the Company may borrow, on a revolving basis, up to \$50 million for working capital purposes, to finance capital contributions to the Bank and ECV. There were no amounts outstanding under this credit at December 31, 2013 or 2012.

Please refer to "Liquidity Management" at page 71, and Note 8 to the Consolidated Financial Statements for additional information regarding the Company's short and long-term borrowings.

**COMPARISON OF 2012 VERSUS 2011**

---

For the year ended December 31, 2012, the Company's net income was \$35.3 million, a 44% increase over the \$24.6 million for the year ended December 31, 2011. The increase in net income for the twelve months ended December 31, 2012 can be attributed primarily to an increase in net interest income of 29%



Table of Contents

as compared to the same period in 2011. Net interest income growth was due substantially to growth in average earning assets of 19% in 2012 and to an increase in the net interest margin.

Net income available to common shareholders as of December 31, 2012 increased 51% to \$34.7 million (\$1.50 per basic common share and \$1.46 per diluted common share), as compared to \$23.0 million (\$1.05 per basic common share and \$1.04 per diluted common share) for the year ended December 31, 2011. A lower dividend rate on preferred stock accounted for a significant amount of the increase in earnings available to common shareholders for the twelve months ended December 31, 2012 as compared to the same period in 2011.

For the twelve months ended December 31, 2012, the Company reported a return on average assets of 1.18% as compared to 0.97% (1.01% excluding the effect of the settlement deposit) for the twelve months of 2011, while the return on average common equity was 14.14% in 2012, as compared to 11.71% for the same twelve month period in 2011. The increase in these ratios was due to an expanded net interest margin, higher noninterest income and improved operating efficiency.

The Company's earnings are largely dependent on net interest income, which represented 86% and 88% of total revenue for the full year in 2012 and 2011, respectively. For the twelve months ended December 31, 2012, the net interest margin was 4.32% as compared to 3.99% (4.17% excluding the settlement deposit), for the twelve months ended December 31, 2011. The higher margin for 2012 as compared to 2011 (excluding the settlement deposit) was due to maintaining loan portfolio yields in 2012 close to 2011 levels due to loan pricing practices, an increase in the mix of average loans held for sale, which benefited earning asset yields, and a reduction in funding costs while maintaining a favorable deposit mix.

The higher margin for the year ended December 31, 2012 as compared to the 2011 (excluding the settlement deposit) was due primarily to lower funding costs for both deposits and borrowings more than offsetting a decline in earning asset yields. Average loan yields declined by 12 basis points (from 5.80% to 5.68%), average investment yields declined by 26 basis points (from 2.32% to 2.06%), and average earning asset yields declined by 21 basis points (from 5.02% to 4.81%) as compared to a decline of 44 basis points (from 1.20% to 0.76%) in the cost of interest bearing liabilities. The net interest spread was 4.05% for the year ended December 31, 2012, as compared to 3.82% for the same period in 2011, an increase of 23 basis points. The benefit of noninterest sources funding earning assets declined from 35 basis points for the year ended December 31, 2011 to 27 basis points for same period in 2012.

Including the effect of the settlement deposit, the margin increased from 3.99% for the year ended December 31, 2011 to 4.32% for the same period in 2012. Including the effect of the settlement deposit, the net interest spread was 4.05% for the year ended December 31, 2012, as compared to 3.60% for the same period in 2011, an increase of 45 basis points. Including the effect of the settlement deposit, the benefit of noninterest sources funding earning assets declined from 39 basis points for the year ended December 31, 2011 to 27 basis points for same period in 2012. The combination of a 45 basis point increase in the net interest spread and 12 basis points decrease in the value of noninterest sources resulted in the 33 basis point increase in the net interest margin.

Excluding the effect of the settlement deposit, for the three months ended December 31, 2012 and 2011, average interest bearing liabilities were 63% and 70%, respectively, of average earning assets, as more earning assets were funded by noninterest bearing sources in the most recent three month period as compared to the same three month period in 2011. Additionally, due to a higher mix of lower earning assets in the three months ended December 31, 2012, as compared to the same period in 2011, the average rate on earning assets for the three months ended December 31, 2012 decreased by 13 basis points from 4.87% to 4.74%. The cost of interest bearing liabilities for the three months ended December 31, 2012 as compared to 2011 decreased by 36 basis points from 1.03% to 0.67%, resulting in an increase in the net interest spread of 23 basis points from 3.84% for the three months ended December 31, 2011 to 4.07% for

Table of Contents

the three months ended December 31, 2012. The net interest margin increased 15 basis points from 4.16% for the three months ended December 31, 2011 to 4.31% for the three months ended December 31, 2012.

Including the effect of the settlement deposit, the net interest margin for the three months ended December 31, 2012 increased to 4.31% from 3.65% for the same period in 2011. This increase was due to a higher mix of average loans for the three months ended December 31, 2012 as compared to the same quarter in 2011 (from 66% to 76%) as the average rate on earning assets for the three months ended December 31, 2012 increased by 47 basis points from 4.27% to 4.74%. The net interest spread was 4.07% for the three months ended December 31, 2012 as compared to 3.24% for the same period in 2011, an increase of 83 basis points. The benefit of noninterest sources funding earning assets decreased from 41 basis points for the three months ended December 31, 2011 to 24 basis points for same period in 2012. The combination of an 83 basis point increase in the net interest spread and 17 basis points decrease in the value of noninterest sources resulted in the 66 basis point decrease in the net interest margin.

In order to fund significant growth in the average balance of loans of 20% over the twelve months ended December 31, 2012 as compared to 2011, the Company has relied primarily upon core deposit growth, together with use of increased levels of brokered and wholesale deposits. The major component of the growth in core deposits has been growth in money market accounts and noninterest deposits primarily as a result of effectively building new and enhanced client relationships. Average growth of deposits was 20% for the twelve months ended December 31, 2012 as compared to the same period in 2011.

In terms of the average balance sheet composition or mix, loans, which generally have higher yields than securities and other earning assets, increased from 76% (decreased from 80% excluding the effect of the settlement deposit) of average earning assets for the year ended December 31, 2011 to 77% of average earning assets for the same period in 2012. The higher growth of average funding sources as compared to average loan growth has added average liquidity to the balance sheet for year ended December 31, 2012 compared to the same period in 2011. The slight increase in average loans as a percentage of average earning assets is due primarily to a large increase in average loans held for sale. For the year ended December 31, 2012, as compared to the same period in 2011, average loans held for sale, increased \$77 million, a 122% increase. The increase in average loans for the year ended December 31, 2012 as compared to the same period in 2011 is primarily attributable to growth in loans for both income producing commercial real estate and construction. Increases in average deposits for the year ended December 31, 2012, as compared to the same period in 2011, is attributable to growth in noninterest bearing demand deposits, and money market accounts. Average investment securities for the year ended December 31, 2012 and 2011 amounted to 11% of average earning assets. The combination of federal funds sold, interest bearing deposits with other banks and loans held for sale, averaged 12% of average earning assets for the year ended December 31, 2012 as compared to 13% for the same period in 2011.

The provision for credit losses was \$16.2 million for the year of 2012 as compared to \$11.0 million in 2011. At December 31, 2012 the allowance for credit losses represented 1.50% of loans outstanding, as compared to 1.44% at December 31, 2011. The allowance for credit losses represented 122% of nonperforming loans at December 31, 2012, as compared to 90% at December 31, 2011. The higher provisioning in 2012 as compared to 2011 is attributable to the change in loan mix, higher reserves for classified loans, loan growth, and higher net charge-offs in the twelve months of 2012 compared to 2011. The increase in the coverage ratio was due substantially to a change in the mix of the loan portfolio while the level of nonperforming loans declined by \$2.1 million, or approximately 6%, at December 31, 2012 as compared to December 31, 2011. For the twelve months ended December 31, 2012, net charge-offs totaled \$8.4 million (0.37% of average loans) compared to \$6.1 million (0.32% of average loans) for the twelve months ended December 31, 2011. Net charge-offs in the twelve months ended December 31, 2012 were primarily attributable to commercial and industrial loans (\$3.1 million), construction loans (\$2.5 million), commercial real estate loans (\$1.2 million), home equity, residential mortgage and consumer loans (\$970 thousand), owner occupied real estate (\$350 thousand) and the unguaranteed portion of SBA loans (\$248 thousand).

Table of Contents

Total noninterest income for the twelve months of 2012 was \$21.4 million compared to \$13.5 million in 2011, an increase of 58%. This increase was due primarily to an \$8.0 million increase in gains realized on the sale of residential mortgage loans. Service charges on deposit accounts increased \$619 thousand in 2012 as compared to 2011, a 19% increase. Other noninterest income increased by \$652 thousand primarily due to other loan income and ATM fees. Investment securities gains were \$690 thousand for the twelve months in 2012 as compared to \$1.4 million for the same period in 2011. A \$529 thousand loss on the early extinguishment of debt was realized in 2012 due to restructuring of FHLB advances. Excluding investment securities gains and the loss on the early extinguishment of debt, total noninterest income was \$21.2 million for the twelve months of 2012 as compared to \$12.1 million for 2011, a 76% increase.

Total noninterest expenses were \$76.5 million for the twelve months of 2012, as compared to \$63.3 million for 2011, a 21% increase. Cost increases for salaries and benefits were \$9.2 million due to staffing increases primarily as a result of growth in residential lending, commercial lending and branch personnel and merit increases, incentive compensation and benefits increases. Premises and equipment expenses were \$1.8 million higher due primarily to the cost of new branch offices, a new commercial lending office, two new residential lending offices and normal increases in leasing costs. Data processing costs increased by \$861 thousand due to system enhancements and expanded customer transaction costs. Legal, accounting, and professional fees increases of \$279 thousand were due substantially to higher professional fees, resolution of problem loans and related collection costs. FDIC insurance premiums were \$106 thousand lower due to FDIC premium rate declines which took effect on April 1, 2011. Other expenses increased for the twelve months of 2012 versus 2011 by \$1.1 million due substantially to increases in broker fees, other losses, and telephone. For the twelve months of 2012, the efficiency ratio improved to 51.40% as compared to 56.22% for the same period in 2011 and the ratio of noninterest expenses to average assets was 2.55% for the twelve months ended December 31, 2012 as compared to 2.51% for the same period in 2011. Cost control remains a significant operating objective of the Company.

During the year of 2012, the allowance for credit losses increased \$7.8 million reflecting \$16.2 million in provision for credit losses and \$8.4 million in net charge-offs during the period. The provision for credit losses was \$16.2 million for 2012 as compared to \$11.0 million in 2011. The higher provisioning in 2012 as compared to 2011 is attributable to the change in loan mix, higher reserves for classified loans, loan growth, and higher net charge-offs in the twelve months of 2012 compared to 2011.

The Company recorded income tax expense of \$20.9 million in 2012 compared to \$13.7 million in 2011, resulting in an effective tax rate of 37.2% and 35.9%, respectively. The higher effective tax rate for the year 2012 relates to a higher marginal tax rate resulting from a higher level of income.

At December 31, 2012, total assets were \$3.41 billion, compared to \$2.83 billion at December 31, 2011, a 20% increase. Total loans (excluding loans held for sale) were \$2.49 billion at December 31, 2012 compared to \$2.06 billion at December 31, 2011, a 21% increase. Loans held for sale amounted to \$226.9 million at December 31, 2012 as compared to \$176.8 million at December 31, 2011, a 28% increase. Total deposits were \$2.90 billion at December 31, 2012, compared to deposits of \$2.39 billion at December 31, 2011, a 21% increase. The investment portfolio totaled \$299.8 million at December 31, 2012, a 5% decrease from the \$313.8 million balance at December 31, 2011. Total borrowed funds (excluding customer repurchase agreements) were \$39.3 million at December 31, 2012 compared to \$49.3 million at December 31, 2011, a 20% decrease. Customer repurchase agreements declined slightly, by \$2.0 million or 2%, to \$101.3 million December 31, 2012.

Total shareholders' equity increased to \$350.0 million at December 31, 2012, compared to \$266.7 million at December 31, 2011. This increase primarily results from the issuance of 2,604,086 shares of common stock during 2012 in the Company's at the market and underwritten offerings, at an average weighted price of \$17.31 per share, for net proceeds of \$43.0 million, as well as net retained earnings of \$34.7 million.

Table of Contents

At December 31, 2012, the investment portfolio amounted to \$299.8 million as compared to a balance of \$313.8 million at December 31, 2011, a decrease of 4%. The investment portfolio is managed to achieve goals related to income, liquidity, interest rate risk management and to provide collateral for customer repurchase agreements and other borrowing relationships.

Federal funds sold amounted to \$7.9 million at December 31, 2012 as compared to \$21.8 million at December 31, 2011. These funds represent excess daily liquidity which is invested on an unsecured basis with well capitalized banks, in amounts generally limited both in the aggregate and to any one bank.

Interest bearing deposits with banks and other short-term investments amounted to \$324.0 million at December 31, 2012 as compared to \$205.2 million at December 31, 2011. The significant increase in these overnight funds during 2012 and 2011 represents excess daily liquidity held at the Federal Reserve to meet future loan demand, to fund future increases in investment securities and to meet other general liquidity needs of the Company.

Loan growth in 2012 was favorable, with loans outstanding reaching \$2.49 billion at December 31, 2012, an increase of \$436.8 million or 21% as compared to \$2.06 billion at December 31, 2011.

At December 31, 2012, the Company had \$30.7 million of loans classified as nonperforming, and \$42.4 million of potential problem loans, as compared to \$32.8 million of nonperforming loans and \$23.5 million of potential problem loans at December 31, 2011.

Included in nonperforming assets at December 31, 2012 is OREO of \$5.3 million, consisting of eleven foreclosed properties. The Company had eleven OREO properties with a net carrying value of \$3.2 million at December 31, 2011. OREO properties are carried at the lower of cost or appraised value less estimated costs to sell. It is the Company's policy to obtain third party appraisals prior to foreclosure, and to obtain updated third party appraisals on OREO properties not less frequently than annually. Generally, the Company would obtain updated appraisals or evaluations where it has reason to believe, based upon market indications (such as comparable sales, legitimate offers below carrying value, broker indications and similar factors), that the current appraisal does not accurately reflect current value. During the year of 2012, the Company sold five foreclosed properties with a net carrying value of \$875 thousand, recording a net gain on sale of \$26 thousand.

Residential mortgage loans held for sale amounted to \$226.9 million at December 31, 2012 compared to \$176.8 million at December 31, 2011. The increase in loans held for sale in 2012 was due to the Company's continued expansion of the Residential Lending origination and sales department throughout 2012. The Company originates and sells loans only on a "servicing released" basis in order to enhance noninterest income. Loans sold are subject to repurchase in circumstances where documentation is deficient or the underlying loan becomes delinquent within a specified period following sale and loan funding. There were no loan repurchases as a result of these defined events in 2012.

Bank owned life insurance is utilized by the Company in accordance with income tax regulations as part of the Company's financing of its benefit programs. At December 31, 2012 this asset amounted to \$14.1 million as compared to \$13.7 million at December 31, 2011, which reflected an increase in cash surrender values, and not new investments.

For the year ended December 31, 2012, total deposits increased \$505.1 million as compared to December 31, 2011. Noninterest bearing deposits increased \$192.9 million to \$881.4 million or a growth rate of 28% as compared to \$688.5 million as of December 31, 2011, while interest bearing deposits increased by \$312.2 million during the same period, a growth rate of 18%. Within interest bearing deposits, money market and savings accounts collectively amounted to \$1.37 billion at December 31, 2012 or 47% of total deposits, as compared to \$1.07 billion, or 45% of total deposits, at December 31, 2011, a 29% increase.

Table of Contents

At December 31, 2012, the Company had \$881.4 million in noninterest bearing demand deposits, representing 30% of total deposits. This compared to \$688.5 million of these deposits at December 31, 2011 or 29% of total deposits. These deposits are primarily business checking accounts.

The Company had no outstanding balances under its federal funds lines of credit provided by correspondent banks at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, the Bank had \$30 million and \$40 million, respectively, of borrowings outstanding under its credit facility from the FHLB. Outstanding FHLB advances are secured by collateral consisting of a blanket lien on qualifying loans in the Bank's commercial mortgage and home equity loan portfolios.

The Company has a credit facility with a regional bank, secured by a portion of the stock of the Bank, pursuant to which the Company could borrow at December 31, 2012 and 2011, on a revolving basis, up to \$40 million for working capital purposes, to finance capital contributions to the Bank and ECV. There were no amounts outstanding under this credit at December 31, 2012 or 2011.

**CONTRACTUAL OBLIGATIONS**

The Company has various financial obligations, including contractual obligations and commitments that may require future cash payments. Except for its loan commitments, as shown in Note 16 to the Consolidated Financial Statements, the following table shows details on these fixed and determinable obligations as of December 31, 2013 in the time period indicated.

| (dollars in thousands)                | Within One<br>Year | One to<br>Three Years | Three to<br>Five Years | Over Five<br>Years | Total            |
|---------------------------------------|--------------------|-----------------------|------------------------|--------------------|------------------|
| Deposits without a stated maturity(1) | \$ 2,779,077       | \$                    | \$                     | \$                 | \$ 2,779,077     |
| Time deposits(1)                      | 310,537            | 124,163               | 11,637                 |                    | 446,337          |
| Borrowed funds(2)                     | 80,471             |                       | 30,000                 | 9,300              | 119,771          |
| Operating lease obligations           | 6,809              | 12,882                | 9,018                  | 9,708              | 38,417           |
| Outside data processing(3)            | 1,799              | 1,806                 |                        |                    | 3,605            |
| <br>Total                             | <br>\$ 3,178,693   | <br>\$ 138,851        | <br>\$ 50,655          | <br>\$ 19,008      | <br>\$ 3,387,207 |

(1) Excludes accrued interest payable at December 31, 2013.

(2) Borrowed funds include customer repurchase agreements, and other short-term and long-term borrowings.

(3) The Bank has outstanding obligations under its current core data processing contract that expires in April 2015 and one other vendor arrangement that relates to data communications and data software that expires in December 2015.

**OFF BALANCE SHEET ARRANGEMENTS**

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.



Table of Contents

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. See Note 16 to the Consolidated Financial Statements for a summary list of loan commitments at December 31, 2013 and 2012.

Loan commitments represent agreements to lend to a customer as long as there is no violation of any condition established in the contract and which have been accepted in writing by the borrower. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the borrower. Collateral obtained varies, and may include certificates of deposit, accounts receivable, inventory, property and equipment, residential and commercial real estate.

Standby letters of credit are conditional commitments issued by the Company which guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Company deems necessary. At December 31, 2013, approximately 93% of the dollar amount of standby letters of credit was collateralized.

In connection with deposit guarantees, the Bank collateralizes certain public funds using qualified investment securities and has purchased surety bonds for the benefit of certain bankruptcy trustee fiduciaries. The cost of insurance is included on noninterest expenses on the Consolidated Statement of Operations.

With the exception of these off-balance sheet arrangements, the Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, capital expenditures or capital resources, that is material to investors.

## **LIQUIDITY MANAGEMENT**

---

Liquidity is a measure of the Company and Bank's ability to meet loan demand and to satisfy depositor withdrawal requirements in an orderly manner. The Bank's primary sources of liquidity consist of cash and cash balances due from correspondent banks, excess reserves at the Federal Reserve, loan repayments, federal funds sold and other short-term investments, maturities and sales of investment securities, income from operations and new core deposits into the Bank. The Bank's investment portfolio of debt securities is held in an available-for-sale status which allows for flexibility, subject to holdings held as collateral for customer repurchase agreements and public funds, to generate cash from sales as needed to meet ongoing loan demand. These sources of liquidity are considered primary and are supplemented by the ability of the Company and Bank to borrow funds or issue brokered deposits, which are termed secondary sources of liquidity and which are substantial. The Company's secondary sources of liquidity include a \$50 million line of credit with a regional bank, secured by a portion of the stock of the Bank, against which there were no amounts outstanding at December 31, 2013. Additionally, the Bank can purchase up to \$127.5 million in federal funds on an unsecured basis from its correspondents, against which there were no amounts outstanding at December 31, 2013 and can borrow unsecured funds under one-way CDARS brokered deposits in the amount of \$563.3 million, against which there was \$7.7 million outstanding at December 31, 2013. The Bank also has a commitment at December 31, 2013 from Promontory to place up to \$300.0 million of brokered deposits from its IND program with the Bank, with an actual balance of \$159.3 million outstanding at December 31, 2013. At December 31, 2013, the Bank was also eligible to make advances from the FHLB up to \$407.0 million based on collateral at the FHLB,

Table of Contents

of which \$30.0 million was outstanding at December 31, 2013. Also, the Bank may enter into repurchase agreements as well as obtaining additional borrowing capabilities from the FHLB provided adequate collateral exists to secure these lending relationships. The Bank also has a back-up borrowing facility through the Discount Window at the Federal Reserve Bank of Richmond ("Federal Reserve Bank"). This facility, which amounts to approximately \$375.0 million, is collateralized with specific loan assets identified to the Federal Reserve Bank. It is anticipated that, except for periodic testing, this facility would be utilized for contingency funding only.

