

TEXAS CAPITAL BANCSHARES INC/TX

Form 10-Q

July 24, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the quarterly period ended June 30, 2014**

.. **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-34657**

**TEXAS CAPITAL BANCSHARES, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Delaware** **75-2679109**  
**(State or other jurisdiction of** **(I.R.S. Employer**  
**incorporation or organization)** **Identification Number)**

**2000 McKinney Avenue, Suite 700, Dallas, Texas,** **75201**  
**U.S.A.**  
**(Address of principal executive officers)** **(Zip Code)**  
**214/932-6600**

**(Registrant's telephone number,**  
**including area code)**

N/A

**(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)**

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

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

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

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  (Do not check if a smaller reporting company) Smaller Reporting Company

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

On July 22, 2014, the number of shares set forth below was outstanding with respect to each of the issuer's classes of common stock:

Common Stock, par value \$0.01 per share 43,111,768



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Texas Capital Bancshares, Inc.

Form 10-Q

Quarter Ended June 30, 2014

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****TEXAS CAPITAL BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME  
UNAUDITED**

(In thousands except per share data)

|  | Three months ended June 30, |            | Six months ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2014                        | 2013       | 2014                      | 2013       |
| <b>Interest income</b>                                       |                             |            |                           |            |
| Interest and fees on loans                                   | \$ 124,234                  | \$ 106,418 | \$ 240,106                | \$ 209,600 |
| Securities   | 471                         | 773        | 1,011                     | 1,712      |
| Federal funds sold   | 8                           | 13         | 48                        | 19         |
| Deposits in other banks                                      | 100                         | 60         | 259                       | 112        |
| Total interest income  | 124,813                     | 107,264    | 241,424                   | 211,443    |
| <b>Interest expense</b>                                      |                             |            |                           |            |
| Deposits   | 4,246                       | 3,228      | 8,276                     | 6,473      |
| Federal funds purchased                                      | 115                         | 206        | 210                       | 418        |
| Repurchase agreements  | 4                           | 5          | 8                         | 9          |
| Other borrowings   | 181                         | 143        | 253                       | 356        |
| Subordinated notes   | 4,241                       | 1,829      | 7,720                     | 3,658      |
| Trust preferred subordinated debentures                      | 619                         | 633        | 1,235                     | 1,267      |
| Total interest expense                                       | 9,406                       | 6,044      | 17,702                    | 12,181     |
| <b>Net interest income</b>                                   | 115,407                     | 101,220    | 223,722                   | 199,262    |
| <b>Provision for credit losses</b>                           | 4,000                       | 7,000      | 9,000                     | 9,000      |
| <b>Net interest income after provision for credit losses</b> | 111,407                     | 94,220     | 214,722                   | 190,262    |
| <b>Non-interest income</b>                                   |                             |            |                           |            |
| Service charges on deposit accounts                          | 1,764                       | 1,749      | 3,460                     | 3,450      |
| Trust fee income   | 1,242                       | 1,269      | 2,524                     | 2,510      |
| Bank owned life insurance (BOLI) income                      | 521                         | 463        | 1,030                     | 961        |
| Brokered loan fees   | 3,357                       | 4,778      | 6,181                     | 9,522      |
| Swap fees  | 410                         | 981        | 1,634                     | 2,633      |
| Other  | 3,239                       | 1,888      | 6,060                     | 3,333      |
| Total non-interest income                                    | 10,533                      | 11,128     | 20,889                    | 22,409     |
| <b>Non-interest expense</b>                                  |                             |            |                           |            |
| Salaries and employee benefits                               | 39,896                      | 45,191     | 81,952                    | 78,732     |
| Net occupancy expense  | 5,073                       | 4,135      | 9,841                     | 7,992