The loss of deposits, through disintermediation, is one of the greater risks to liquidity. Disintermediation occurs most commonly when rates rise and depositors withdraw deposits seeking higher rates in alternative savings and investment sources than the Bank may offer. The Bank was founded under a philosophy of relationship banking and, therefore, believes that it has less of an exposure to disintermediation and resultant liquidity concerns than do many banks. The Bank makes competitive deposit interest rate comparisons weekly and feels its interest rate offerings are competitive. There is, however, a risk that some deposits would be lost if rates were to increase and the Bank elected not to remain competitive with its deposit rates. Under those conditions, the Bank believes that it is well positioned to use other sources of funds such as FHLB borrowings, brokered deposits, repurchase agreements and correspondent banks' lines of credit to offset a decline in deposits in the short run. Over the long-term, an adjustment in assets and change in business emphasis could compensate for a potential loss of deposits. The Bank also maintains a marketable investment portfolio to provide flexibility in the event of significant liquidity needs. The ALCO has adopted policy guidelines which emphasize the importance of core deposits, adequate asset liquidity and a contingency funding plan.

At December 31, 2013, under the Bank's liquidity formula, it had \$1.77 billion of primary and secondary liquidity sources. The amount is deemed adequate to meet current and projected funding needs.

**CAPITAL RESOURCES AND ADEQUACY**

---

The assessment of capital adequacy depends on a number of factors such as asset quality and mix, liquidity, earnings performance, changing competitive conditions and economic forces, regulatory measures and policy, as well as the overall level of growth and complexity of the balance sheet. The adequacy of the Company's current and future capital needs is monitored by management and discussed with ALCO on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level and type of capital to support anticipated asset growth, to absorb potential losses, and to maintain a well capitalized regulatory position.

The federal banking regulators have issued guidance for those institutions, which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land acquisitions which represent in total 100% or more of an institution's total risk-based capital; or (2) total commercial real estate loans representing 300% or more of the institution's total risk-based capital and the institution's commercial real estate loan portfolio has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans, and the Company has experienced significant growth in its commercial real estate portfolio in recent years. At December 31, 2013, non-owner-occupied commercial real estate loans (including construction, land and land development loans) represent 409% of total risk based capital. Construction, land and land development loans represent 154% of total risk based capital. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened risk management procedures, and strong underwriting criteria with respect to its commercial real estate



Table of Contents

portfolio. Monitoring practices include periodic stress testing analysis to evaluate changes to cash flows, owing to interest rate increases and declines in net operating income. Nevertheless, we may be required to maintain higher levels of capital as a result of our commercial real estate concentrations, which could require us to obtain additional capital, and may adversely affect shareholder returns.

The Company has a credit facility with a regional bank, pursuant to which the Company may borrow, on a revolving basis, up to \$50 million for working capital purposes, to finance capital contributions to the Bank in whole and to ECV in part. The credit facility is secured by a first lien on a portion of the stock of the Bank, pursuant to which the Company may borrow, and bears interest at a floating rate equal to the Wall Street Journal Prime Rate minus 0.25% with a floor interest rate of 3.50%. Interest is payable on a monthly basis. The term of the credit facility expires on September 30, 2014. There were no amounts outstanding under this credit facility at December 31, 2013 or 2012.

On July 14, 2011, the Company entered into and consummated a Securities Purchase Agreement (the "Purchase Agreement") with the Secretary of the Treasury of the United States (the "Secretary") under the Small Business Lending Fund program. Pursuant to the Purchase Agreement, the Company issued 56,600 shares of the Series B Preferred Stock, having a liquidation amount per share equal to \$1,000, for a total purchase price of \$56.6 million.

The Series B Preferred Stock is entitled to receive non-cumulative dividends, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" (as defined in the Purchase Agreement) by the Bank. The dividend rate for the first ten dividend periods was one percent (1%). For the eleventh calendar quarter through four and one half years after issuance, the dividend rate will be fixed at one percent (1%) based upon the increase in QBSL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent (9%).

The Series B Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

On September 3, 2013 the Company amended the terms of the \$9.3 million of subordinated notes dated August 30, 2010. Under the amendment, the maturity date is extended from September 30, 2016 to September 30, 2021 and the interest rate is changed from 10%, to a fixed interest rate of 8.5% until August 30, 2016 and thereafter at a fixed rate of interest equal to the then current yield on the 5 year U.S. Treasury Note plus 7.03%. The notes are intended to qualify as Tier 2 capital for regulatory purposes to the fullest extent permitted under the currently applicable capital regulations. It is anticipated that the notes will not continue to qualify for Tier 2 capital treatment upon implementation of recently adopted Basel III capital requirements. The payment of principal on the notes may only be accelerated upon the occurrence of certain bankruptcy or receivership related events relating to the Company or, to the extent permitted under capital rules to be adopted by the Federal Reserve Board pursuant to the Dodd-Frank Act, a major bank subsidiary of the Company.

Under current capital rules, the capital treatment of the notes must be phased out, at a rate of 20% of the original principal amount per year during the last five years of the term of the notes, commencing on October 1, 2016. Currently, \$9.3 million of subordinated notes are includible as Tier 2 capital.

At December 31, 2013, the capital position of the Company and its wholly owned subsidiary, the Bank, continues to exceed regulatory requirements and guidelines. The primary indicators relied on by bank regulators in measuring the capital position are the Tier 1 risk-based capital ratio, Total risk-based capital ratio, and the Leverage ratio. Tier 1 capital consists of common and qualifying preferred shareholders' equity (including without limit the preferred stock issued to the Treasury) less goodwill and other intangibles. Total risk-based capital consists of Tier 1 capital, plus qualifying subordinated debt, and the

Table of Contents

qualifying portion of the allowance for credit losses, and for the Company to a limited extent, excess amounts of restricted core capital elements. Risk-based capital ratios are calculated with reference to risk-weighted assets, which are prescribed by regulation. The measure of Tier 1 capital to average assets for the prior quarter is often referred to as the Leverage ratio.

The Company's capital ratios were all well in excess of guidelines established by the Federal Reserve Board and the Bank's capital ratios were in excess of those required to be classified as a "well capitalized" institution under the prompt corrective action provisions of the Federal Deposit Insurance Act. The Company's and Bank's capital ratios at December 31, 2013 and 2012 are shown in Note 18 to the Consolidated Financial Statements.

The ability of the Company to continue to grow is dependent on its earnings and those of the Bank, the ability to obtain additional funds for contribution to the Bank's capital, through additional borrowings, through the sale of additional common stock or preferred stock, or through the issuance of additional qualifying equity equivalents, such as subordinated debt. The capital levels required to be maintained by the Company and Bank may be impacted as a result of the Bank's concentrations in commercial real estate loans. See "Regulation" at page 9 and "Risk Factors" at page 19.

---

**IMPACT OF INFLATION AND CHANGING PRICES**

The Consolidated Financial Statements and Notes thereto have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations. Unlike most industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods or services.

---

**NEW AUTHORITATIVE ACCOUNTING GUIDANCE**

Refer to Note 1 to the Consolidated Financial Statements for New Authoritative Accounting Guidance and their expected impact on the Company's Financial Statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Asset/Liability Management of Interest Rate Risk**

A fundamental risk in banking is exposure to market risk, or interest rate risk, since a bank's net income is largely dependent on net interest income. The Bank's ALCO formulates and monitors the management of interest rate risk through policies and guidelines established by it and the full Board of Directors and through review of detailed reports discussed quarterly. In its consideration of risk limits, the ALCO considers the impact on earnings and capital, the level and direction of interest rates, liquidity, local economic conditions, outside threats and other factors. Banking is generally a business of managing the maturity and re-pricing mismatch inherent in its asset and liability cash flows and to provide net interest income growth consistent with the Company's profit objectives.

During the year ended December 31, 2013, the Company was able to both increase its net interest income (by 14%), its net interest spread (from 4.05% to 4.11%) and manage its overall interest rate risk position.

The Company, through its ALCO and ongoing financial management practices, monitors the interest rate environment in which it operates and adjusts the rates and maturities of its assets and liabilities to remain competitive and to achieve its overall financial objectives subject to established risk limits. In the

Table of Contents

current and expected future interest rate environment, the Company has been maintaining its investment portfolio to manage the balance between yield and prepayment risk in its portfolio of mortgage backed securities should interest rates remain at current levels and has been managing the investment portfolio to mitigate extension risk and related declines in market values in that same portfolio should interest rates increase. Additionally, the Company has very limited call risk in its U.S. agency investment portfolio. During the twelve months ended December 31, 2013, average investment portfolio balances increased as compared to balances at December 31, 2012, as cash flow from significant declines in loans held for sale has been deployed into a combination of higher yielding loans, and higher average investments. Cash flows from mortgage backed securities and sales of U.S. agency securities were reinvested primarily into a combination of structured mortgage backed securities and additional investments have been made in high quality municipal bonds. The percentage mix of municipal securities increased to 27% of total investments at December 31, 2013 from 26% at December 31, 2012, as the relative value of these type investments seemed attractive and was also compatible with the Company's goal of reducing its income tax liability. The portion of the portfolio invested in mortgage backed securities increased from 58% to 60% at December 31, 2013 as compared to December 31, 2012 and the portion of the portfolio represented in U.S. Government agency investments declined from 16% to 13%. The duration of the investment portfolio was increased to 4.3 years at December 31, 2013 from 3.8 years at December 31, 2012, due primarily to a higher mix and dollar amount of municipal securities.

In the loan portfolio, the re-pricing duration was 26 months at December 31, 2013, and 25 months at December 31, 2012, with fixed rate loans amounting to 43% of total loans at both December 31, 2013 and 2012. Variable and adjustable rate loans comprised 57% of total loans at December 31, 2013, and 2012. Variable rate loans are indexed primarily to the Wall Street Journal prime interest rate, while adjustable rate loans are indexed primarily to the five year U.S. Treasury interest rate. In the deposit portfolio, the duration of the portfolio was 19 months at December 31, 2013, as compared to 26 months at December 31, 2012. The change since December 31, 2012 was due substantially to updating a decay rate analysis for non-maturing deposits. The growth of core deposits, which enhances franchise value and provides a stable funding source, resulted in higher average liquidity in 2013 as compared to 2012. The Company experienced core deposit growth of \$328 million for the year ended December 31, 2013, in spite of a large deposit loss in March 2013 directly related to the expiration of unlimited deposit insurance as of January 1, 2013.

The Company has continued its emphasis on funding loans in its marketplace, and has been able to achieve favorable loan pricing, including interest rate floors on many loan originations, although competition for new loans persisted throughout 2013. A disciplined approach to loan pricing, together with loans floors existing in 51% of total loans (at December 31, 2013), has resulted in more stable loan portfolio yields over the past twelve months, as average loan yields have declined by just 17 basis points (from 5.68% to 5.51%) for 2013 as compared to 2012. Subject to interest rate floors, variable and adjustable rate loans provide additional income opportunities should interest rates rise from current levels.

The net unrealized loss before income tax on the investment portfolio was \$5.5 million at December 31, 2013 as compared to a net unrealized gain before tax of \$9.1 million at December 31, 2012, with \$19 thousand of realized net gains recorded during the year ended December 31, 2013. The net unrealized loss on the investment portfolio was due primarily to a substantial increase in interest rates beginning in the latter half of the second quarter of 2013, which substantially reduced the fair market value of the portfolio at June 30, 2013. The unrealized loss position has been reduced in the fourth quarter of 2013, as market interest rates have declined slightly and the slower pace of residential mortgage loan prepayments has positively impacted the fair market value of the Bank's mortgage backed securities. At December 31, 2013, the unrealized loss position represented 1.4% of the portfolio's book value.

There can be no assurance that the Company will be able to successfully achieve its optimal asset liability mix, as a result of competitive pressures, customer preferences and the inability to perfectly forecast future interest rates and movements.

Table of Contents

One of the tools used by the Company to manage its interest rate risk is a static GAP analysis presented below. The Company also employs an earnings simulation model on a quarterly basis to monitor its interest rate sensitivity and risk and to model its balance sheet cash flows and the related income statement effects in different interest rate scenarios. The model utilizes current balance sheet data and attributes and is adjusted for assumptions as to investment maturities (including prepayments), loan prepayments, interest rates, and the level of noninterest income and noninterest expense. The data is then subjected to a "shock test" which assumes a simultaneous change in interest rates up 100, 200, 300, and 400 basis points or down 100 and 200, along the entire yield curve, but not below zero. The results are analyzed as to the impact on net interest income, net income and the market equity over the next twelve and twenty-four month periods from December 31, 2013. In addition to, analysis of simultaneous changes in interest rates along the yield curve, changes based on interest rate "ramps" is also performed. This analysis represents the impact of a more gradual change in interest rates, as well as yield curve shape changes.

For the analysis presented below, at December 31, 2013, the simulation assumes a 50 basis point change in interest rates on money market and interest bearing transaction deposits for each 100 basis point change in market interest rates in a decreasing interest rate shock scenario with a floor of 10 basis points, and assumes a 70 basis point change in interest rates on money market and interest bearing transaction deposits for each 100 basis point change in market interest rates in an increasing interest rate shock scenario.

As quantified in the table below, the Company's analysis at December 31, 2013 shows a moderate effect on net interest income (over the next 12 months) as well as a moderate effect on the economic value of equity when interest rates are shocked both down 100 basis points and up 100, 200, 300, and 400 basis points. This moderate impact is due substantially to the significant level of variable rate and re-priceable assets and liabilities and related shorter relative durations. The re-pricing duration of the investment portfolio at December 31, 2013 is 4.3 years, the loan portfolio 2.2 years; the interest bearing deposit portfolio 1.6 years and the borrowed funds portfolio 1.3 years.

The following table reflects the result of simulation analysis on the December 31, 2013 asset and liabilities balances:

| Change in interest rates (basis points) | Percentage change in net interest income | Percentage change in net income | Percentage change in market value of portfolio equity |
|---|--|---------------------------------|---|
| +400                                    | +3.9%                                    | +3.9%                           | -12.8%  |
| +300                                    | +1.4%                                    | -0.9%                           | -10.3%  |
| +200                                    | -1.1%                                    | -5.8%                           | -7.9%   |
| +100                                    | -2.1%                                    | -7.2%                           | -4.7%   |
| 0                                       |  |                                 |   |
| -100                                    | -3.3%                                    | -7.1%                           | -4.4%   |
| -200                                    | -6.3%                                    | -13.7%                          | -7.7%   |

The results of simulation are well within the policy limits adopted by the Company. For net interest income, the Company has adopted a policy limit of 10% for a 100 basis point change, 12% for a 200 basis point change, 18% for a 300 basis point change and 24% for a 400 basis point change. For the market value of equity, the Company has adopted a policy limit of 12% for a 100 basis point change, 15% for a 200 basis point change, 20% for a 300 basis point change and 25% for a 400 basis point change. The changes in net interest income, net income and the economic value of equity in both a higher and lower interest rate shock scenario at December 31, 2013 are considered to be moderate levels of risk. The negative impact of -2.1% in net interest income and -7.2% in net income given a 100 basis point increase in market interest rates reflects in large measure the impact of floor interest rates in a substantial portion of the loan portfolio and to a lower level of expected residential mortgage sales activity.

For the analysis at December 31, 2013 as compared to December 31, 2012, the Company shortened its assumption of the duration of demand deposit and money market accounts based on analysis of more

Table of Contents

recent experience. Additionally, the analysis at December 31, 2013 as compared to December 31, 2012 increased the discount rate used to value demand deposits to better assess the higher operating cost factor of these type deposits. The impact of these assumption changes is to lower the core deposit value, which negatively impacts the market value of equity.

Generally speaking, the loss of economic value of portfolio equity in a lower interest rate environment is due to lower values of core deposits more than offsetting the gains in loan and investment values; while the gain of economic value of portfolio equity in a higher interest rate environment is due to higher value of core deposits more than offsetting lower values of fixed rate loans and investments. The Company believes its balance sheet is well positioned in the current interest rate environment.

During 2013, the Company continued to manage its interest rate sensitivity position to moderate levels of risk, as indicated in the simulation results above. Except for the lower level of asset liquidity at December 31, 2013 as compared to December 31, 2012 (due substantially to significantly lower balances of residential mortgage loans held for sale), and accounting for the assumption changes in the deposit decay rate analysis noted above, the interest rate risk position at December 31, 2013 was similar to the interest rate risk position at December 31, 2012. As compared to December 31, 2012, the sum of federal funds sold, interest bearing deposits with banks and other short-term investments and loans held for sale declined by \$219 million at December 31, 2013.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or repricing periods, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate mortgage loans, have features that limit changes in interest rates on a short-term basis and over the life of the loan. Further, in the event of a change in interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their debt may decrease in the event of a significant interest rate increase.

During 2013, average market interest rates increased as compared to 2012 and the yield curve steepened. As compared to the year 2012 the average two year U.S. Treasury rate in 2013 increased by 3 basis points from 0.27% to 0.30%, the average five year U.S. Treasury rate increased by 40 basis points from 0.76% to 1.16% and the average ten year U.S. Treasury rate increased by 55 basis points from 1.79% to 2.34%. In that environment, the Company was able to increase its net interest spread for 2013 to 4.11% compared to 4.05% for the year of 2012. The Company believes that the change in the net interest spread for the full year 2013 has been consistent with its risk analysis at December 31, 2012. On an annual basis, the Company analyses through back-testing the actual change in its net interest spread against expected change and actual market interest rate movements and other factors impacting actual versus projected results.

**GAP Analysis**

Banks and other financial institutions earnings are significantly dependent upon net interest income, which is the difference between interest earned on earning assets and interest expense on interest bearing liabilities. Net interest income represented 85% of the Company's revenue for the year ended December 31, 2013, as compared to 86% of the Company's revenue for the year ended December 31, 2012. The Company's net interest margin was 4.30% at December 31, 2013, as compared to 4.32% for the year ended December 31, 2012. The stable net interest margin for the year ended December 31, 2013 as compared to the year ended December 31, 2012, was due to declining funding costs more than offsetting declines in yields on earning assets and to a slightly higher loan to deposit ratio in 2013 versus 2012 (90.8% versus 89.8%).

Table of Contents

Generally speaking, in falling interest rate environments, net interest income is maximized with longer term, higher yielding assets being funded by lower yielding short-term funds, or what is referred to as a negative mismatch or GAP. Conversely, in a rising interest rate environment, net interest income is maximized with shorter term, higher yielding assets being funded by longer-term liabilities or what is referred to as a positive mismatch or GAP.

The GAP position, which is a measure of the difference in maturity and re-pricing volume between assets and liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indication of the sensitivity of the Company to changes in interest rates. A negative GAP indicates the degree to which the volume of re-priceable liabilities exceeds re-priceable assets in given time periods.

At December 31, 2013, the Company had a positive GAP position of approximately \$374 million or 10% of total assets out to three months and a positive cumulative GAP position of \$340 million or 9% of total assets out to 12 months; as compared to a positive GAP position of approximately \$542 million or 16% of total assets out to three months and a positive cumulative GAP position of approximately \$560 million or 16% out to 12 months at December 31, 2012. The change in the positive GAP position at December 31, 2013, as compared to December 2012, was due substantially to lower levels of asset liquidity including significantly lower levels of residential mortgage loans held for sale. The GAP analysis reports variable and adjustable rate loans as re-priceable without regard to interest rate floors, which impact is captured in simulation analysis only. The change in the GAP position at December 31, 2013 as compared to December 31, 2012 is not judged material to the Company's overall interest rate risk position, which relies more heavily on simulation analysis, which captures the full optimality within the balance sheet. The current position is within guideline limits established by the ALCO.

While management believes that this overall position creates a reasonable balance in managing its interest rate risk and maximizing its net interest margin within plan objectives, there can be no assurance as to actual results.

If interest rates increase, the Company's net interest income and net interest margin are expected to decrease modestly due to an excess of rate sensitive assets over liabilities, adjusted for the impact of loan floors and the assumption of an increase in money market interest rates by 70% of the change in market interest rates, and the estimated impact on residential mortgage loan originations.

If interest rates decline, the Company's net interest income and margin are expected to increase modestly as the floors on the loan portfolio provide added value, variable rate deposits are reduced (although rates are close to zero) and the positive impact of lower market interest rates on residential mortgage originations.

Because competitive market behavior does not necessarily track the trend of interest rates but at times moves ahead of financial market influences, the change in the cost of liabilities may be different than anticipated by the GAP model. If this were to occur, the effects of a declining interest rate environment may not be in accordance with management's expectations.

Table of Contents**GAP Analysis****December 31, 2013****(dollars in thousands)**

| Repriceable in:  | 0-3 months          | 4-12 months        | 13-36 months      | 37-60 months       | Over<br>60 months | Total Rate<br>Sensitive | Non-<br>sensitive | Total<br>Assets     |
|--|---------------------|--------------------|-------------------|--------------------|-------------------|-------------------------|-------------------|---------------------|
| <b>RATE SENSITIVE ASSETS:</b>                          |                     |                    |                   |                    |                   |                         |                   |                     |
| Investment securities                                  | \$ 25,784           | \$ 44,326          | \$ 90,874         | \$ 69,507          | \$ 158,914        | \$ 389,405              |                   |                     |
| Loans(1)(2)  | 1,548,783           | 253,243            | 640,931           | 450,075            | 94,156            | 2,987,188               |                   |                     |
| Fed funds and other short-term investments             | 297,383             |                    |                   |                    |                   | 297,383                 |                   |                     |
| Other earning assets                                   | 50,965              |                    |                   |                    |                   | 50,965                  |                   |                     |
| <b>Total</b>   | <b>\$ 1,922,915</b> | <b>\$ 297,569</b>  | <b>\$ 731,805</b> | <b>\$ 519,582</b>  | <b>\$ 253,070</b> | <b>\$ 3,724,941</b>     | <b>\$ 46,562</b>  | <b>\$ 3,771,503</b> |
| <b>RATE SENSITIVE LIABILITIES:</b>                     |                     |                    |                   |                    |                   |                         |                   |                     |
| Noninterest bearing demand                             | \$ 34,656           | \$ 103,968         | \$ 276,908        | \$ 276,907         | \$ 156,970        | \$ 849,409              |                   |                     |
| Interest bearing transaction                           | 83,007              |                    | 17,786            | 17,787             |                   | 118,580                 |                   |                     |
| Savings and money market                               | 1,267,761           |                    | 271,664           | 271,663            |                   | 1,811,088               |                   |                     |
| Time deposits  | 82,790              | 227,748            | 124,162           | 11,637             |                   | 446,337                 |                   |                     |
| Customer repurchase agreements and fed funds purchased | 80,471              |                    |                   |                    |                   | 80,471                  |                   |                     |
| Other borrowings                                       |                     |                    | 39,300            |                    |                   | 39,300                  |                   |                     |
| <b>Total</b>   | <b>\$ 1,548,685</b> | <b>\$ 331,716</b>  | <b>\$ 729,820</b> | <b>\$ 577,994</b>  | <b>\$ 156,970</b> | <b>\$ 3,345,185</b>     | <b>\$ 32,455</b>  | <b>\$ 3,377,640</b> |
| <b>GAP</b>   | <b>\$ 374,230</b>   | <b>\$ (34,147)</b> | <b>\$ 1,985</b>   | <b>\$ (58,412)</b> | <b>\$ 96,100</b>  | <b>\$ 379,756</b>       |                   |                     |
| <b>Cumulative GAP</b>                                  | <b>\$ 374,230</b>   | <b>\$ 340,083</b>  | <b>\$ 342,068</b> | <b>\$ 283,656</b>  | <b>\$ 379,756</b> |                         |                   |                     |
| Cumulative gap as percent of total assets              | 9.92%               | 9.02%              | 9.07%             | 7.52%              | 10.07%            |                         |                   |                     |

(1) Includes loans held for sale.

(2) Nonaccrual loans are included in the over 60 months category.

Over the next twelve months, as reflected in the GAP table above, the Company has an excess of rate sensitive assets over rate sensitive liabilities of 9%.

During 2013, the Company recognized the probability of higher interest rates and repositioned both its investment portfolio and its borrowed funds to better position the Company for that probability, while not exposing the Company to negative effects should interest rates either stay fairly stable or decline. While the sum of federal funds sold, interest bearing deposits with banks and other short-term investments and loans held for sale declined by \$219 million at December 31, 2013 as compared to December 31, 2012; on an average basis, the balance sheet during 2013 experienced an increase in liquidity, which added to average asset sensitivity.

Although NOW and MMA accounts are subject to immediate re-pricing, the Bank's GAP model has incorporated a re-pricing schedule to account for a lag in rate changes based on our experience, as measured by the amount of those deposit rate changes relative to the amount of rate change in assets.





Table of Contents

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Report of Stegman & Company  
Independent Registered Public Accounting Firm**

To the Board of Directors and  
Shareholders of Eagle Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Eagle Bancorp, Inc. (the "Company") as of December 31, 2013 and 2012, and the consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2013. We also have audited the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in the *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on these Consolidated Financial Statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the Consolidated Financial Statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Consolidated Financial Statements referred to above present fairly, in all material respects, the financial position of Eagle Bancorp, Inc. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2013 in

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Eagle Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in the *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ STEGMAN AND COMPANY

Baltimore, Maryland  
March 13, 2014

Table of Contents**EAGLE BANCORP, INC.****Consolidated Balance Sheets****(dollars in thousands, except share and per share data)**

|  | <b>December 31, 2013</b> | <b>December 31, 2012</b> |
|--|--------------------------|--------------------------|
| <b>Assets</b>  |                          |                          |
| Cash and due from banks  | \$ 9,577                 | \$ 7,439                 |
| Federal funds sold   | 5,695                    | 7,852                    |
| Interest bearing deposits with banks and other short-term investments  | 291,688                  | 324,043                  |
| Investment securities available for sale, at fair value  | 378,133                  | 299,820                  |
| Federal Reserve and Federal Home Loan Bank stock   | 11,272                   | 10,694                   |
| Loans held for sale  | 42,030                   | 226,923                  |
| Loans  | 2,945,158                | 2,493,095                |
| Less allowance for credit losses   | (40,921)                 | (37,492)                 |
| Loans, net   | 2,904,237                | 2,455,603                |
| Premises and equipment, net  | 16,737                   | 15,261                   |
| Deferred income taxes  | 28,949                   | 19,128                   |
| Bank owned life insurance  | 39,738                   | 14,135                   |
| Intangible assets, net   | 3,510                    | 3,785                    |
| Other real estate owned  | 9,225                    | 5,299                    |
| Other assets   | 30,712                   | 19,459                   |
| <b>Total Assets</b>  | <b>\$ 3,771,503</b>      | <b>\$ 3,409,441</b>      |
| <b>Liabilities and Shareholders' Equity</b>  |                          |                          |
| <b>Liabilities</b>   |                          |                          |
| Deposits:  |                          |                          |
| Noninterest bearing demand   | \$ 849,409               | \$ 881,390               |
| Interest bearing transaction   | 118,580                  | 113,813                  |
| Savings and money market   | 1,811,088                | 1,374,869                |
| Time, \$100,000 or more  | 203,706                  | 232,875                  |
| Other time   | 242,631                  | 294,275                  |
| Total deposits   | 3,225,414                | 2,897,222                |
| Customer repurchase agreements   | 80,471                   | 101,338                  |
| Long-term borrowings   | 39,300                   | 39,300                   |
| Other liabilities  | 32,455                   | 21,605                   |
| <b>Total Liabilities</b>   | <b>3,377,640</b>         | <b>3,059,465</b>         |
| <b>Shareholders' Equity</b>  |                          |                          |
| Preferred stock, par value \$.01 per share, shares authorized 1,000,000, Series B, \$1,000 per share liquidation preference, shares issued and outstanding 56,600 at December 31, 2013 and 2012. | 56,600                   | 56,600                   |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|  |              |              |
|--|--------------|--------------|
| Common stock, par value \$.01 per share; shares authorized 50,000,000, shares issued and outstanding 25,885,863 and 22,954,889, respectively | 253          | 226          |
| Warrant  | 946          | 946          |
| Additional paid in capital   | 242,990      | 180,593      |
| Retained earnings  | 96,393       | 106,146      |
| Accumulated other comprehensive (loss) income  | (3,319)      | 5,465        |
| <b>Total Shareholders' Equity</b>  | 393,863      | 349,976      |
| <b>Total Liabilities and Shareholders' Equity</b>  | \$ 3,771,503 | \$ 3,409,441 |

See notes to consolidated financial statements.

Table of Contents**EAGLE BANCORP, INC.****Consolidated Statements of Operations****Years Ended December 31,****(dollars in thousands, except per share data)**

|   | 2013       | 2012       | 2011       |
|---|------------|------------|------------|
| <b>Interest Income</b>  |            |            |            |
| Interest and fees on loans  | \$ 148,801 | \$ 134,600 | \$ 112,320 |
| Interest and dividends on investment securities                   | 7,792      | 6,824      | 6,181      |
| Interest on balances with other banks and short-term investments  | 689        | 475        | 513        |
| Interest on federal funds sold                                    | 12         | 44         | 110        |
| <br>  |            |            |            |
| Total interest income   | 157,294    | 141,943    | 119,124    |
| <br>  |            |            |            |
| <b>Interest Expense</b>   |            |            |            |
| Interest on deposits  | 10,614     | 12,057     | 17,248     |
| Interest on customer repurchase agreements                        | 254        | 325        | 685        |
| Interest on short-term borrowings                                 |            | 3          |            |
| Interest on long-term borrowings                                  | 1,636      | 2,029      | 2,144      |
| <br>  |            |            |            |
| Total interest expense  | 12,504     | 14,414     | 20,077     |
| <br>  |            |            |            |
| <b>Net Interest Income</b>  | 144,790    | 127,529    | 99,047     |
| <b>Provision for Credit Losses</b>                                | 9,602      | 16,190     | 10,983     |
| <br>  |            |            |            |
| <b>Net Interest Income After Provision For Credit Losses</b>      | 135,188    | 111,339    | 88,064     |
| <br>  |            |            |            |
| <b>Noninterest Income</b>   |            |            |            |
| Service charges on deposits                                       | 4,607      | 3,937      | 3,318      |
| Gain on sale of loans   | 14,578     | 13,942     | 6,057      |
| Gain on sale of investment securities                             | 19         | 690        | 1,445      |
| Loss on early extinguishment of debt                              |            | (529)      |            |
| Increase in the cash surrender value of bank owned life insurance | 720        | 392        | 401        |
| Other income  | 4,792      | 2,932      | 2,280      |
| <br>  |            |            |            |
| Total noninterest income  | 24,716     | 21,364     | 13,501     |
| <br>  |            |            |            |
| <b>Noninterest Expense</b>  |            |            |            |
| Salaries and employee benefits                                    | 47,481     | 43,684     | 34,518     |
| Premises and equipment expenses                                   | 11,923     | 10,218     | 8,371      |
| Marketing and advertising   | 1,686      | 1,759      | 1,626      |
| Data processing   | 5,903      | 4,415      | 3,554      |
| Legal, accounting and professional fees                           | 3,449      | 4,253      | 3,974      |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|  |                  |                  |                  |
|--|------------------|------------------|------------------|
| FDIC insurance                                     | 2,263            | 2,089            | 2,195            |
| Other expenses                                     | 11,874           | 10,113           | 9,038            |
| <br>   |                  |                  |                  |
| Total noninterest expense                          | 84,579           | 76,531           | 63,276           |
| <br>   |                  |                  |                  |
| <b>Income Before Income Tax Expense</b>            | <b>75,325</b>    | <b>56,172</b>    | <b>38,289</b>    |
| <b>Income Tax Expense</b>                          | <b>28,318</b>    | <b>20,883</b>    | <b>13,731</b>    |
| <br>   |                  |                  |                  |
| <b>Net Income</b>                                  | <b>47,007</b>    | <b>35,289</b>    | <b>24,558</b>    |
| <b>Preferred Stock Dividends</b>                   | <b>566</b>       | <b>566</b>       | <b>1,511</b>     |
| <br>   |                  |                  |                  |
| <b>Net Income Available to Common Shareholders</b> | <b>\$ 46,441</b> | <b>\$ 34,723</b> | <b>\$ 23,047</b> |

**Earnings Per Common Share**

|         |         |         |         |
|---------|---------|---------|---------|
| Basic   | \$ 1.81 | \$ 1.50 | \$ 1.05 |
| Diluted | \$ 1.76 | \$ 1.46 | \$ 1.04 |

See notes to consolidated financial statements.

Table of Contents

**EAGLE BANCORP, INC.**

**Consolidated Statements of Comprehensive Income**

**Years Ended December 31,**

**(dollars in thousands)**

|  | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|--|-------------|-------------|-------------|
| <b>Net Income</b>  | \$ 47,007   | \$ 35,289   | \$ 24,558   |
| <b>Other comprehensive income, net of tax:</b>                   |             |             |             |
| Net unrealized (loss) gain on securities available for sale      | (8,773)     | 1,004       | 3,684       |
| Reclassification adjustment for net gains included in net income | (11)        | (414)       | (867)       |
| <br>   |             |             |             |
| Net change in unrealized (loss) gains on securities              | (8,784)     | 590         | 2,817       |
| <br>   |             |             |             |
| <b>Comprehensive Income</b>                                      | \$ 38,223   | \$ 35,879   | \$ 27,375   |

See notes to consolidated financial statements.

Table of Contents**EAGLE BANCORP, INC.****Consolidated Statements of Changes in Shareholders' Equity**

(dollars in thousands)

|  | Preferred<br>Stock | Common<br>Stock | Warrant       | Additional<br>Paid<br>in Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Shareholders'<br>Equity |
|--|--------------------|-----------------|---------------|----------------------------------|----------------------|---|----------------------------------|
| <b>Balance January 1, 2011</b>                                     | <b>\$ 22,582</b>   | <b>\$ 197</b>   | <b>\$ 946</b> | <b>\$ 130,382</b>                | <b>\$ 48,551</b>     | <b>\$ 2,058</b>   | <b>\$ 204,716</b>                |
| Net Income   |                    |                 |               |                                  | 24,558               |   | 24,558                           |
| Net change in other comprehensive income                           |                    |                 |               |                                  |                      | 2,817   | 2,817                            |
| Stock-based compensation   |                    |                 |               | 1,077                            |                      |   | 1,077                            |
| Exercise of options for 150,237 shares of common stock             |                    |                 |               | 944                              |                      |   | 944                              |
| Tax benefit on non-qualified options exercised                     |                    |                 |               | 143                              |                      |   | 143                              |
| Employee stock purchase plan 12,034 shares                         |                    |                 |               | 124                              |                      |   | 124                              |
| Issuance of Series B Preferred Stock                               | 56,600             |                 |               |                                  |                      |   | 56,600                           |
| Redemption of Series A Preferred Stock (25,559 shares)             | (23,235)           |                 |               |                                  |                      |   | (23,235)                         |
| Preferred stock dividends  |                    |                 |               |                                  | (1,033)              |   | (1,033)                          |
| Discount accretion   | 653                |                 |               |                                  | (653)                |   |                                  |
| <b>Balance December 31, 2011</b>                                   | <b>56,600</b>      | <b>197</b>      | <b>946</b>    | <b>132,670</b>                   | <b>71,423</b>        | <b>4,875</b>  | <b>266,711</b>                   |
| Net Income   |                    |                 |               |                                  | 35,289               |   | 35,289                           |
| Net change in other comprehensive income                           |                    |                 |               |                                  |                      | 590   | 590                              |
| Stock-based compensation   |                    |                 |               | 2,495                            |                      |   | 2,495                            |
| Exercise of options for 167,882 shares of common stock             |                    |                 |               | 1,682                            |                      |   | 1,682                            |
| Common stock issued 2,864,495 shares                               |                    | 26              |               | 42,930                           |                      |   | 42,956                           |
| Tax benefit on non-qualified options exercised                     |                    |                 |               | 369                              |                      |   | 369                              |
| Employee stock purchase plan 31,248 shares                         |                    |                 |               | 447                              |                      |   | 447                              |
| Preferred stock dividends  |                    |                 |               |                                  | (566)                |   | (566)                            |
| <b>Balance December 31, 2012</b>                                   | <b>56,600</b>      | <b>226</b>      | <b>946</b>    | <b>180,593</b>                   | <b>106,146</b>       | <b>5,465</b>  | <b>349,976</b>                   |
| Net Income   |                    |                 |               |                                  | 47,007               |   | 47,007                           |
| Net change in other comprehensive income                           |                    |                 |               |                                  |                      | (8,784)   | (8,784)                          |
| 10% common stock dividend 2,340,518 shares                         |                    | 24              |               | 56,159                           | (56,183)             |   |                                  |
| Cash paid in lieu of fractional shares                             |                    |                 |               |                                  | (11)                 |   | (11)                             |
| Stock-based compensation   |                    |                 |               | 3,304                            |                      |   | 3,304                            |
| Common stock issued 563,343 shares under equity compensation plans |                    | 3               |               | 1,981                            |                      |   | 1,984                            |
| Tax benefits related to stock compensation                         |                    |                 |               | 410                              |                      |   | 410                              |
| Employee stock purchase plan 27,113 shares                         |                    |                 |               | 543                              |                      |   | 543                              |
| Preferred stock dividends  |                    |                 |               |                                  | (566)                |   | (566)                            |
| <b>Balance December 31, 2013</b>                                   | <b>\$ 56,600</b>   | <b>\$ 253</b>   | <b>\$ 946</b> | <b>\$ 242,990</b>                | <b>\$ 96,393</b>     | <b>\$ (3,319)</b>   | <b>\$ 393,863</b>                |



See notes to consolidated financial statements.

Table of Contents**EAGLE BANCORP, INC.****Consolidated Statements of Cash Flows****Years Ended December 31,****(dollars in thousands)**

|  | <b>2013</b>      | <b>2012</b>      | <b>2011</b>      |
|--|------------------|------------------|------------------|
| <b>Cash Flows From Operating Activities:</b>   |                  |                  |                  |
| Net Income   | \$ 47,007        | \$ 35,289        | \$ 24,558        |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities:  |                  |                  |                  |
| Provision for credit losses  | 9,602            | 16,190           | 10,983           |
| Depreciation and amortization  | 4,227            | 3,390            | 2,571            |
| Gains on sale of loans   | (14,578)         | (13,942)         | (6,057)          |
| Securities premium amortization (discount accretion), net                                    | 3,162            | 8,734            | 2,861            |
| Origination of loans held for sale   | (983,332)        | (1,471,248)      | (815,592)        |
| Proceeds from sale of loans held for sale  | 1,182,803        | 1,435,093        | 725,394          |
| Net increase in cash surrender value of BOLI   | (720)            | (392)            | (401)            |
| Increase in deferred income taxes  | (3,965)          | (4,848)          | (2,080)          |
| Net loss (gain) on sale of other real estate owned   | 772              | (26)             | 444              |
| Net gain on sale of investment securities  | (19)             | (690)            | (1,445)          |
| Loss on early extinguishment of debt   |                  | 529              |                  |
| Stock-based compensation expense   | 3,304            | 2,495            | 1,077            |
| Excess tax benefits from stock-based compensation  | (410)            | (369)            | (143)            |
| (Increase) decrease in other assets  | (26)             | 3,797            | (8,962)          |
| Increase in other liabilities  | 10,850           | 1,818            | 10,656           |
| <b>Net cash provided by (used in) operating activities</b>                                   | <b>258,677</b>   | <b>15,820</b>    | <b>(56,136)</b>  |
| <b>Cash Flows From Investing Activities:</b>   |                  |                  |                  |
| (Decrease) increase in interest bearing deposits with other banks and short-term investments | (88)             | 11               | 11,652           |
| Purchases of available for sale investment securities  | (148,373)        | (117,554)        | (263,887)        |
| Proceeds from maturities of available for sale securities                                    | 35,985           | 47,007           | 93,602           |
| Proceeds from sale/call of available for sale securities                                     | 22,148           | 77,084           | 85,923           |
| Purchases of Federal Reserve and Federal Home Loan Bank stock                                | (731)            | (2,776)          | (2,055)          |
| Proceeds from redemption of Federal Reserve and Federal Home Loan Bank stock                 | 153              | 2,324            | 1,341            |
| Net increase in loans  | (474,542)        | (447,557)        | (389,580)        |
| Proceeds from sale of other real estate owned  | 6,783            | 901              | 5,995            |
| Proceeds from redemption of BOLI   | 95               |                  |                  |
| Purchases of BOLI  | (25,603)         |                  |                  |
| Purchases of annuities   | (11,227)         |                  |                  |
| Bank premises and equipment acquired   | (5,336)          | (6,007)          | (5,524)          |
| <b>Net cash used in investing activities</b>   | <b>(600,736)</b> | <b>(446,567)</b> | <b>(462,533)</b> |
| <b>Cash Flows From Financing Activities:</b>   |                  |                  |                  |
| Increase in deposits   | 328,192          | 504,803          | 665,297          |
| (Decrease) increase in customer repurchase agreements  | (20,867)         | (2,024)          | 5,778            |
| Issuance of Series B Preferred Stock   |                  |                  | 56,600           |
| Redemption of Series A Preferred Stock   |                  |                  | (23,235)         |
| Decrease in long-term borrowings   |                  | (10,000)         |                  |
| Payment of dividends on preferred stock  | (566)            | (566)            | (1,033)          |
| Issuance of common stock   |                  | 42,956           |                  |
| Proceeds from exercise of stock options  | 1,984            | 1,685            | 944              |
| Excess tax benefits from stock-based compensation  | 410              | 369              | 143              |
| Payment in lieu of fractional shares   | (11)             |                  |                  |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|
| Proceeds from employee stock purchase plan                  | 543               | 447               | 124               |
| <b>Net cash provided by financing activities</b>            | <b>309,685</b>    | <b>537,670</b>    | <b>704,618</b>    |
| <b>Net (Decrease) Increase In Cash and Cash Equivalents</b> | <b>(32,374)</b>   | <b>106,923</b>    | <b>185,949</b>    |
| <b>Cash and Cash Equivalents at Beginning of Period</b>     | <b>339,334</b>    | <b>232,411</b>    | <b>46,462</b>     |
| <b>Cash and Cash Equivalents at End of Period</b>           | <b>\$ 306,960</b> | <b>\$ 339,334</b> | <b>\$ 232,411</b> |

**Supplemental Cash Flows Information:**

|                   |           |           |           |
|-------------------|-----------|-----------|-----------|
| Interest paid     | \$ 12,910 | \$ 14,935 | \$ 20,045 |
| Income taxes paid | \$ 23,945 | \$ 18,151 | \$ 16,100 |

**Non-Cash Investing Activities**

|   |           |          |          |
|---|-----------|----------|----------|
| Transfers from loans to other real estate owned | \$ 14,842 | \$ 3,955 | \$ 2,740 |
| Transfers from other real estate owned to loans | \$ 3,361  | \$       | \$ 3,124 |

See notes to consolidated financial statements.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011:**

**Note 1 Summary of Significant Accounting Policies**

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 investment in subsidiaries is recorded on the Company's books (Parent Only) on the basis of its equity in the net assets of the subsidiary. The accounting and reporting policies of the Company conform to generally accepted accounting principles ("GAAP") in the United States of America and to general practices in the banking industry. Certain reclassifications have been made to amounts previously reported to conform to the classification made in 2013. The following is a summary of the more significant accounting policies.

**Nature of Operations**

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland, Washington, D.C., and Northern Virginia. 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 and the origination of small business 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. As of December 31, 2013, the Bank offers its products and services through eighteen banking offices 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, provides subordinated financing for the acquisition, development and construction of real estate projects. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending Revenue Recognition below.

**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.

**Cash Flows**

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

**Loans Held for Sale**

The Company engages in sales of residential mortgage loans and the guaranteed portion of SBA loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations.

The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of December 31, 2013 and December 31, 2012. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Intangible assets in the Consolidated Balance Sheets. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in Other income in the Consolidated Statement of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives but are effectively offset by whole loan purchase commitments from various investors. The period of time between issuance of a loan commitment to the customer and closing and sale of the loan to an investor generally ranges from 30 to 90 days under current market conditions. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the investor commits to purchase a loan at a price representing a premium on the day the borrower commits to an interest rate with the intent that the buyer/investor has assumed the interest rate risk on the loan. As a result, the Company is not generally exposed to losses on loans sold nor will it realize gains, related to rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

In circumstances where the Company does not deliver the whole loan to an investor, but rather elects to retain the loan in its portfolio, the loan is transferred from held for sale at fair value.

**Investment Securities**

The Company has no securities classified as trading, nor are any investment securities classified as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income/(loss), a separate component of shareholders' equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the Consolidated Statements of Operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayments and call optionality. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management's intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include: (1) duration and magnitude of the decline in value; (2) the financial condition of the issuer or issuers; and (3) structure of the security.

The entire amount of an impairment loss is recognized in earnings only when: (1) the Company intends to sell the debt security; (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis; or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in shareholders' equity as comprehensive income, net of deferred taxes.

**Loans**

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs on loans are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

**Higher Risk Lending Revenue Recognition**

The Company has occasionally made higher risk acquisition, development, and construction ("ADC") loans that entail higher risks than ADC loans made following normal underwriting practices ("higher risk loan transactions"). These higher risk loan transactions are currently made through the Company's subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts, based on capital levels, and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standard Executive

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

Committee ("AcSEC") guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC's guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Certain additional interest is included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2013, 2012 or 2011 (although normal interest income was recorded) and had five higher risk lending transactions outstanding as of December 31, 2013, as compared to four higher risk lending transaction outstanding as of December 31, 2012, amounting to \$7.4 million and \$3.5 million, respectively.

**Allowance for Credit Losses**

The allowance for credit losses represents an amount, which in management's judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification ("ASC") Topic 450, "*Contingencies*," or ASC Topic 310, "*Receivables*." Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management's evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management's judgment with respect to various other conditions including credit administration and

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank, periodically review the Bank's loan portfolio and allowance for credit losses. Such review may result in recognition of additions to the allowance based on their judgments of information available to them at the time of their examination.

**Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from seven years for furniture, fixtures and equipment, three to five years for computer software and hardware, and ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the Consolidated Statements of Operations.

**Other Real Estate Owned (OREO)**

Assets acquired through loan foreclosure are held for sale and are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by recent appraisals. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through noninterest expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in market conditions or appraised values.

**Goodwill and Other Intangible Assets**

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company's testing of potential goodwill impairment at December 31, 2013, resulted in no impairment being recorded.

**Customer Repurchase Agreements**

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over



Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company's Consolidated Balance Sheets, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

**Marketing and Advertising**

Marketing and advertising costs are generally expensed as incurred.

**Income Taxes**

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, "Income Taxes." Under the liability method, deferred-tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made in the Company's tax reserves for uncertain tax positions or accompanying potential tax penalties and interest for underpayments of income taxes. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at either December 31, 2013 or December 31, 2012.

**Transfer of Financial Assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company; (2) the transferee obtain the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but be deemed immaterial based on the specific facts and circumstances.

**Earnings per Common Share**

Basic net income per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents. Earnings per share amounts for periods ending prior to June 30, 2013 have been adjusted to reflect a 10% stock dividend paid on June 14, 2013.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 1 Summary of Significant Accounting Policies (Continued)**

**Stock-Based Compensation**

In accordance with ASC Topic 718, "*Compensation*," the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value (computed at the date of option grant) of any outstanding fixed stock option grant and restricted stock award, which vest subsequent to December 31, 2005. Compensation expense on variable stock option grants (i.e. performance based grants) if any, is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 13 for a description of stock-based compensation awards, activity and expense for the years ended December 31, 2013, 2012 and 2011.

**New Authoritative Accounting Guidance**

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the reporting of reclassifications out of accumulated other comprehensive income. The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the Consolidated Financial Statements, the adoption of ASU No. 2013-02 had no impact on the Company's consolidated statements of income and condition. See Note 19 to the consolidated financial statements for the disclosures required by ASU No. 2013-02.

**Note 2 Cash and Due from Banks**

Regulation D of the Federal Reserve Act requires that banks maintain reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2013, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest-bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 3 Investment Securities Available-for-Sale**

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2013 and 2012 are as follows:

| <b>December 31, 2013</b>               | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated<br/>Fair<br/>Value</b> |
|--|---------------------------|---------------------------------------|--|-------------------------------------|
| <b>(dollars in thousands)</b>          |                           |                                       |  |                                     |
| U. S. Government agency securities     | \$ 46,640                 | \$ 843                                | \$ 148                                 | \$ 47,335                           |
| Residential mortgage backed securities | 234,206                   | 1,143                                 | 6,675                                  | 228,674                             |
| Municipal bonds                        | 102,423                   | 2,017                                 | 2,700                                  | 101,740                             |
| Other equity investments               | 396                       |                                       | 12                                     | 384                                 |
|  | <b>\$ 383,665</b>         | <b>\$ 4,003</b>                       | <b>\$ 9,535</b>                        | <b>\$ 378,133</b>                   |

| <b>December 31, 2012</b>               | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated<br/>Fair<br/>Value</b> |
|--|---------------------------|---------------------------------------|--|-------------------------------------|
| <b>(dollars in thousands)</b>          |                           |                                       |  |                                     |
| U. S. Government agency securities     | \$ 47,606                 | \$ 1,477                              | \$ 1                                   | \$ 49,082                           |
| Residential mortgage backed securities | 170,649                   | 2,730                                 | 296                                    | 173,083                             |
| Municipal bonds                        | 72,050                    | 5,314                                 | 51                                     | 77,313                              |
| Other equity investments               | 407                       |                                       | 65                                     | 342                                 |
|  | <b>\$ 290,712</b>         | <b>\$ 9,521</b>                       | <b>\$ 413</b>                          | <b>\$ 299,820</b>                   |

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 4.3 years. The gross unrealized loss on other equity investments represents common stock of one local banking company owned by the Company, and traded on a broker "bulletin board" exchange. The estimated fair value is determined by broker quoted prices. The unrealized loss is deemed a result of generally weak valuations for many smaller community bank stocks. The individual banking company is profitable, has good financial trends and has a satisfactory capital position. 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 December 31, 2013 represent an other-than-temporary impairment for the reasons noted. 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. In addition, at December 31, 2013, the Company held \$11.3 million in equity securities in a combination of Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") stocks, which are held for regulatory purposes and are not marketable.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 3 Investment Securities Available-for-Sale (Continued)**

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 as of December 31, 2013 and 2012 are as follows:

| December 31, 2013<br>(dollars in thousands) | Less than 12 Months     |                      | 12 Months or Greater    |                      | Total                   |                      |
|---|-------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|
|   | Estimated<br>Fair Value | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses |
| U. S. Government agency securities          | \$ 4,782                | \$ 148               | \$                      | \$                   | \$ 4,782                | \$ 148               |
| Residential mortgage backed securities      | 155,475                 | 5,992                | 15,658                  | 683                  | 171,133                 | 6,675                |
| Municipal bonds                             | 50,450                  | 2,512                | 3,196                   | 188                  | 53,646                  | 2,700                |
| Other equity investments                    |                         |                      | 165                     | 12                   | 165                     | 12                   |
|   | \$ 210,707              | \$ 8,652             | \$ 19,019               | \$ 883               | \$ 229,726              | \$ 9,535             |

| December 31, 2012<br>(dollars in thousands) | Less than 12 Months     |                      | 12 Months or Greater    |                      | Total                   |                      |
|---|-------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|
|   | Estimated<br>Fair Value | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses |
| U. S. Government agency securities          | \$ 2,999                | \$ 1                 | \$                      | \$                   | \$ 2,999                | \$ 1                 |
| Residential mortgage backed securities      | 44,992                  | 263                  | 2,743                   | 33                   | 47,735                  | 296                  |
| Municipal bonds                             | 3,964                   | 51                   |                         |                      | 3,964                   | 51                   |
| Other equity investments                    |                         |                      | 112                     | 65                   | 112                     | 65                   |
|   | \$ 51,955               | \$ 315               | \$ 2,855                | \$ 98                | \$ 54,810               | \$ 413               |

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2013 and 2012 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (dollars in thousands)                       | December 31, 2013 |                         | December 31, 2012 |                         |
|--|-------------------|-------------------------|-------------------|-------------------------|
|  | Amortized<br>Cost | Estimated<br>Fair Value | Amortized<br>Cost | Estimated<br>Fair Value |
| U. S. Government agency securities maturing: |                   |                         |                   |                         |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| One year or less                       | \$ 19,025  | \$ 19,133  | \$ 5,038   | \$ 5,053   |
| After one year through five years      | 27,615     | 28,202     | 42,568     | 44,029     |
| Residential mortgage backed securities | 234,206    | 228,674    | 170,649    | 173,083    |
| Municipal bonds maturing:              |            |            |            |            |
| After one year through five years      | 25,718     | 26,008     | 11,469     | 11,978     |
| Five years through ten years           | 76,705     | 75,732     | 60,581     | 65,335     |
| Other equity investments               | 396        | 384        | 407        | 342        |
|  | \$ 383,665 | \$ 378,133 | \$ 290,712 | \$ 299,820 |

In 2013, gross realized gains on sales of investment securities were \$237 thousand and gross realized losses on sales of investment securities were \$218 thousand. In 2012, gross realized gains on sales of investment securities were \$941 thousand and gross realized losses on sales of investment securities were

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 3 Investment Securities Available-for-Sale (Continued)**

\$251 thousand. In 2011, realized gains on sales of investment securities were \$1.4 million and there were no realized losses on sales of investment securities.

Proceeds from sales and calls of investment securities in 2013 were \$22.1 million, in 2012 were \$77.1 million, and in 2011 were \$85.9 million.

At December 31, 2013, \$274.2 million (fair value) of securities were pledged as collateral for certain government deposits, and securities sold under agreement to repurchase. The outstanding balance of no single issuer, except for U.S. Government and U.S. Government agency securities, exceeded ten percent of shareholders' equity at December 31, 2013 or 2012.

**Note 4 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.

Loans, net of unamortized net deferred fees, at December 31, 2013 and 2012 are summarized by type as follows:

| (dollars in thousands)                  | December 31, 2013   |             | December 31, 2012   |             |
|---|---------------------|-------------|---------------------|-------------|
|   | Amount              | %           | Amount              | %           |
| Commercial                              | \$ 694,350          | 24%         | \$ 545,070          | 22%         |
| Income producing commercial real estate | 1,119,800           | 38%         | 914,638             | 37%         |
| Owner occupied commercial real estate   | 317,491             | 11%         | 297,857             | 12%         |
| Real estate mortgage residential        | 90,418              | 3%          | 61,871              | 3%          |
| Construction commercial and residential | 574,167             | 19%         | 533,722             | 21%         |
| Construction C&I (owner occupied)       | 34,659              | 1%          | 28,808              | 1%          |
| Home equity                             | 110,242             | 4%          | 106,844             | 4%          |
| Other consumer                          | 4,031               |             | 4,285               |             |
| <b>Total loans</b>                      | <b>2,945,158</b>    | <b>100%</b> | <b>2,493,095</b>    | <b>100%</b> |
| Less: Allowance for Credit Losses       | (40,921)            |             | (37,492)            |             |
| <b>Net loans</b>                        | <b>\$ 2,904,237</b> |             | <b>\$ 2,455,603</b> |             |

Unamortized net deferred fees amounted to \$12.7 million and \$8.8 million at December 31, 2013 and 2012, of which \$235 thousand and \$301 thousand at December 31, 2013 and 2012, respectively, represented net deferred costs on home equity loans.

As of December 31, 2013 and 2012, the Bank serviced \$67.6 million and \$41.2 million, respectively, of loan participations which are not reflected as loan balances on the Consolidated Balance Sheets.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 4 Loans and Allowance for Credit Losses (Continued)**

*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 investment real estate. The combination of owner occupied commercial real estate and owner occupied commercial real estate construction represent 12% of the loan portfolio. At December 31, 2013, the combination of commercial real estate and real estate construction loans represent approximately 69% of the loan portfolio. When owner occupied commercial real estate and owner occupied commercial construction loans are excluded, the percentage of commercial real estate and construction loans to total loans decreases to 57%. 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 1.00. Personal guarantees are generally 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 cash flow, equipment and account receivable financing. This loan category represents approximately 24% of the loan portfolio at December 31, 2013 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 1% 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.

Approximately 4% of the loan portfolio at December 31, 2013 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

The remaining 3% of the loan portfolio consists of residential mortgage loans. These are typically loans underwritten to the same underwriting standards as residential loans held for sale but for shorter terms, generally less than 10 years.

Loans are secured primarily by duly recorded first deeds of trust. In some cases, the Bank may accept a recorded junior trust position. In general, borrowers will have a proven ability to build, lease, manage

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 4 Loans and Allowance for Credit Losses (Continued)**

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 its 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 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 1.00. 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.

The Company's loan portfolio includes loans made for real estate Acquisition, Development and Construction ("ADC") purposes, including both investment and owner occupied projects. ADC loans amounted to \$608.8 million at December 31, 2013. A portion of the ADC portfolio, both speculative and non-speculative, includes loan funded interest reserves at origination. ADC loans containing loan funded interest reserves represent approximately 47% of the outstanding ADC loan portfolio at December 31, 2013. 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: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) 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



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 4 Loans and Allowance for Credit Losses (Continued)**

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: (i) 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; (ii) a construction loan administration department independent of the lending function; (iii) third party independent construction loan inspection reports; (iv) 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 (v) 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.

From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, ECV. Such loans, which are made to finance projects (which may also be financed at the Bank level), may have higher risk characteristics than loans made by the Bank, such as lower priority interests and/or higher loan to value ratios. The Company seeks an overall financial return on these transactions commensurate with the risks and structure of each individual loan. Certain transactions may bear current interest at a rate with a significant premium to normal market rates. Other loan transactions may carry a standard rate of current interest, but also earn additional interest based on a percentage of the profits of the underlying project or a fixed accrued rate of interest.

The following tables detail activity in the allowance for credit losses by portfolio segment for the years ended December 31, 2013 and 2012. 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<br>Producing<br>Commercial<br>Real<br>Estate | Owner<br>Occupied<br>Commercial<br>Real<br>Estate | Real<br>Estate<br>Mortgage<br>Residential | Construction<br>Commercial<br>and<br>Residential | Home<br>Equity | Other<br>Consumer | Total     |
|---|------------|---|---|---|--|----------------|-------------------|-----------|
| <b>For the Year Ended<br/>December 31, 2013</b> |            |   |   |   |  |                |                   |           |
| Allowance for credit losses:                    |            |   |   |   |  |                |                   |           |
| Balance at beginning of period                  | \$ 9,412   | \$ 9,148  | \$ 2,781  | \$ 659                                    | \$ 13,391  | \$ 1,730       | \$ 371            | \$ 37,492 |
| Loans charged-off                               | (4,275)    | (602)   |   |   | (2,010)  | (89)           | (63)              | (7,039)   |
| Recoveries of loans previously<br>charged-off   | 161        |   |   |   | 688  | 11             | 6                 | 866       |
| Net loans charged-off                           | (4,114)    | (602)   |   |   | (1,322)  | (78)           | (57)              | (6,173)   |
| Provision for credit losses                     | 4,482      | 1,813   | 1,118   | 285                                       | 1,865  | 219            | (180)             | 9,602     |
| Ending balance                                  | \$ 9,780   | \$ 10,359   | \$ 3,899  | \$ 944                                    | \$ 13,934  | \$ 1,871       | \$ 134            | \$ 40,921 |
| <b>For the Year Ended<br/>December 31, 2012</b> |            |   |   |   |  |                |                   |           |
| Allowance for credit losses:                    |            |   |   |   |  |                |                   |           |
| Individually evaluated for<br>impairment        | \$ 1,323   | \$ 1,098  | \$ 1,853  | \$ 27                                     | \$ 1,625   | \$ 526         | \$ 68             | \$ 6,520  |
| Collectively evaluated for<br>impairment        | 8,457      | 9,261   | 2,046   | 917                                       | 12,309   | 1,345          | 66                | 34,401    |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                |    |       |    |        |    |       |    |     |    |        |    |       |    |     |    |        |
|----------------|----|-------|----|--------|----|-------|----|-----|----|--------|----|-------|----|-----|----|--------|
| Ending balance | \$ | 9,780 | \$ | 10,359 | \$ | 3,899 | \$ | 944 | \$ | 13,934 | \$ | 1,871 | \$ | 134 | \$ | 40,921 |
|----------------|----|-------|----|--------|----|-------|----|-----|----|--------|----|-------|----|-----|----|--------|

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 4 Loans and Allowance for Credit Losses (Continued)**

| (dollars in thousands)                          | Commercial | Income<br>Producing<br>Commercial<br>Real Estate | Owner<br>occupied<br>Commercial<br>Real Estate | Real<br>Estate<br>Mortgage<br>Residential | Construction<br>Commercial<br>and<br>Residential | Home<br>Equity | Other<br>Consumer | Total     |
|---|------------|--|--|---|--|----------------|-------------------|-----------|
| <b>For the Year Ended<br/>December 31, 2012</b> |            |  |  |   |  |                |                   |           |
| Allowance for credit losses:                    |            |  |  |   |  |                |                   |           |
| Balance at beginning of period                  | \$ 9,609   | \$ 7,304   | \$ 1,898                                       | \$ 399                                    | \$ 8,546   | \$ 1,528       | \$ 369            | \$ 29,653 |
| Loans charged-off                               | (3,481)    | (1,189)  | (350)  | (300)                                     | (3,033)  | (698)          | (47)              | (9,098)   |
| Recoveries of loans previously<br>charged-off   | 144        | 18   |  |   | 510  | 73             | 2                 | 747       |
| Net loans charged-off                           | (3,337)    | (1,171)  | (350)  | (300)                                     | (2,523)  | (625)          | (45)              | (8,351)   |
| Provision for credit losses                     | 3,140      | 3,015  | 1,233  | 560                                       | 7,368  | 827            | 47                | 16,190    |
| Ending balance                                  | \$ 9,412   | \$ 9,148   | \$ 2,781                                       | \$ 659                                    | \$ 13,391  | \$ 1,730       | \$ 371            | \$ 37,492 |
| <b>For the Year Ended<br/>December 31, 2012</b> |            |  |  |   |  |                |                   |           |
| Allowance for credit losses:                    |            |  |  |   |  |                |                   |           |
| Individually evaluated for<br>impairment        | \$ 2,158   | \$ 1,201   | \$ 753   | \$  | \$ 3,718   | \$ 243         | \$ 41             | \$ 8,114  |
| Collectively evaluated for<br>impairment        | 7,254      | 7,947  | 2,028  | 659                                       | 9,673  | 1,487          | 330               | 29,378    |
| Ending balance                                  | \$ 9,412   | \$ 9,148   | \$ 2,781                                       | \$ 659                                    | \$ 13,391  | \$ 1,730       | \$ 371            | \$ 37,492 |

The Company's recorded investments in loans as of December 31, 2013 and December 31, 2012 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<br>Producing<br>Commercial<br>Real Estate | Owner<br>occupied<br>Commercial<br>Real Estate | Real<br>Estate<br>Mortgage<br>Residential | Construction<br>Commercial<br>and<br>Residential | Home<br>Equity | Other<br>Consumer | Total     |
|----------------------------------|------------|--|--|---|--|----------------|-------------------|-----------|
| <b>December 31, 2013</b>         |            |  |  |   |  |                |                   |           |
| Recorded investment in<br>loans: |            |  |  |   |  |                |                   |           |
|                                  | \$ 9,614   | \$ 2,682   | \$ 7,574                                       | \$ 113                                    | \$ 13,862  | \$ 682         | \$ 70             | \$ 34,597 |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                                       |            |              |            |           |            |            |          |              |  |
|---------------------------------------|------------|--------------|------------|-----------|------------|------------|----------|--------------|--|
| Individually evaluated for impairment |            |              |            |           |            |            |          |              |  |
| Collectively evaluated for impairment | 684,736    | 1,117,118    | 309,917    | 90,305    | 594,964    | 109,560    | 3,961    | 2,910,561    |  |
| Ending balance                        | \$ 694,350 | \$ 1,119,800 | \$ 317,491 | \$ 90,418 | \$ 608,826 | \$ 110,242 | \$ 4,031 | \$ 2,945,158 |  |

**December 31, 2012**

|                                       |            |            |            |           |            |            |          |              |  |
|---------------------------------------|------------|------------|------------|-----------|------------|------------|----------|--------------|--|
| Recorded investment in loans:         |            |            |            |           |            |            |          |              |  |
| Individually evaluated for impairment | \$ 15,177  | \$ 11,401  | \$ 8,723   | \$        | \$ 36,502  | \$ 510     | \$ 43    | \$ 72,356    |  |
| Collectively evaluated for impairment | 529,893    | 903,237    | 289,134    | 61,871    | 526,028    | 106,334    | 4,242    | 2,420,739    |  |
| Ending balance                        | \$ 545,070 | \$ 914,638 | \$ 297,857 | \$ 61,871 | \$ 562,530 | \$ 106,844 | \$ 4,285 | \$ 2,493,095 |  |

At December 31, 2013, the nonperforming loans acquired from Fidelity have a carrying value of \$2.0 million and an unpaid principal balance of \$11.5 million and were evaluated separately in accordance with ASC Topic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality." 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

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 4 Loans and Allowance for Credit Losses (Continued)**

will result in additional loan loss provisions and related allowance for credit losses. Subsequent upward adjustments to the valuation of impaired loans acquired will result in accretable discount. No adjustments have been made to the fair value amounts of impaired loans subsequent to the allowable period of adjustment from the date of acquisition.

*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.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 4 Loans and Allowance for Credit Losses (Continued)**

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.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 4 Loans and Allowance for Credit Losses (Continued)**

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 December 31, 2013.

| (dollars in thousands)                  | Pass                | Watch and<br>Special<br>Mention | Substandard      | Doubtful  | Total<br>Loans      |
|---|---------------------|---------------------------------|------------------|-----------|---------------------|
| <b>December 31, 2013</b>                |                     |                                 |                  |           |                     |
| Commercial                              | \$ 655,409          | \$ 29,327                       | \$ 9,614         | \$        | \$ 694,350          |
| Income producing commercial real estate | 1,095,285           | 21,833                          | 2,682            |           | 1,119,800           |
| Owner occupied commercial real estate   | 294,337             | 15,580                          | 7,574            |           | 317,491             |
| Real estate mortgage residential        | 89,501              | 804                             | 113              |           | 90,418              |
| Construction commercial and residential | 575,321             | 19,643                          | 13,862           |           | 608,826             |
| Home equity                             | 107,415             | 2,145                           | 682              |           | 110,242             |
| Other consumer                          | 3,961               |                                 | 70               |           | 4,031               |
| <b>Total</b>                            | <b>\$ 2,821,229</b> | <b>\$ 89,332</b>                | <b>\$ 34,597</b> | <b>\$</b> | <b>\$ 2,945,158</b> |

|   |                     |                  |                  |             |                     |
|---|---------------------|------------------|------------------|-------------|---------------------|
| <b>December 31, 2012</b>                |                     |                  |                  |             |                     |
| Commercial                              | \$ 495,072          | \$ 34,821        | \$ 15,170        | \$ 7        | \$ 545,070          |
| Income producing commercial real estate | 892,569             | 10,668           | 11,401           |             | 914,638             |
| Owner occupied commercial real estate   | 275,864             | 13,270           | 8,723            |             | 297,857             |
| Real estate mortgage residential        | 61,134              | 737              |                  |             | 61,871              |
| Construction commercial and residential | 508,166             | 17,862           | 36,502           |             | 562,530             |
| Home equity                             | 104,302             | 2,032            | 510              |             | 106,844             |
| Other consumer                          | 4,230               | 12               | 43               |             | 4,285               |
| <b>Total</b>                            | <b>\$ 2,341,337</b> | <b>\$ 79,402</b> | <b>\$ 72,349</b> | <b>\$ 7</b> | <b>\$ 2,493,095</b> |

*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. When interest accrual is discontinued, all unpaid accrued interest is reversed. 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.



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 4 Loans and Allowance for Credit Losses (Continued)**

The following presents by class of loan, information related to nonaccrual loans as of the year ended December 31, 2013 and 2012.

| (dollars in thousands)                  | December 31, 2013 |        | December 31, 2012 |        |
|---|-------------------|--------|-------------------|--------|
| Commercial                              | \$                | 6,779  | \$                | 4,799  |
| Income producing commercial real estate |                   | 2,525  |                   | 3,458  |
| Owner occupied commercial real estate   |                   | 5,452  |                   | 2,578  |
| Real estate mortgage residential        |                   | 887    |                   | 699    |
| Construction commercial and residential |                   | 8,366  |                   | 18,594 |
| Home equity                             |                   | 623    |                   | 513    |
| Other consumer                          |                   | 70     |                   | 43     |
| <br>                                    |                   |        |                   |        |
| Total nonaccrual loans(1)(2)            | \$                | 24,702 | \$                | 30,684 |

(1) Excludes troubled debt restructurings ("TDRs") that were performing under their restructured terms totaling \$7.9 million at December 31, 2013, and \$15.3 million at December 31, 2012.

(2) Gross interest income that would have been recorded in 2013 if nonaccrual loans shown above had been current and in accordance with their original terms was \$1.8 million, while interest actually recorded on such loans was \$117 thousand. See Note 1 to the Consolidated Financial Statements for a description of the Company's policy for placing loans on nonaccrual status.

The following table presents by class, an aging analysis and the recorded investments in loans past due as of December 31, 2013 and 2012.

| (dollars in thousands)                  | Loans<br>30-59<br>Days<br>Past Due |           | Loans<br>60-89 Days<br>Past Due |           | Loans 90<br>Days<br>or More<br>Past Due |              | Total Past<br>Due<br>Loans | Current<br>Loans | Total<br>Recorded<br>Investment in<br>Loans |
|---|------------------------------------|-----------|---------------------------------|-----------|---|--------------|----------------------------|------------------|---|
| December 31, 2013                       |                                    |           |                                 |           |   |              |                            |                  |   |
| Commercial                              | \$ 1,698                           | \$ 11,146 | \$ 6,779                        | \$ 19,623 | \$ 674,727                              | \$ 694,350   |                            |                  |   |
| Income producing commercial real estate | 818                                |           | 2,525                           | 3,343     | 1,116,457                               | 1,119,800    |                            |                  |   |
| Owner occupied commercial real estate   | 360                                | 2,121     | 5,452                           | 7,933     | 309,558                                 | 317,491      |                            |                  |   |
| Real estate mortgage residential        |                                    |           | 887                             | 887       | 89,531                                  | 90,418       |                            |                  |   |
| Construction commercial and residential |                                    |           | 8,366                           | 8,366     | 600,460                                 | 608,826      |                            |                  |   |
| Home equity                             | 626                                | 359       | 623                             | 1,608     | 108,634                                 | 110,242      |                            |                  |   |
| Other consumer                          |                                    | 15        | 70                              | 85        | 3,946                                   | 4,031        |                            |                  |   |
| <br>                                    |                                    |           |                                 |           |   |              |                            |                  |   |
| Total                                   | \$ 3,502                           | \$ 13,641 | \$ 24,702                       | \$ 41,845 | \$ 2,903,313                            | \$ 2,945,158 |                            |                  |   |



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 4 Loans and Allowance for Credit Losses (Continued)**

| (dollars in thousands)                  | Loans<br>30-59 Days<br>Past Due | Loans<br>60-89<br>Days<br>Past Due | Loans 90<br>Days<br>or More<br>Past Due | Total Past<br>Due<br>Loans | Current<br>Loans    | Total<br>Recorded<br>Investment in<br>Loans |
|---|---------------------------------|------------------------------------|---|----------------------------|---------------------|---|
| December 31, 2012                       |                                 |                                    |   |                            |                     |   |
| Commercial                              | \$ 3,784                        | \$ 598                             | \$ 4,799                                | \$ 9,181                   | \$ 535,889          | \$ 545,070                                  |
| Income producing commercial real estate | 1,538                           | 992                                | 3,458                                   | 5,988                      | 908,650             | 914,638                                     |
| Owner occupied commercial real estate   | 369                             | 4,081                              | 2,578                                   | 7,028                      | 290,829             | 297,857                                     |
| Real estate mortgage residential        |                                 | 107                                | 699                                     | 806                        | 61,065              | 61,871                                      |
| Construction commercial and residential | 6,276                           | 675                                | 18,594                                  | 25,545                     | 536,985             | 562,530                                     |
| Home equity                             | 1,150                           | 352                                | 513                                     | 2,015                      | 104,829             | 106,844                                     |
| Other consumer                          |                                 | 5                                  | 43                                      | 48                         | 4,237               | 4,285                                       |
| <b>Total</b>                            | <b>\$ 13,117</b>                | <b>\$ 6,810</b>                    | <b>\$ 30,684</b>                        | <b>\$ 50,611</b>           | <b>\$ 2,442,484</b> | <b>\$ 2,493,095</b>                         |

*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.

The following table presents by class, information related to impaired loans for the years ended December 31, 2013 and 2012.

| (dollars in thousands)                  | Unpaid<br>Contractual<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment<br>Quarter<br>To Date | Year<br>To Date | Interest<br>Income<br>Recognized<br>Quarter<br>To Date | Year<br>To Date |
|---|---|--|---|---------------------------------|----------------------|---|-----------------|--|-----------------|
| <b>December 31, 2013</b>                |   |  |   |                                 |                      |   |                 |  |                 |
| Commercial                              | \$ 6,779                                      | \$ 2,327                                       | \$ 4,452                                    | \$ 6,779                        | \$ 1,323             | \$ 8,193  | \$ 8,877        | \$ 53  | \$ 131          |
| Income producing commercial real estate | 5,902   | 1,322  | 4,580                                       | 5,902                           | 1,098                | 6,183   | 5,755           | 38   | 175             |
| Owner occupied commercial               | 5,452   | 111  | 5,341                                       | 5,452                           | 1,853                | 5,939   | 6,285           | 52   | 108             |
| Real estate mortgage residential        | 887   | 774  | 113   | 887                             | 27                   | 891   | 792             | 2  | 2               |
| Construction commercial and residential | 13,233  | 5,358  | 7,575                                       | 12,933                          | 1,625                | 13,405  | 17,298          | 44   | 169             |
| Home equity                             | 623   |  | 623   | 623                             | 526                  | 567   | 508             | 2  | 4               |
| Other consumer                          | 70  |  | 70  | 70                              | 68                   | 58  | 34              | 1  | 2               |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|       |           |          |           |           |          |           |           |        |        |
|-------|-----------|----------|-----------|-----------|----------|-----------|-----------|--------|--------|
| Total | \$ 32,946 | \$ 9,892 | \$ 22,754 | \$ 32,646 | \$ 6,520 | \$ 35,236 | \$ 39,549 | \$ 192 | \$ 591 |
|-------|-----------|----------|-----------|-----------|----------|-----------|-----------|--------|--------|

Table of Contents

## Eagle Bancorp, Inc.

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 4 Loans and Allowance for Credit Losses (Continued)**

| (dollars in thousands)                  | Unpaid<br>Contractual<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |                  | Interest<br>Income<br>Recognized |                    |
|---|---|--|---|---------------------------------|----------------------|-----------------------------------|------------------|----------------------------------|--------------------|
|   |   |  |   |                                 |                      | Quarter<br>To Date                | Year<br>To Date  | Quarter<br>To<br>Date            | Year<br>To<br>Date |
| <b>December 31, 2012</b>                |   |  |   |                                 |                      |                                   |                  |                                  |                    |
| Commercial                              | \$ 9,461                                      | \$ 5,767                                       | \$ 3,481                                    | \$ 9,248                        | \$ 2,158             | \$ 8,372                          | \$ 7,772         | \$ 151                           | \$ 245             |
| Income producing commercial real estate | 5,600   | 3,830  | 1,770                                       | 5,600                           | 1,201                | 5,695                             | 6,609            | 38                               | 152                |
| Owner occupied commercial               | 6,659   | 5,602  | 1,057                                       | 6,659                           | 753                  | 4,517                             | 2,746            | 213                              | 252                |
| Real estate mortgage residential        | 699   | 699  |   | 699                             |                      | 706                               | 714              |                                  |                    |
| Construction commercial and residential | 25,347  | 14,727   | 8,508                                       | 23,235                          | 3,718                | 24,859                            | 26,430           | 63                               | 202                |
| Home equity                             | 513   | 134  | 379   | 513                             | 243                  | 592                               | 534              | 1                                | 9                  |
| Other consumer                          | 43  | 1  | 42  | 43                              | 41                   | 25                                | 17               | 2                                | 2                  |
| <b>Total</b>                            | <b>\$ 48,322</b>                              | <b>\$ 30,760</b>                               | <b>\$ 15,237</b>                            | <b>\$ 45,997</b>                | <b>\$ 8,114</b>      | <b>\$ 44,766</b>                  | <b>\$ 44,822</b> | <b>\$ 468</b>                    | <b>\$ 862</b>      |

*Modifications*

A modification of a loan constitutes a troubled debt restructuring ("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.

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.

The following table presents by class, information related to loans modified in a TDR during the years ended December 31, 2013 and 2012.

| (dollars in thousands)                  | Number of<br>Contracts | TDRs Performing<br>to Modified Terms | TDRs Not<br>Performing<br>to Modified Terms |                 | Total<br>TDRs    |
|---|------------------------|--------------------------------------|---|-----------------|------------------|
|   |                        |                                      |   |                 |                  |
| <b>December 31, 2013</b>                |                        |                                      |   |                 |                  |
| Commercial                              | 3                      | \$                                   | \$  | 4,042           | \$ 4,042         |
| Income producing commercial real estate | 3                      |                                      | 3,377                                       | 217             | 3,594            |
| Owner occupied commercial real estate   | 1                      |                                      |   | 4,081           | 4,081            |
| Construction commercial and residential | 2                      |                                      | 4,567                                       | 912             | 5,479            |
| <b>Total</b>                            | <b>9</b>               | <b>\$</b>                            | <b>7,944</b>                                | <b>\$ 9,252</b> | <b>\$ 17,196</b> |



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 4 Loans and Allowance for Credit Losses (Continued)**

| (dollars in thousands)                  | Number of<br>Contracts | TDRs Performing<br>to Modified Terms | TDRs Not<br>Performing<br>to Modified Terms | Total<br>TDRs |
|---|------------------------|--------------------------------------|---|---------------|
| <b>December 31, 2012</b>                |                        |                                      |   |               |
| Commercial                              | 3                      | \$ 4,449                             | \$  | \$ 4,449      |
| Income producing commercial real estate | 2                      | 2,142                                | 217   | 2,359         |
| Owner occupied commercial real estate   | 1                      | 4,081                                |   | 4,081         |
| Construction commercial and residential | 2                      | 4,641                                | 966   | 5,607         |
| <br>                                    |                        |                                      |   |               |
| Total                                   | 8                      | \$ 15,313                            | \$ 1,183                                    | \$ 16,496     |

During the year ended December 31, 2013, four performing TDRs totaling approximately \$8.1 million experienced defaults on their modified terms. A default is considered to have occurred once the TDR is past due 90 days or more, or it has been placed on nonaccrual. These four previously performing TDRs were reclassified; three to nonperforming loans, one to OREO after the Company took possession of the underlying collateral. 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. One loan totaling \$1.2 million was modified in a TDR during the year ended December 31 2013, as compared to two loans totaling \$2.6 million were modified during the year ended December 31, 2012.

*Related Party Loans*

Certain directors and executive officers have had loan transactions with the Company. Such loans were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outsiders. The following table summarizes changes in amounts of loans outstanding, both direct and indirect, to those persons during 2013 and 2012.

| (dollars in thousands) | 2013      | 2012      |
|------------------------|-----------|-----------|
| Balance at January 1,  | \$ 31,435 | \$ 24,685 |
| Additions              | 7,091     | 13,488    |
| Repayments             | (8,403)   | (6,738)   |

Balance at December 31,                   \$ 30,123   \$ 31,435

**Note 5 Premises and Equipment**

Premises and equipment include the following at December 31:

| (dollars in thousands) | 2013 | 2012 |
|------------------------|------|------|
|------------------------|------|------|

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|  |           |           |
|--|-----------|-----------|
| Leasehold improvements                         | \$ 18,213 | \$ 16,183 |
| Furniture and equipment                        | 18,289    | 14,986    |
| Less accumulated depreciation and amortization | (19,765)  | (15,908)  |
| Total premises and equipment, net              | \$ 16,737 | \$ 15,261 |



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 5 Premises and Equipment (Continued)**

Total depreciation and amortization expense for the years ended December 31, 2013, 2012, and 2011, was \$3.9 million, \$3.1 million, and \$2.3 million, respectively.

The Company leases banking and office space in twenty three locations under non-cancelable lease arrangements accounted for as operating leases. The initial lease periods range from five to ten years and provide for one or more five year renewal options. The leases in some cases provide for scheduled annual rent escalations and require that the Bank (lessee) pay certain operating expenses applicable to the leased space. Rent expense applicable to operating leases amounted to \$6.9 million for 2013, \$6.1 million in 2012, and \$5.3 million in 2011. The Company subleased two leased premises during 2013 and 2012, and three leased premises during 2011 and recorded \$57 thousand, \$99 thousand, and \$324 thousand respectively, as a reduction of rent expense during 2013, 2012, and 2011.

At December 31, 2013, future minimum lease payments under non-cancelable operating leases having an initial term in excess of one year are as follows:

**Years ending December 31:****(dollars in thousands)**

|            |          |
|------------|----------|
| 2014       | \$ 6,809 |
| 2015       | 6,818    |
| 2016       | 6,064    |
| 2017       | 4,849    |
| 2018       | 4,169    |
| Thereafter | 9,708    |

|                                     |                  |
|-------------------------------------|------------------|
| <b>Total minimum lease payments</b> | <b>\$ 38,417</b> |
|-------------------------------------|------------------|

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 6 Intangible Assets**

Intangible assets are included in the Consolidated Balance Sheets as a separate line item, net of accumulated amortization and consist of the following items:

| (dollars in thousands) | Gross<br>Intangible<br>Assets | Additions | Accumulated<br>Amortization | Net<br>Intangible<br>Assets |
|------------------------|-------------------------------|-----------|-----------------------------|-----------------------------|
| 2013                   |                               |           |                             |                             |
| Goodwill(1)            | \$ 2,163                      | \$        | \$                          | \$ 2,163                    |
| Core deposit(2)        | 2,520                         |           | (1,407)                     | 1,113                       |
| Excess servicing(3)    | 526                           | 339       | (631)                       | 234                         |
|                        | \$ 5,209                      | \$ 339    | \$ (2,038)                  | \$ 3,510                    |

|                     |          |       |            |          |
|---------------------|----------|-------|------------|----------|
| 2012                |          |       |            |          |
| Goodwill(1)         | \$ 2,163 | \$    | \$         | \$ 2,163 |
| Core deposit(2)     | 2,520    |       | (1,041)    | 1,479    |
| Excess servicing(3) | 490      | 36    | (383)      | 143      |
|                     | \$ 5,173 | \$ 36 | \$ (1,424) | \$ 3,785 |

- 
- (1) The Company recorded an initial amount of unidentified intangible (goodwill) incident to the acquisition of Fidelity & Trust Financial Corporation ("Fidelity") of approximately \$360 thousand. Based on allowable adjustments through August 31, 2009, the unidentified intangible (goodwill) amounted to approximately \$2.2 million.
- (2) In connection with the Fidelity acquisition (August 2008) and a one branch purchase (January 2011) the Company made an allocation of the purchase price to the core deposit intangibles which were \$2.3 million and \$215 thousand respectively based on an independent evaluation. The amount of the core deposit intangible relating to the one branch acquisition was fully amortized at December 31, 2013. The amount of the core deposit intangible relating to the Fidelity acquisition at December 31, 2013 was \$1.1 million, which is being amortized over its remaining economic life of 2.2 years as a component of other noninterest expense.
- (3) The Company recognizes a servicing asset for the computed value of servicing fees on the sale of the guaranteed portion of SBA loans, which is in excess of a normal servicing fee. Assumptions related to the loan term and amortization period are made to arrive at the initial recorded value.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The aggregate amortization expense was \$614 thousand, \$396 thousand, and \$314 thousand for the years ended December 31, 2013, 2012, and 2011, respectively.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 6 Intangible Assets (Continued)**

The future estimated annual amortization expense is presented below:

**Years ending December 31:****(dollars in thousands)**

|      |        |
|------|--------|
| 2014 | \$ 309 |
| 2015 | 301    |
| 2016 | 293    |
| 2017 | 150    |
| 2018 | 60     |

|       |          |
|-------|----------|
| Total | \$ 1,113 |
|-------|----------|

**Note 7 Deposits**

The following table provides information regarding the Bank's deposit composition and shows the average rate being paid on the interest bearing deposits at December 31, 2013, 2012 and 2011.

| (dollars in thousands)       | 2013         |              | 2012         |              | 2011         |              |
|------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                              | Balance      | Average Rate | Balance      | Average Rate | Balance      | Average Rate |
| Noninterest bearing demand   | \$ 849,409   |              | \$ 881,390   |              | \$ 688,506   |              |
| Interest bearing transaction | 118,580      | 0.26%        | 113,813      | 0.34%        | 80,105       | 0.38%        |
| Savings and money market     | 1,811,088    | 0.35%        | 1,374,869    | 0.48%        | 1,068,370    | 0.72%        |
| Time, \$100,000 or more      | 203,706      | 0.88%        | 232,875      | 1.12%        | 332,470      | 1.08%        |
| Other time                   | 242,631      | 0.54%        | 294,275      | 0.71%        | 222,644      | 1.72%        |
| Total                        | \$ 3,225,414 |              | \$ 2,897,222 |              | \$ 2,392,095 |              |

The remaining maturity of time deposits at December 31, 2013, 2012 and 2011 are as follows:

| (dollars in thousands)                     | 2013      | 2012       | 2011       |
|--|-----------|------------|------------|
| Three months or less                       | \$ 82,790 | \$ 102,022 | \$ 132,387 |
| More than three months through six months  | 109,101   | 88,156     | 112,167    |
| More than six months through twelve months | 118,646   | 104,122    | 89,486     |
| Over twelve months                         | 135,800   | 232,850    | 221,074    |

|       |            |            |            |
|-------|------------|------------|------------|
| Total | \$ 446,337 | \$ 527,150 | \$ 555,114 |
|-------|------------|------------|------------|

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 7 Deposits (Continued)**

Interest expense on deposits for the years ended December 31, 2013, 2012 and 2011 is as follows:

| (dollars in thousands)       | 2013             | 2012             | 2011             |
|------------------------------|------------------|------------------|------------------|
| Interest bearing transaction | \$ 298           | \$ 289           | \$ 236           |
| Savings and money market     | 5,765            | 5,946            | 8,488            |
| Time, \$100,000 or more      | 2,080            | 2,729            | 5,695            |
| Other time                   | 2,471            | 3,093            | 2,829            |
| <b>Total</b>                 | <b>\$ 10,614</b> | <b>\$ 12,057</b> | <b>\$ 17,248</b> |

**Note 8 Borrowings**

Information relating to short-term and long-term borrowings is as follows for the years ended December 31:

| (dollars in thousands)  | 2013             |       | 2012              |       | 2011              |       |
|---|------------------|-------|-------------------|-------|-------------------|-------|
|   | Amount           | Rate  | Amount            | Rate  | Amount            | Rate  |
| <b>Short-term:</b>  |                  |       |                   |       |                   |       |
| At Year-End:  |                  |       |                   |       |                   |       |
| Customer repurchase agreements and federal funds purchased repurchase | \$ 80,471        | 0.28% | \$ 101,338        | 0.31% | \$ 103,362        | 0.43% |
| <b>Total</b>  | <b>\$ 80,471</b> |       | <b>\$ 101,338</b> |       | <b>\$ 103,362</b> |       |

**Average Daily Balance:**

|   |            |       |            |       |            |       |
|---|------------|-------|------------|-------|------------|-------|
| Customer repurchase agreements and federal funds purchased repurchase | \$ 94,566  | 0.27% | \$ 96,141  | 0.34% | \$ 116,367 | 0.59% |
| Federal Home Loan Bank current portion                                |            |       | 503        | 0.41% |            |       |
| <b>Maximum Month-end Balance:</b>                                     |            |       |            |       |            |       |
| Customer repurchase agreements and federal funds purchased repurchase | \$ 106,975 | 0.23% | \$ 111,580 | 0.34% | \$ 147,671 | 0.53% |
| Federal Home Loan Bank current portion                                |            |       | 10,000     | 2.98% |            |       |

**Long-term:**

|                               |           |       |           |        |           |        |
|-------------------------------|-----------|-------|-----------|--------|-----------|--------|
| At Year-End:                  |           |       |           |        |           |        |
| Federal Home Loan Bank        | \$ 30,000 | 2.46% | \$ 30,000 | 2.43%  | \$ 40,000 | 2.96%  |
| Subordinated Notes            | 9,300     | 8.50% | 9,300     | 10.00% | 9,300     | 10.00% |
| United Bank Line of Credit    |           |       |           |        |           |        |
| <b>Average Daily Balance:</b> |           |       |           |        |           |        |
| Federal Home Loan Bank        | \$ 30,000 | 2.46% | \$ 37,404 | 2.90%  | \$ 40,000 | 2.96%  |
| Subordinated Notes            | 9,300     | 9.64% | 9,300     | 10.00% | 9,300     | 10.00% |

**United Bank Line of Credit****Maximum Month-end Balance:**

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                            |    |        |        |    |        |        |    |        |        |
|----------------------------|----|--------|--------|----|--------|--------|----|--------|--------|
| Federal Home Loan Bank     | \$ | 30,000 | 2.46%  | \$ | 40,000 | 2.96%  | \$ | 40,000 | 2.96%  |
| Subordinated Notes         |    | 9,300  | 10.00% |    | 9,300  | 10.00% |    | 9,300  | 10.00% |
| United Bank Line of Credit |    |        |        |    |        |        |    |        |        |

111

---

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 8 Borrowings (Continued)**

The Company offers its business customers a repurchase agreement sweep account in which it collateralizes these funds with U.S. Government agency and mortgage backed securities segregated in its investment portfolio for this purpose. By entering into the agreement, the customer agrees to have the Bank repurchase the designated securities on the business day following the initial transaction in consideration of the payment of interest at the rate prevailing on the day of the transaction.

The Bank has commitments from correspondent banks under which it can purchase up to \$127.5 million in federal funds on an unsecured basis, against which there were no amounts outstanding at December 31, 2013 and can borrow unsecured funds under one-way Certificates of Deposit Account Registry Service ("CDARS") brokered deposits in the amount of \$555.6 million, against which there was \$7.7 million outstanding at December 31, 2013. The Bank has a commitment at December 31, 2013 from the Promontory Interfinancial Network to place up to \$300.0 million of brokered deposits from its Insured Network Deposit ("IND") program with the Bank in amounts requested by the Bank, against which there was \$159.3 million outstanding at December 31, 2013. At December 31, 2013, the Bank was also eligible to make advances from the FHLB up to \$427.7 million based on collateral at the FHLB, of which \$30.0 million was outstanding at December 31, 2013. The Bank may enter into repurchase agreements as well as obtain additional borrowing capabilities from the FHLB provided adequate collateral exists to secure these lending relationships. The Bank also has a back-up borrowing facility through the Discount Window at the Federal Reserve Bank of Richmond ("Federal Reserve Bank"). This facility, which amounts to approximately \$375.0 million, is collateralized with specific loan assets identified to the Federal Reserve Bank. It is anticipated that, except for periodic testing, this facility would be utilized for contingency funding only.

In December 2013, the Company renewed its Loan Agreement and related Stock Security Agreement and Promissory Note (the "credit facility") with a regional bank, pursuant to which the Company may borrow, on a revolving basis, up to \$50 million for working capital purposes, or to finance capital contributions to the Bank in whole and to ECV in part. This facility was originally entered into in August 2008 and has been renegotiated over the past five years to its current terms. The credit facility is secured by a first lien on a portion of the stock of the Bank, and bears interest at a floating rate equal to the Wall Street Journal Prime Rate minus 0.25% with a floor interest rate of 3.50%. Interest is payable on a monthly basis. The term of the credit facility expires on September 30, 2014. There were no amounts outstanding under this credit at December 31, 2013 or 2012.

On September 3, 2013 the Company amended the terms of the \$9.3 million of subordinated notes dated August 30, 2010. Under the amendment, the maturity date is extended from September 30, 2016 to September 30, 2021 and the interest rate is changed from 10%, to a fixed interest rate of 8.5% until August 30, 2016 and thereafter at a fixed rate of interest equal to the then current yield on the 5 year U.S. Treasury Note plus 7.03%. The notes are intended to qualify as Tier 2 capital for regulatory purposes to the fullest extent permitted under the currently applicable capital regulations. It is not anticipated that the notes will qualify for capital treatment upon implementation of recently adopted Basel III capital requirements. The payment of principal on the notes may only be accelerated upon the occurrence of certain bankruptcy or receivership related events relating to the Company or, to the extent permitted under capital rules to be adopted by the Federal Reserve Board pursuant to the Dodd-Frank Act, a major bank subsidiary of the Company.



Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 8 Borrowings (Continued)**

Under current capital rules, the capital treatment of the notes must be phased out, at a rate of 20% of the original principal amount per year during the last five years of the term of the notes, commencing on October 1, 2016. Currently, \$9.3 million of subordinated notes are includible as Tier 2 capital.

**Note 9 Preferred Stock and Warrants**

On July 14, 2011, the Company entered into and consummated a Securities Purchase Agreement (the "Purchase Agreement") with the Secretary of the Treasury of the United States (the "Secretary") under the Small Business Lending Fund program. Pursuant to the Purchase Agreement, the Company issued 56,600 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock"), having a liquidation amount per share equal to \$1,000, for a total purchase price of \$56,600,000.

The Series B Preferred Stock is entitled to receive non-cumulative dividends, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QSBL" (as defined in the Purchase Agreement) by the Bank. The dividend rate for the first ten dividend periods was one percent (1%). For the eleventh calendar quarter through four and one half years after issuance, the dividend rate will be fixed at one percent (1%) based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent (9%).

The Series B Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

On July 14, 2011, concurrent with the sale of the Series B Preferred Stock under the Small Business Lending Fund, the Company entered into and consummated a letter agreement with the United States Treasury Department, pursuant to which the Company redeemed, out of the proceeds of the issuance of the Series B Preferred Stock, all 23,325 outstanding shares of the Series A Preferred Stock related to the Company's participation in the Troubled Asset Relief Program's Capital Purchase Program (the "CPP"), for a redemption price of \$23,425,398, including accrued but unpaid dividends to the date of redemption. The Series A Preferred Stock was originally issued on December 5, 2008 for an amount of \$38,235,000. Previously, on December 23, 2009, \$15,000,000 of Series A Preferred Stock was redeemed.

On November 18, 2011 under provisions of the CPP the Company issued to the Treasury warrants for 423,977 shares (as adjusted reflect the 10% stock dividend paid on June 14, 2013) of Company common stock at \$6.76 per share (as adjusted for the 10% stock dividend paid on June 14, 2013) were sold by the Treasury. At December 31, 2013 those warrants remain outstanding and have an expiration date of December 8, 2018. Upon exercise, which is at the option of the holder, the Company will issue a number of shares of Company common stock in exchange for the warrants equal to the number of shares subject to the warrant less the number of shares determined by multiplying the number of shares subject to the warrant by the strike price and dividing the result by the current share price.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 10 Income Taxes**

Federal and state income tax expense consists of the following for the years ended December 31:

| (dollars in thousands)              | 2013             | 2012             | 2011             |
|-------------------------------------|------------------|------------------|------------------|
| Current federal income tax          | \$ 26,136        | \$ 20,937        | \$ 12,760        |
| Current state income tax            | 6,147            | 4,543            | 3,051            |
| <b>Total current</b>                | <b>32,283</b>    | <b>25,480</b>    | <b>15,811</b>    |
| Deferred federal income tax benefit | (3,909)          | (4,564)          | (2,062)          |
| Deferred state income tax benefit   | (56)             | (33)             | (18)             |
| <b>Total deferred</b>               | <b>(3,965)</b>   | <b>(4,597)</b>   | <b>(2,080)</b>   |
| <b>Total income tax expense</b>     | <b>\$ 28,318</b> | <b>\$ 20,883</b> | <b>\$ 13,731</b> |

Temporary timing differences between the amounts reported in the financial statements and the tax bases of assets and liabilities result in deferred taxes. Gross deferred tax assets and liabilities, shown as the sum of the appropriate tax effect for each significant type of temporary difference, is presented below for the years ended December 31:

| (dollars in thousands)                           | 2013          | 2012          | 2011          |
|--|---------------|---------------|---------------|
| <b>Deferred tax assets</b>                       |               |               |               |
| Allowance for credit losses                      | \$ 16,440     | \$ 15,035     | \$ 11,864     |
| Deferred loan fees and costs                     | 5,039         | 3,020         | 1,871         |
| Stock-based compensation                         | 1,370         | 829           | 453           |
| Net operating loss                               | 3,449         | 3,952         | 3,952         |
| Unrealized loss on securities available for sale | 2,213         |               |               |
| Deferred rent                                    |               |               | 51            |
| Premises and equipment                           | 1,283         | 989           | 653           |
| Other  | 4             | 4             | 4             |
| <b>Total deferred tax assets</b>                 | <b>29,798</b> | <b>23,829</b> | <b>18,848</b> |
| <b>Deferred tax liabilities</b>                  |               |               |               |
| Unrealized gain on securities available for sale |               | (3,643)       | (3,250)       |
| Excess servicing                                 | (95)          | (58)          | (72)          |
| Deferred rent                                    | (264)         | (322)         |               |
| Intangible assets                                | (490)         | (678)         | (853)         |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                                 |           |           |           |
|---------------------------------|-----------|-----------|-----------|
| Total deferred tax liabilities  | (849)     | (4,701)   | (4,175)   |
| Net deferred income tax account | \$ 28,949 | \$ 19,128 | \$ 14,673 |

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 10 Income Taxes (Continued)**

A reconciliation of the statutory federal income tax rate to the Company's effective income tax rate for the years ended December 31 follows:

|   | 2013   | 2012   | 2011   |
|---|--------|--------|--------|
| Statutory federal income tax rate                     | 35.00% | 35.00% | 35.00% |
| Increase (decrease) due to                            |        |        |        |
| State income taxes, net of federal income tax benefit | 5.26   | 5.22   | 5.15   |
| Tax exempt interest and dividend income               | (2.17) | (2.46) | (3.03) |
| Stock-based compensation expense                      | 0.06   | 0.08   | 0.18   |
| Other   | (0.56) | (0.66) | (1.44) |
| Effective tax rates                                   | 37.59% | 37.18% | 35.86% |

The net operating loss carry forward acquired in conjunction with the Fidelity acquisition is subject to annual limits under Section 382 of the Internal Revenue Code of \$718 thousand and expires in 2027. The Company remains subject to examination for the years ending after December 31, 2009.

**Note 11 Net Income per Common Share**

The calculation of net income per common share for the years ended December 31 was as follows:

|   | 2013      | 2012      | 2011      |
|---|-----------|-----------|-----------|
| <b>(dollars and shares in thousands, except per share data)</b> |           |           |           |
| Basic:  |           |           |           |
| Net income available to common shareholders                     | \$ 46,441 | \$ 34,723 | \$ 23,047 |
| Average common shares outstanding                               | 25,726    | 23,136    | 21,819    |
| Basic net income per common share                               | \$ 1.81   | \$ 1.50   | \$ 1.05   |
| Diluted:  |           |           |           |
| Net income available to common shareholders                     | \$ 46,441 | \$ 34,723 | \$ 23,047 |
| Average common shares outstanding                               | 25,726    | 23,136    | 21,819    |
| Adjustment for common share equivalents                         | 633       | 608       | 498       |
| Average common shares outstanding-diluted                       | 26,359    | 23,744    | 22,317    |
| Diluted net income per common share                             | \$ 1.76   | \$ 1.46   | \$ 1.04   |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|                      |        |         |         |
|----------------------|--------|---------|---------|
| Anti-dilutive shares | 35,079 | 131,182 | 218,620 |
|----------------------|--------|---------|---------|

The Company declared a 10% stock dividend payable on June 14, 2013. Per share amounts and the number of outstanding shares for periods ended prior to June 30, 2013 have been adjusted to give effect to the 10% common stock dividend.

**Note 12 Related Party Transactions**

During 2013, approximately \$897 thousand in interest was paid to the current or former directors of the Company or accounts for the benefit of such persons in respect of subordinated notes, which were amended in 2013. See Note 8 for additional information regarding the subordinated notes.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 12 Related Party Transactions (Continued)**

The Bank leases office space, at a current monthly base rental of \$96,125, excluding certain pass through expenses, from limited liability companies in which a trust for the benefit of an executive officer's children has an 85% interest in one instance and a 51% interest in another.

The Bank has obtained certain deposits through title company clients in which a director of the Bank has a direct interest and for which a broker fee of 0.50% of average deposits is paid monthly in arrears. During 2013 and 2012, approximately \$1 thousand and \$2 thousand, respectively, in broker fees were paid.

Mr. Rogers is a partner in the law firm Shulman, Rogers, Gandal, Pordy & Ecker, P.A. which has provided, and continues to provide, legal services to the Company and its subsidiaries. During 2013, the Company and its subsidiaries paid aggregate fees of \$970,840 to that firm. Under Mr. Roger's arrangement with his firm, he does not participate in the profits or revenues resulting from the provision of legal services to the Company and its subsidiaries, and he receives no other compensation or benefits in lieu of such participation.

**Note 13 Stock-Based Compensation**

The following discussion includes the effects of changes in stock options and restricted stock shares and exercise prices resulting from the 10% common stock dividend paid on June 14, 2013.

The Company maintains the 1998 Stock Option Plan ("1998 Plan"), the 2006 Stock Plan ("2006 Plan") and the 2011 Employee Stock Purchase Plan ("2011 ESPP"). In connection with the acquisition of Fidelity, the Company assumed the Fidelity 2004 Long Term Incentive Plan and 2005 Long Term Incentive Plan (the "Fidelity Plans"). No additional options may be granted under the 1998 Plan or the Fidelity Plans.

The 2006 Plan provides for the issuance of awards of incentive stock options, non-qualifying stock options, restricted stock and stock appreciation rights to selected key employees and members of the Board. As amended, 1,996,500 shares of common stock are subject to issuance pursuant to awards under the 2006 Plan. Stock options awards are issued with an exercise price equal to the average of the high and low price of the Company's shares at the date of grant.

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, and for restricted stock awards is based on the average of the high and low stock price of the Company's shares 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. No performance-based awards are outstanding at December 31, 2013.

In January 2013, the Company awarded an employee stock options to purchase 3,300 shares which have a ten-year term and vest in five substantially equal installments on the first through fifth anniversary of the date of grant.

In February 2013, the Company awarded 421,425 shares of restricted stock to senior officers, directors and employees. The shares vest in four substantially equal installments beginning on the first anniversary of the date of grant.

In May 2013, the Company awarded 3,025 shares of restricted stock to eight employees. The shares vest in four substantially equal installments beginning on the first anniversary of the date of grant.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 13 Stock-Based Compensation (Continued)**

Below is a summary of stock option activity for the twelve months ended December 31, 2013, 2012 and 2011. The information excludes restricted stock units and awards.

|                   | 2013      |                                 | 2012      |                                 | 2011      |                                 |
|-------------------|-----------|---------------------------------|-----------|---------------------------------|-----------|---------------------------------|
|                   | Shares    | Weighted-Average Exercise Price | Shares    | Weighted-Average Exercise Price | Shares    | Weighted-Average Exercise Price |
| Beginning Balance | 722,155   | \$ 10.18                        | 919,371   | \$ 10.23                        | 1,099,306 | \$ 9.63                         |
| Issued            | 3,300     | 20.03                           | 5,500     | 15.48                           | 4,950     | 11.78                           |
| Exercised         | (198,588) | 9.99                            | (167,882) | 10.01                           | (150,237) | 6.32                            |
| Forfeited         | (2,420)   | 7.40                            | (3,493)   | 6.22                            | (17,952)  | 6.57                            |
| Expired           | (23,113)  | 10.05                           | (31,341)  | 13.92                           | (16,696)  | 10.48                           |
| Ending Balance    | 501,334   | \$ 10.34                        | 722,155   | \$ 10.18                        | 919,371   | \$ 10.23                        |

The following summarizes information about stock options outstanding at December 31, 2013. The information excludes restricted stock units and awards.

| Outstanding:             | Stock Options Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life |
|--------------------------|---------------------------|---------------------------------|---|
| Range of Exercise Prices |                           |                                 |   |
| \$5.76 \$8.00            | 242,770                   | \$ 5.76                         | 5.02  |
| \$8.01 \$10.00           | 73,242                    | 9.67                            | 0.88  |
| \$10.01 \$20.00          | 109,994                   | 12.55                           | 3.79  |
| \$20.01 \$24.46          | 75,328                    | 22.52                           | 1.90  |
|                          | 501,334                   | \$ 10.34                        | 3.68  |

| Exercisable:             | Stock Options Exercisable | Weighted-Average Exercise Price |
|--------------------------|---------------------------|---------------------------------|
| Range of Exercise Prices |                           |                                 |
| \$5.76 \$8.00            | 143,147                   | \$ 5.76                         |
| \$8.01 \$10.00           | 73,242                    | 9.67                            |
| \$10.01 \$20.00          | 78,517                    | 12.97                           |
| \$20.01 \$24.46          | 72,028                    | 22.64                           |

366,934 \$ 11.40



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 13 Stock-Based Compensation (Continued)**

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, 2013, 2012 and 2011.

|  | Year Ended December 31, |         |        |        |
|--|-------------------------|---------|--------|--------|
|  | 2013                    | 2012    | 2011   |        |
| Expected Volatility                      | 34.12%                  | 36.64%  | 33.61% | 36.64% |
| Weighted-Average Volatility              | 34.12%                  | 36.64%  | 35.60% |        |
| Expected Dividends                       | 0.0%                    | 0.0%    | 0.0%   |        |
| Expected Term (In years)                 | 7.5                     | 7.5     | 6.0    | 7.5    |
| Risk-Free Rate                           | 1.31%                   | 1.13%   | 1.82%  |        |
| Weighted-Average Fair Value (Grant date) | \$ 7.83                 | \$ 6.35 | \$4.61 |        |

The expected lives are based on the "simplified" method allowed by ASC Topic 718 "Compensation," whereby the expected term is equal to the midpoint between the vesting date and the end of the contractual term of the award.

The total intrinsic value of outstanding stock options and outstanding exercisable stock options was \$10.2 million and \$7.1 million, respectively, at December 31, 2013 and 2012. The total intrinsic value of stock options exercised during the years ended December 31, 2013, 2012 and 2011 was \$3.1 million, \$1.1 million and \$855 thousand, respectively. The total fair value of stock options vested was \$133 thousand, \$136 thousand and \$151 thousand for 2013, 2012 and 2011, respectively. Unrecognized stock-based compensation expense related to stock options totaled \$135 thousand at December 31, 2013. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 3.70 years.

Cash proceeds, tax benefits and intrinsic value related to total stock options exercised is as follows:

| (dollars in thousands)                          | Year Ended December 31, |          |        |
|---|-------------------------|----------|--------|
|   | 2013                    | 2012     | 2011   |
| Proceeds from stock options exercised           | \$ 1,984                | \$ 1,685 | \$ 944 |
| Tax benefits related to stock options exercised | 410                     | 369      | 143    |
| Intrinsic value of stock options exercised      | 3,060                   | 1,100    | 855    |

The Company has unvested restricted stock award grants of 614,580 shares from the 2006 Plan at December 31, 2013. Unrecognized stock based compensation expense related to restricted stock awards totaled \$8.7 million at December 31, 2013. At such date, the weighted-average period over which this

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 13 Stock-Based Compensation (Continued)**

unrecognized expense was expected to be recognized was 2.90 years. The following table summarizes the unvested restricted stock awards at December 31, 2013 and 2012:

|                       | Year Ended December 31, |   |           |   |
|-----------------------|-------------------------|---|-----------|---|
|                       | 2013                    |   | 2012      |   |
|                       | Shares                  | Weighted-<br>Average Grant<br>Date Fair Value | Shares    | Weighted-<br>Average Grant<br>Date Fair Value |
| Unvested at Beginning | 348,353                 | \$ 13.79                                      | 222,793   | \$ 10.61                                      |
| Issued                | 424,450                 | 20.64   | 268,115   | 15.30   |
| Forfeited             | (1,318)                 | 13.23   | (15,051)  | 11.05   |
| Vested                | (156,905)               | 13.04   | (127,504) | 11.73   |
| Unvested at End       | 614,580                 | \$ 18.71                                      | 348,353   | \$ 13.79                                      |

Approved by shareholders in May 2011, the 2011 ESPP reserved 550,000 shares of common stock 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 December 31, 2013, the 2011 ESPP had 473,804 shares remaining for issuance.

Included in salaries and employee benefits the Company recognized \$3.3 million, \$2.5 million and \$1.1 million in stock-based compensation expense for 2013, 2012 and 2011, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

**Note 14 Employee Benefit Plans**

The Company has a qualified 401(k) Plan which covers all employees who have reached the age of 21 and have completed at least one month of service as defined by the Plan. The Company makes contributions to the Plan based on a matching formula, which is annually reviewed. For years 2013, 2012 and 2011, the Company recognized \$878 thousand, \$780 thousand, and \$628 thousand in expense, respectively. These amounts are included in salaries and employee benefits in the accompanying Consolidated Statements of Operations.

**Note 15 Supplemental Executive Retirement Plan**

In February 2013, the Compensation Committee authorized Supplemental Executive Retirement and Death Benefit Agreements (the "SERP Agreements") with each 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 or alternatively, a lump sum payment at the option of the executive. 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

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 15 Supplemental Executive Retirement Plan (Continued)**

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 has elected to finance the retirement benefits by purchasing fixed annuity contracts with three insurance carriers totaling \$10.7 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. The annuity contracts accrued \$551 thousand of income for the year ended December 31, 2013, which is included in other noninterest income on the Consolidated Statement of Operations. The cash surrender value of the annuity contracts is \$11.2 million at December 31, 2013 and is included in Other assets on the Consolidated Balance Sheet. For the year ended December 31, 2013, the Company recorded benefit expense accruals of \$1.7 million for this post retirement benefit.

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

**Note 16 Financial Instruments with Off-Balance Sheet Risk**

Various commitments to extend credit are made in the normal course of banking business. Letters of credit are also issued for the benefit of customers. These commitments are subject to loan underwriting standards and geographic boundaries consistent with the Company's loans outstanding.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Loan commitments outstanding and lines and letters of credit at December 31, 2013 and 2012 are as follows:

| (dollars in thousands)    | 2013             | 2012           |
|---------------------------|------------------|----------------|
| Unfunded loan commitments | \$ 1,150,556     | \$ 718,386     |
| Unfunded lines of credit  | 79,786           | 74,094         |
| Letters of credit         | 51,768           | 58,378         |
| <br>Total                 | <br>\$ 1,282,110 | <br>\$ 850,858 |

Because most of the Company's business activity is with customers located in the Washington, D.C., metropolitan area, a geographic concentration of credit risk exists within the loan portfolio, the performance of which will be influenced by the economy of the region.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 16 Financial Instruments with Off-Balance Sheet Risk (Continued)**

The Bank maintains a reserve for the potential repurchase of residential mortgage loans, which amounted to \$57 thousand at December 31, 2013 and \$225 thousand at December 31, 2012. These amounts are included in Other liabilities in the accompanying Consolidated Balance Sheets. Changes in the balance of the reserve are a component of Other expenses in the accompanying Consolidated Statements of Operations. The reserve is available to absorb losses on the repurchase of loans sold related to document and other fraud, early payment default and early payoff. Through December 31, 2013, no reserve charges have occurred related to fraud or early payment default.

**Note 17 Litigation**

In the normal course of its business, the Company is involved in litigation arising from banking, financial, and other activities it conducts. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Company's financial condition, operating results or liquidity.

**Note 18 Regulatory Matters**

The Company and Bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain amounts and ratios (set forth in the table below) of total capital and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2013 and 2012, that the Company and Bank met all capital adequacy requirements to which they are subject.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 18 Regulatory Matters (Continued)**

The actual capital amounts and ratios for the Company and Bank as of December 31, 2013 and 2012 are presented in the table below:

| (dollars in thousands)                   | Company          |        | Bank             |        | For<br>Capital<br>Adequacy<br>Purposes<br>Ratio | To Be Well<br>Capitalized<br>Under<br>Prompt<br>Corrective<br>Action<br>Provision<br>Ratio* |
|--|------------------|--------|------------------|--------|---|---|
|  | Actual<br>Amount | Ratio  | Actual<br>Amount | Ratio  |   |   |
| <b>As of December 31, 2013</b>           |                  |        |                  |        |   |   |
| Total capital (to risk weighted assets)  | \$ 440,332       | 13.01% | \$ 403,910       | 12.00% | 8.0%  | 10.0%   |
| Tier 1 capital (to risk weighted assets) | 390,111          | 11.53% | 363,166          | 10.79% | 4.0%  | 6.0%  |
| Tier 1 capital (to average assets)       | 390,111          | 10.93% | 363,166          | 10.22% | 3.0%  | 5.0%  |
| <b>As of December 31, 2012</b>           |                  |        |                  |        |   |   |
| Total capital (to risk weighted assets)  | \$ 381,808       | 12.20% | \$ 350,609       | 11.25% | 8.0%  | 10.0%   |
| Tier 1 capital (to risk weighted assets) | 338,138          | 10.80% | 312,974          | 10.05% | 4.0%  | 6.0%  |
| Tier 1 capital (to average assets)       | 338,138          | 10.44% | 312,974          | 9.70%  | 3.0%  | 5.0%  |

\*

Applies to Bank only

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Company. At December 31, 2013, the Bank could pay dividends to the parent to the extent of its earnings so long as it maintained required capital ratios.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 19 Other Comprehensive Income**

The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2013, 2012 and 2011.

| (dollars in thousands)   | Before Tax         | Tax Effect        | Net of Tax        |
|--|--------------------|-------------------|-------------------|
| <b>Year Ended December 31, 2013</b>                                    |                    |                   |                   |
| Net unrealized loss on securities available-for-sale:                  |                    |                   |                   |
| Net unrealized loss on securities available-for-sale                   | \$ (14,622)        | \$ (5,849)        | \$ (8,773)        |
| Less: Reclassification adjustment for net gains included in net income | (19)               | (8)               | (11)              |
| <b>Other Comprehensive Loss</b>  | <b>\$ (14,641)</b> | <b>\$ (5,857)</b> | <b>\$ (8,784)</b> |
| <br>   |                    |                   |                   |
| <b>Year Ended December 31, 2012</b>                                    |                    |                   |                   |
| Net unrealized gain on securities available-for-sale:                  |                    |                   |                   |
| Net unrealized gain on securities available-for-sale                   | \$ 1,673           | \$ 669            | \$ 1,004          |
| Less: Reclassification adjustment for net gains included in net income | (690)              | (276)             | (414)             |
| <b>Other Comprehensive Income</b>                                      | <b>\$ 983</b>      | <b>\$ 393</b>     | <b>\$ 590</b>     |
| <br>   |                    |                   |                   |
| <b>Year Ended December 31, 2011</b>                                    |                    |                   |                   |
| Net unrealized gain on securities available-for-sale:                  |                    |                   |                   |
| Net unrealized gain on securities available-for-sale                   | \$ 6,140           | \$ 2,456          | \$ 3,684          |
| Less: Reclassification adjustment for net gains included in net income | (1,445)            | (578)             | (867)             |
| <b>Other Comprehensive Income</b>                                      | <b>\$ 4,695</b>    | <b>\$ 1,878</b>   | <b>\$ 2,817</b>   |

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 19 Other Comprehensive Income (Continued)**

The following table presents the changes in each component of accumulated other comprehensive income (loss), net of tax, for the years ended December 31, 2013, 2012 and 2011.

| (dollars in thousands)   | Securities<br>Available For Sale | Accumulated Other<br>Comprehensive (Loss) Income |
|--|----------------------------------|--|
| <b>Year Ended December 31, 2013</b>                              |                                  |  |
| <b>Balance at Beginning of Period</b>                            | \$ 5,465                         | \$ 5,465   |
| Other comprehensive (loss) before reclassifications              | (8,773)                          | (8,773)  |
| Amounts reclassified from accumulated other comprehensive income | (11)                             | (11)   |
| <b>Net other comprehensive (loss) during period</b>              | <b>(8,784)</b>                   | <b>(8,784)</b>                                   |
| <br>Balance at End of Period                                     | <br>\$ (3,319)                   | <br>\$ (3,319)                                   |
| <b>Year Ended December 31, 2012</b>                              |                                  |  |
| <b>Balance at Beginning of Period</b>                            | \$ 4,875                         | \$ 4,875   |
| Other comprehensive income before reclassifications              | 1,004                            | 1,004  |
| Amounts reclassified from accumulated other comprehensive income | (414)                            | (414)  |
| <b>Net other comprehensive income during period</b>              | <b>590</b>                       | <b>590</b>                                       |
| <br>Balance at End of Period                                     | <br>\$ 5,465                     | <br>\$ 5,465                                     |
| <b>Year Ended December 31, 2011</b>                              |                                  |  |
| <b>Balance at Beginning of Period</b>                            | \$ 2,058                         | \$ 2,058   |
| Other comprehensive income before reclassifications              | 3,684                            | 3,684  |
| Amounts reclassified from accumulated other comprehensive income | (867)                            | (867)  |
| <b>Net other comprehensive income during period</b>              | <b>2,817</b>                     | <b>2,817</b>                                     |
| <br>Balance at End of Period                                     | <br>\$ 4,875                     | <br>\$ 4,875                                     |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the years ended December 31, 2013, 2012 and 2011.

| 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 |
|--|--|---------------|---------------|---|
|  | Year Ended December 31,  |               |               |   |
|  | 2013   | 2012          | 2011          |   |
| Realized gain on sale of investment securities   | \$ 19  | \$ 690        | \$ 1,445      | Gain on sale of investment securities                             |
|  | (8)  | (276)         | (578)         | Tax Expense   |
| <b>Total Reclassifications for the Period</b>  | <b>\$ 11</b>   | <b>\$ 414</b> | <b>\$ 867</b> | <b>Net of Tax</b>   |



Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 20 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. |

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 20 Fair Value Measurements (Continued)***Assets and Liabilities Recorded as 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 December 31, 2013 and 2012:

| (dollars in thousands)  | Quoted Prices<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant Other<br>Unobservable<br>Inputs (Level 3) | Total<br>(Fair Value) |
|---|----------------------------|---|---|-----------------------|
| <b>December 31, 2013</b>  |                            |   |   |                       |
| Investment securities available for sale:   |                            |   |   |                       |
| U. S. Government agency securities  | \$                         | \$ 47,335   | \$  | \$ 47,335             |
| Residential mortgage backed securities  |                            | 228,674   |   | 228,674               |
| Municipal bonds   |                            | 101,740   |   | 101,740               |
| Other equity investments  | 165                        |   | 219   | 384                   |
| Residential mortgage loans held for sale  |                            | 42,030  |   | 42,030                |
| <br>Total assets measured at fair value on a recurring basis as of<br>December 31, 2013 | <br>\$ 165                 | <br>\$ 419,779                                      | <br>\$ 219  | <br>\$ 420,163        |

| (dollars in thousands)  | Quoted Prices<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant Other<br>Unobservable<br>Inputs (Level 3) | Total<br>(Fair Value) |
|---|----------------------------|---|---|-----------------------|
| <b>December 31, 2012</b>  |                            |   |   |                       |
| Investment securities available for sale:   |                            |   |   |                       |
| U. S. Government agency securities  | \$                         | \$ 49,082   | \$  | \$ 49,082             |
| Residential mortgage backed securities  |                            | 173,083   |   | 173,083               |
| Municipal bonds   |                            | 77,313  |   | 77,313                |
| Other equity investments  | 112                        |   | 230   | 342                   |
| Residential mortgage loans held for sale  |                            | 226,923   |   | 226,923               |
| <br>Total assets measured at fair value on a recurring basis as of<br>December 31, 2012 | <br>\$ 112                 | <br>\$ 526,401                                      | <br>\$ 230  | <br>\$ 526,743        |

*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

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

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. Government agency debt securities, mortgage backed securities issued by government sponsored entities and municipal bonds. Securities classified as Level 3 include securities in less liquid markets.

The Company's residential loans held for sale are reported on an aggregate basis at the lower of cost or fair value.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 20 Fair Value Measurements (Continued)**

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

| (dollars in thousands)                              | Other Equity Investments |                   |
|---|--------------------------|-------------------|
|   | December 31, 2013        | December 31, 2012 |
| Balance, beginning of period                        | \$ 230                   | \$ 226            |
| Realized gains included in other noninterest income |                          | 4                 |
| Principal redemption                                | (11)                     |                   |
| Balance, end of period                              | \$ 219                   | \$ 230            |

*Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis*

The Company may be required from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. There are no liabilities, which the Company measures at fair value on a nonrecurring basis. Assets measured at fair value on a nonrecurring basis are included in the table below:

| (dollars in thousands)   | Quoted Prices<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant Other<br>Unobservable<br>Inputs (Level 3) | Total<br>(Fair Value) |
|--|----------------------------|---|---|-----------------------|
| <b>December 31, 2013</b>   |                            |   |   |                       |
| Impaired loans:  |                            |   |   |                       |
| Commercial   | \$                         | \$ 4,367  | \$ 1,089  | \$ 5,456              |
| Income producing commercial real estate  |                            | 2,806   | 1,998   | 4,804                 |
| Owner occupied commercial real estate  |                            | 2,712   | 887   | 3,599                 |
| Real estate mortgage residential   |                            | 86  | 774   | 860                   |
| Construction commercial and residential  |                            | 4,228   | 7,080   | 11,308                |
| Home equity  |                            | 50  | 47  | 97                    |
| Other consumer   |                            |   | 2   | 2                     |
| Other real estate owned  |                            | 9,225   |   | 9,225                 |
| Total assets measured at fair value on a nonrecurring basis as of<br>December 31, 2013 | \$                         | \$ 23,474   | \$ 11,877   | \$ 35,351             |

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 20 Fair Value Measurements (Continued)**

| (dollars in thousands)  | Quoted Prices<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant Other<br>Unobservable<br>Inputs (Level 3) | Total<br>(Fair Value) |
|---|----------------------------|---|---|-----------------------|
| <b>December 31, 2012</b>  |                            |   |   |                       |
| Impaired loans:   |                            |   |   |                       |
| Commercial  | \$                         | \$  | 3,040   | \$ 7,090              |
| Income producing commercial real estate                           |                            |   | 2,723   | 1,676                 |
| Owner occupied commercial real estate                             |                            |   | 5,699   | 207                   |
| Real estate mortgage residential                                  |                            |   |   | 699                   |
| Construction commercial and residential                           |                            |   | 9,219   | 10,298                |
| Home equity   |                            |   | 267   | 3                     |
| Other consumer  |                            |   |   | 2                     |
| Other real estate owned   |                            |   | 4,969   | 330                   |
|   |                            |   |   | 5,299                 |
| Total assets measured at fair value on a nonrecurring basis as of |                            |   |   |                       |
| December 31, 2012   | \$                         | \$  | 25,917  | \$ 17,265             |
|   |                            |   |   | \$ 43,182             |

*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. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. 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 December 31, 2013, substantially all of the totally 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.

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.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 20 Fair Value Measurements (Continued)**

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.

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:* Values are estimated by discounting the future cash flows using the current rates at which similar deposits would be earning.

*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 amount approximate the fair values at the reporting date.

*Loans held for sale:* Fair values are at the carrying value (lower of cost or market) since such loans are typically committed to be sold (servicing released) at a profit.

*Loans:* For variable rate loans that re-price on a scheduled basis, fair values are based on carrying values. The fair value of the remaining loans are estimated by discounting the estimated future cash flows using the current interest rate at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term.

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

*Other earning assets:* The fair value of the annuity investments is the carrying amount at the reporting date.

*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.

Table of Contents

**Eagle Bancorp, Inc.**

**Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)**

**Note 20 Fair Value Measurements (Continued)**

*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 and federal funds purchased:* 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.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 20 Fair Value Measurements (Continued)**

The estimated fair values of the Company's financial instruments at December 31, 2013 and 2012 are as follows:

| (dollars in thousands)                           | Fair Value Measurements |            |   |   |   |
|--|-------------------------|------------|---|---|---|
|  | Carrying Value          | Fair Value | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>December 31, 2013</b>                         |                         |            |   |   |   |
| <b>Assets</b>                                    |                         |            |   |   |   |
| Cash and due from banks                          | \$ 9,577                | \$ 9,577   | \$  | \$ 9,577                                      | \$  |
| Federal funds sold                               | 5,695                   | 5,695      |   | 5,695   |   |
| Interest bearing deposits with other banks       | 291,688                 | 291,688    |   | 291,688                                       |   |
| Investment securities                            | 378,133                 | 378,133    | 165   | 377,749                                       | 219                                       |
| Federal Reserve and Federal Home Loan Bank stock | 11,272                  | 11,272     |   | 11,272  |   |
| Loans held for sale                              | 42,030                  | 42,030     |   | 42,030  |   |
| Loans  | 2,945,158               | 2,979,180  |   | 14,249  | 2,964,931                                 |
| Bank owned life insurance                        | 39,738                  | 39,738     |   | 39,738  |   |
| Other earning assets                             | 11,227                  | 11,227     |   | 11,227  |   |
| <b>Liabilities</b>                               |                         |            |   |   |   |
| Noninterest bearing deposits                     | 849,409                 | 849,409    |   | 849,409                                       |   |
| Interest bearing deposits                        | 2,376,005               | 2,375,861  |   | 2,375,861                                     |   |
| Borrowings                                       | 119,771                 | 120,764    |   | 120,764                                       |   |
| <b>December 31, 2012</b>                         |                         |            |   |   |   |
| <b>Assets</b>                                    |                         |            |   |   |   |
| Cash and due from banks                          | \$ 7,439                | \$ 7,439   | \$  | \$ 7,439                                      | \$  |
| Federal funds sold                               | 7,852                   | 7,852      |   | 7,852   |   |
| Interest bearing deposits with other banks       | 324,043                 | 324,043    |   | 324,043                                       |   |
| Investment securities                            | 299,820                 | 299,820    | 112   | 299,478                                       | 230                                       |
| Federal Reserve and Federal Home Loan Bank stock | 10,694                  | 10,694     |   | 10,694  |   |
| Loans held for sale                              | 226,923                 | 226,923    |   | 226,923                                       |   |
| Loans  | 2,493,095               | 2,515,409  |   | 33,990  | 2,481,419                                 |
| Bank owned life insurance                        | 14,135                  | 14,135     |   | 14,135  |   |
| <b>Liabilities</b>                               |                         |            |   |   |   |
| Noninterest bearing deposits                     | 881,390                 | 881,390    |   | 881,390                                       |   |
| Interest bearing deposits                        | 2,015,832               | 2,017,623  |   | 2,017,623                                     |   |
| Borrowings                                       | 140,638                 | 142,765    |   | 142,765                                       |   |



Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 21 Quarterly Results of Operations (unaudited)**

The following table reports quarterly results of operations (unaudited) for 2013, 2012 and 2011:

| (dollars in thousands except per share data)          | 2013              |                  |                   |                  |
|---|-------------------|------------------|-------------------|------------------|
|   | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
| Total interest income                                 | \$ 41,652         | \$ 39,724        | \$ 37,985         | \$ 37,933        |
| Total interest expense                                | 2,938             | 3,021            | 3,121             | 3,424            |
| Net interest income                                   | 38,714            | 36,703           | 34,864            | 34,509           |
| Provision for credit losses                           | 2,508             | 1,372            | 2,357             | 3,365            |
| Net interest income after provision for credit losses | 36,206            | 35,331           | 32,507            | 31,144           |
| Noninterest income                                    | 4,304             | 5,236            | 7,065             | 8,111            |
| Noninterest expense                                   | 21,524            | 21,673           | 20,685            | 20,697           |
| Income before income tax expense                      | 18,986            | 18,894           | 18,887            | 18,558           |
| Income tax expense                                    | 6,983             | 7,137            | 7,212             | 6,986            |
| Net income  | 12,003            | 11,757           | 11,675            | 11,572           |
| Preferred stock dividends and discount accretion      | 141               | 142              | 142               | 141              |
| Net income available to common shareholders           | \$ 11,862         | \$ 11,615        | \$ 11,533         | \$ 11,431        |
| <b>Earnings per common share</b>                      |                   |                  |                   |                  |
| Basic(1 & 2)  | \$ 0.46           | \$ 0.45          | \$ 0.45           | \$ 0.45          |
| Diluted(1& 2)   | \$ 0.45           | \$ 0.44          | \$ 0.44           | \$ 0.44          |

| (dollars in thousands except per share data) | 2012              |                  |                   |                  |
|--|-------------------|------------------|-------------------|------------------|
|  | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
| Total interest income                        | \$ 38,164         | \$ 36,636        | \$ 34,575         | \$ 32,568        |
| Total interest expense                       | 3,427             | 3,328            | 3,561             | 4,098            |
| Net interest income                          | 34,737            | 33,308           | 31,014            | 28,470           |
| Provision for credit losses                  | 4,139             | 3,638            | 4,443             | 3,970            |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

|   |           |          |          |          |
|---|-----------|----------|----------|----------|
| Net interest income after provision for credit losses | 30,598    | 29,670   | 26,571   | 24,500   |
| Noninterest income                                    | 6,060     | 4,851    | 4,441    | 6,012    |
| Noninterest expense                                   | 20,325    | 19,107   | 18,537   | 18,562   |
| Income before income tax expense                      | 16,333    | 15,414   | 12,475   | 11,950   |
| Income tax expense                                    | 6,135     | 5,739    | 4,692    | 4,317    |
| Net income  | 10,198    | 9,675    | 7,783    | 7,633    |
| Preferred stock dividends and discount accretion      | 141       | 142      | 142      | 141      |
| Net income available to common shareholders           | \$ 10,057 | \$ 9,533 | \$ 7,641 | \$ 7,492 |

|                           |         |         |         |         |
|---------------------------|---------|---------|---------|---------|
| Earnings per common share |         |         |         |         |
| Basic(1 & 2)              | \$ 0.40 | \$ 0.41 | \$ 0.34 | \$ 0.34 |
| Diluted(1& 2)             | \$ 0.39 | \$ 0.40 | \$ 0.33 | \$ 0.33 |

132

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 21 Quarterly Results of Operations (unaudited) (Continued)**

| (dollars in thousands except per share data)          | 2011              |                  |                   |                  |
|---|-------------------|------------------|-------------------|------------------|
|   | Fourth<br>Quarter | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
| Total interest income                                 | \$ 33,091         | \$ 30,741        | \$ 28,996         | \$ 26,296        |
| Total interest expense                                | 4,820             | 5,365            | 5,102             | 4,790            |
| Net interest income                                   | 28,271            | 25,376           | 23,894            | 21,506           |
| Provision for credit losses                           | 2,765             | 2,887            | 3,215             | 2,116            |
| Net interest income after provision for credit losses | 25,506            | 22,489           | 20,679            | 19,390           |
| Noninterest income                                    | 3,864             | 3,511            | 3,193             | 2,933            |
| Noninterest expense                                   | 18,307            | 15,723           | 14,933            | 14,313           |
| Income before income tax expense                      | 11,063            | 10,277           | 8,939             | 8,010            |
| Income tax expense                                    | 3,889             | 3,783            | 3,185             | 2,874            |
| Net income  | 7,174             | 6,494            | 5,754             | 5,136            |
| Preferred stock dividends and discount accretion      | 142               | 166              | 883               | 320              |
| Net income available to common shareholders           | \$ 7,032          | \$ 6,328         | \$ 4,871          | \$ 4,816         |
| <b>Earnings per common share</b>                      |                   |                  |                   |                  |
| Basic(1 & 2)  | \$ 0.32           | \$ 0.29          | \$ 0.23           | \$ 0.22          |
| Diluted(1& 2)   | \$ 0.32           | \$ 0.28          | \$ 0.22           | \$ 0.22          |

(1) Earnings per common share are calculated on a quarterly basis and may not be additive to the year to date amount.

(2) Per share amounts have been adjusted to give effect to the 10% common stock dividend paid on June 14, 2013.

Table of Contents**Eagle Bancorp, Inc.****Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)****Note 22 Parent Company Financial Information**

Condensed financial information for Eagle Bancorp, Inc. (Parent Company only) is as follows:

**Condensed Balance Sheets**

| (dollars in thousands)                                  | December 31,<br>2013 | December 31,<br>2012 |
|---|----------------------|----------------------|
| <b>Assets</b>   |                      |                      |
| Cash  | \$ 17,140            | \$ 16,877            |
| Cash equivalents  | 8,693                | 8,641                |
| Investment securities available for sale, at fair value | 265                  | 212                  |
| Investment in subsidiaries                              | 376,416              | 332,477              |
| Other assets  | 1,000                | 1,353                |
| <b>Total Assets</b>                                     | <b>\$ 403,514</b>    | <b>\$ 359,560</b>    |
| <b>Liabilities</b>                                      |                      |                      |
| Other liabilities                                       | \$ 351               | \$ 284               |
| Long-term borrowings                                    | 9,300                | 9,300                |
| <b>Total liabilities</b>                                | <b>9,651</b>         | <b>9,584</b>         |
| <b>Shareholders' Equity</b>                             |                      |                      |
| Preferred stock, Series B                               | 56,600               | 56,600               |
| Common stock  | 253                  | 226                  |
| Warrant   | 946                  | 946                  |
| Additional paid in capital                              | 242,990              | 180,593              |
| Retained earnings                                       | 96,393               | 106,146              |
| Accumulated other comprehensive (loss) income           | (3,319)              | 5,465                |
| <b>Total shareholders' equity</b>                       | <b>393,863</b>       | <b>349,976</b>       |
| <b>Total Liabilities and Shareholders' Equity</b>       | <b>\$ 403,514</b>    | <b>\$ 359,560</b>    |



Table of Contents

## Eagle Bancorp, Inc.

Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)

## Note 22 Parent Company Financial Information (Continued)

## Condensed Statements of Operations

| (dollars in thousands)   | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2013                    | 2012      | 2011      |
| <b>Income</b>  |                         |           |           |
| Other interest and dividends   | \$ 117                  | \$ 78     | \$ 5,056  |
| Gain on sale of investment securities  |                         |           |           |
| Total Income   | 117                     | 78        | 5,056     |
| <b>Expenses</b>  |                         |           |           |
| Interest expense   | 897                     | 946       | 943       |
| Legal and professional   | 142                     | 192       | 214       |
| Directors' fees  | 187                     | 237       | 178       |
| Other  | 946                     | 816       | 781       |
| Total Expenses   | 2,172                   | 2,191     | 2,116     |
| (Loss) Income Before Income Tax (Benefit) and Equity in Undistributed Income of Subsidiaries | (2,055)                 | (2,113)   | 2,940     |
| Income Tax Benefit   | (810)                   | (838)     | (813)     |
| (Loss) Income Before Equity in Undistributed Income of Subsidiaries                          | (1,245)                 | (1,275)   | 3,753     |
| Equity in Undistributed Income of Subsidiaries   | 48,252                  | 36,564    | 20,805    |
| <b>Net Income</b>  | 47,007                  | 35,289    | 24,558    |
| Preferred Stock Dividends and Discount Accretion   | 566                     | 566       | 1,511     |
| <b>Net Income Available to Common Shareholders</b>   | \$ 46,441               | \$ 34,723 | \$ 23,047 |

Table of Contents

## Eagle Bancorp, Inc.

Notes to Consolidated Financial Statements  
for the Years Ended December 31, 2013, 2012 and 2011: (Continued)

## Note 22 Parent Company Financial Information (Continued)

## Condensed Statements of Cash Flows

| (dollars in thousands)  | Year Ended December 31, |                  |                  |
|---|-------------------------|------------------|------------------|
|   | 2013                    | 2012             | 2011             |
| <b>Cash Flows From Operating Activities</b>   |                         |                  |                  |
| Net Income  | \$ 47,007               | \$ 35,289        | \$ 24,558        |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |                         |                  |                  |
| Equity in undistributed income of subsidiary  | (48,252)                | (36,564)         | (20,805)         |
| Excess tax benefit on stock-based compensation  | (410)                   | (369)            | (143)            |
| Decrease (increase) in other assets   | 353                     | (34)             | 784              |
| Increase (decrease) in other liabilities  | 67                      | (50)             | 203              |
| <b>Net cash (used in) provided by operating activities</b>                                  | <b>(1,235)</b>          | <b>(1,728)</b>   | <b>4,597</b>     |
| <b>Cash Flows From Investing Activities</b>   |                         |                  |                  |
| Investment in subsidiary (net)  | (810)                   | (34,143)         | (31,964)         |
| <b>Net cash (used in) investing activities</b>  | <b>(810)</b>            | <b>(34,143)</b>  | <b>(31,964)</b>  |
| <b>Cash Flows From Financing Activities</b>   |                         |                  |                  |
| Issuance of Series B Preferred Stock  |                         |                  | 56,600           |
| Redemption of Series A Preferred Stock  |                         |                  | (23,235)         |
| Cash paid in lieu of fractional shares  | (11)                    |                  |                  |
| Issuance of common stock  |                         | 42,956           |                  |
| Proceeds from exercise of stock options   | 1,984                   | 1,685            | 944              |
| Preferred stock dividends   | (566)                   | (566)            | (1,033)          |
| Excess tax benefit on stock-based compensation  | 410                     | 369              | 143              |
| Proceeds from employee stock purchase plan  | 543                     | 447              | 124              |
| <b>Net cash provided by financing activities</b>  | <b>2,360</b>            | <b>44,891</b>    | <b>33,543</b>    |
| <b>Net Increase in Cash</b>   | <b>315</b>              | <b>9,020</b>     | <b>6,176</b>     |
| <b>Cash and Cash Equivalents at Beginning of Year</b>                                       | <b>25,518</b>           | <b>16,498</b>    | <b>10,322</b>    |
| <b>Cash and Cash Equivalents at End of Year</b>   | <b>\$ 25,833</b>        | <b>\$ 25,518</b> | <b>\$ 16,498</b> |





Table of Contents

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES**

None

**ITEM 9A. CONTROLS AND PROCEDURES**

The Company's management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated, as of the last day of the period covered by this report, the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

**MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of Eagle Bancorp, Inc. (the "Company") is responsible for the preparation, integrity and fair presentation of the financial statements included in this Annual Report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning the effects of events and transactions that are accounted for or disclosed.

Management is also responsible for establishing and maintaining effective internal control over financial reporting. The Company's internal control over financial reporting includes those policies and procedures that pertain to the Company's ability to record, process, summarize and report reliable financial data. The internal control system contains monitoring mechanisms, and appropriate actions taken to correct identified deficiencies. Management believes that internal controls over financial reporting, which are subject to scrutiny by management and the Company's internal auditors, support the integrity and reliability of the financial statements. Management recognizes that there are inherent limitations in the effectiveness of any internal control system, including the possibility of human error and the circumvention or overriding of internal controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. In addition, because of changes in conditions and circumstances, the effectiveness of internal control over financial reporting may vary over time. The Audit Committee of the Board of Directors (the "Committee"), is comprised entirely of outside directors who are independent of management. The Committee is responsible for the appointment and compensation of the independent auditors and makes decisions regarding the appointment or removal of members of the internal audit function. The Committee meets periodically with management, the independent auditors, and the internal auditors to ensure that they are carrying out their responsibilities. The Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting, and auditing procedures of the Company in addition to reviewing the Company's financial reports. The independent auditors and the internal auditors have full and unlimited access to the Audit Committee, with or without the presence of management, to discuss the adequacy of internal control over financial reporting, and any other matters which they believe should be brought to the attention of the Audit Committee.

Management assessed the Company's system of internal control over financial reporting as of December 31, 2013. This assessment was conducted based on the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission "Internal Control Integrated Framework (1992)." Based on this assessment, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2013. Management's assessment concluded that there were no material weaknesses within the Company's internal control structure.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the quarter ended December 31, 2013 that have

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The 2013 financial statements have been audited by the independent registered public accounting firm of Stegman & Company ("Stegman"). Personnel from Stegman were given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees thereof. Management believes that all representations made to the independent auditors were valid and appropriate. The resulting report from Stegman accompanies the financial statements. Stegman has also issued a report on the effectiveness of internal control over financial reporting. That report has also been made a part of this Annual Report.

/s/ Ronald D. Paul  
Chairman, President and Chief Executive Officer of the Company

/s/ James H. Langmead  
Executive Vice President and Chief Financial Officer of the  
Company  
138

---

Table of Contents**ITEM 9B. OTHER INFORMATION**

None

**PART III****ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item is incorporated by reference to the material appearing under the captions "Election of Directors" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934" in the Company's definitive proxy statement for the Annual Meeting of Shareholders to be held on May 15, 2014 (the "Proxy Statement"). The Company has adopted a code of ethics that applies to its Chief Executive Officer and Chief Financial Officer. A copy of the code of ethics will be provided to any person, without charge, upon written request directed to Jane Cornett, Corporate Secretary, Eagle Bancorp, Inc., 7830 Old Georgetown Road, Third Floor, Bethesda, Maryland 20814. There have been no material changes in the procedures previously disclosed by which shareholders may recommend nominees to the Company's Board of Directors.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item is incorporated by reference to the material appearing under the captions "Election of Directors Director's Compensation" and "Executive Compensation" in the Proxy Statement.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

*Securities Authorized for Issuance Under Equity Compensation Plans.* The following table sets forth information regarding outstanding options and other rights to purchase or acquire common stock granted under the Company's compensation plans as of December 31, 2013:

**Equity Compensation Plan Information**

| Plan category  | Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and rights | Weighted average<br>exercise price of<br>outstanding options,<br>warrants and rights | Number of securities<br>remaining available for<br>future issuance under<br>equity compensation<br>plans excluding<br>securities reflected<br>in column (a) |
|--|---|--|---|
|  | (a)   | (b)  | (c)   |
| Equity compensation plans approved by security holders(1)  | 501,334   | \$ 10.34   | 976,401(2)  |
| Equity compensation plans not approved by security holders | 0   | 0  | 0   |
| <b>Total</b>   | <b>501,334</b>  | <b>\$ 10.34</b>  | <b>976,401</b>  |

(1) Consists of the Company's 2011 Employee Stock Purchase Plan, 2006 Stock Plan, 1998 Stock Option Plan and the Fidelity Long Term Incentive Plans. For additional information, see Note 13 to the Consolidated Financial Statements.

(2) Shares available for issuance under the 2011 Employee Stock Purchase Plan and the 2006 Stock Plan.

The remainder of the information required by this Item is incorporated by reference to the material appearing under the caption "Voting Securities and Principal Shareholders" in the Proxy Statement.

Table of Contents

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information required by this Item is incorporated by reference to the material appearing under the captions "Election of Directors" and "Certain Relationships and Related Transactions" in the Proxy Statement.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item is incorporated by reference to the material appearing under the caption "Ratification of Appointment of Independent Registered Public Accounting Firm Fees Paid to Independent Accounting Firm" in the Proxy Statement.

Table of Contents

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

The following financial statements are included in this report

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at December 31, 2013 and 2012

Consolidated Statements of Operations for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011

Notes to the Consolidated Financial Statements

All financial statement schedules have been omitted as the required information is either inapplicable or included in the Consolidated Financial Statements or related notes.

**Exhibit No. Description of Exhibit**

- 3.1 Certificate of Incorporation of the Company, as amended(1)
- 3.2 Articles Supplementary to the Articles of Incorporation for the Series B Preferred Stock(2)
- 3.3 Bylaws of the Company(3)
- 4.1 Warrant to Purchase Common Stock(4)
- 4.2 Form of Subordinated Note due 2016(5)
- 4.3 Form of Amendment Agreement to Subordinated Note(6)
- 10.1 1998 Stock Option Plan(7)
- 10.2 Employment Agreement, dated September 1, 2011, between James H. Langmead and the Bank(8)
- 10.3 Employment Agreement, dated September 1, 2011, between Thomas D. Murphy and the Bank(9)
- 10.4 Amended and Restated Employment Agreement between Ronald D. Paul and the Company(10)
- 10.5 Employment Agreement, dated September 1, 2011, between Susan G. Riel and the Bank(12)
- 10.6 Fee Agreement between Robert P. Pincus and the Company(12)
- 10.7 2006 Stock Plan(13)
- 10.8 Employment Agreement, dated September 1, 2011, among Michael T. Flynn the Company and the Bank(14)
- 10.9 Employment Agreement, dated September 1, 2011, between Laurence E. Bensignor and the Bank(15)



## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 10.10              | Employment Agreement, dated September 1, 2011, between the Bank and Janice Williams(16)   |
| 10.11              | 2013 Senior Executive Incentive Plan(17)  |
| 10.12              | Eagle Bancorp, Inc. 2011 Employee Stock Purchase Plan(18)   |
| 10.13              | Employment Agreement dated as of February 23, 2012, between the Bank and Antonio F. Marquez(19)   |
| 10.14              | Employment Agreement dated as of April 24, 2013, between the Bank and Virginia Heine(20)  |
| 10.15              | First Amendment to Employment Agreement of Laurence E. Bensignor(21)  |
| 10.16              | First Amendment to Employment Agreement of Michael T. Flynn(22)   |
| 10.17              | First Amendment to Employment Agreement of James H. Langmead(23)  |
| 10.18              | First Amendment to Employment Agreement of Antonio F. Marquez(24)   |
| 10.19              | First Amendment to Employment Agreement of Thomas D. Murphy(25)   |
| 10.20              | First Amendment to Employment Agreement of Susan G. Riel(26)  |
| 10.21              | First Amendment to Employment Agreement of Janice Williams(27)  |
| 10.22              | Form of Supplemental Executive Retirement Plan Agreement (filed herewith)   |
| 11                 | Statement Regarding Computation of Per Share Income<br><br>Please refer to Note 11 to the Consolidated Financial Statements for the year ended December 31, 2013. |
| 12                 | Statement re: Computation of Ratios   |
| 21                 | Subsidiaries of the Registrant  |
| 23                 | Consent of Independent Registered Accounting Firm   |
| 31.1               | Certification of Ronald D. Paul   |
| 31.2               | Certification of James H. Langmead  |
| 32.1               | Certification of Ronald D. Paul   |
| 32.2               | Certification of James H. Langmead  |



## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 101                | Interactive data files pursuant to Rule 405 of Regulation S-T:<br>(i)Consolidated Balance Sheets at December 31, 2013 and 2012<br>(ii)Consolidated Statement of Operations for the years ended December 31, 2013, 2012 and 2011<br>(iii)Consolidated Statement of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011<br>(iv)Consolidated Statement of Changes in Shareholders' Equity for the years ended December 31, 2013, 2012 and 2011<br>(v)Consolidated Statement of Cash Flows for the years ended December 31, 2013, 2012 and 2011<br>(vi)Notes to the Consolidated Financial Statements |

---

- (1) Incorporated by reference to the exhibit of the same number to the Company's Current Report on Form 8-K filed on July 16, 2008.
- (2) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 15, 2011.
- (3) Incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on June 27, 2012.
- (4) Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 8, 2008.
- (5) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 1, 2010.
- (6) Incorporated by reference to Exhibit 4 to the Company's Form 10-Q for the Quarter ended September 30, 2013.
- (7) Incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended December 31, 1998.
- (8) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 23, 2011.
- (9) Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 23, 2011.
- (10) Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K/A filed on December 22, 2008.
- (11) Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 23, 2011.
- (12) Incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-4 (Registration No. 333-150763)
- (13) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (No. 333-187713)
- (14) Incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K filed on December 23, 2011
- (15) Incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on December 23, 2011.

## Edgar Filing: EAGLE BANCORP INC - Form 10-K

### Table of Contents

- (16) Incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 23, 2011.
- (17) Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 15, 2013.
- (18) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (Registration No. 333-175966).
- (19) Incorporated by reference to Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2012.
- (20) Incorporated by reference to Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (21) Incorporated by reference to Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (22) Incorporated by reference to Exhibit 10.16 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (23) Incorporated by reference to Exhibit 10.17 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (24) Incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (25) Incorporated by reference to Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (26) Incorporated by reference to Exhibit 10.20 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.
- (27) Incorporated by reference to Exhibit 10.21 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2013.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

EAGLE BANCORP, INC.

March 14, 2014

by:                                 /s/ RONALD D. PAUL

Ronald D. Paul, *Chairman, President and CEO*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Name   | Position  | Date           |
|--|---|----------------|
| <u>                                /s/ LESLIE M. ALPERSTEIN, PH.D.</u> | Director  | March 14, 2014 |
| Leslie M. Alperstein, Ph.D.  |   |                |
| <u>                                /s/ DUDLEY C. DWORKEN</u>           | Director  | March 14, 2014 |
| Dudley C. Dworken  |   |                |
| <u>                                /s/ HARVEY M. GOODMAN</u>           | Director  | March 14, 2014 |
| Harvey M. Goodman  |   |                |
| <u>                                /s/ NORMAN R. POZEZ</u>             | Director  | March 14, 2014 |
| Norman R. Pozez  |   |                |
| <u>                                /s/ DONALD R. ROGERS</u>            | Director  | March 14, 2014 |
| Donald R. Rogers   |   |                |
| <u>                                /s/ LELAND M. WEINSTEIN</u>         | Director  | March 14, 2014 |
| Leland M. Weinstein  |   |                |
| <u>                                /s/ RONALD D. PAUL</u>              | Chairman, President and Principal<br>Executive Officer of the Company | March 14, 2014 |
| Ronald D. Paul   |   |                |

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Table of Contents

| Name                  | Position   | Date           |
|-----------------------|--|----------------|
| /s/ ROBERT P. PINCUS  | Vice Chairman  | March 14, 2014 |
| Robert P. Pincus      |  |                |
| /s/ JAMES H. LANGMEAD | Executive Vice President and Chief Financial Officer of<br>the Company Principal Financial and Accounting<br>Officer | March 14, 2014 |
| James H. Langmead     |  |                |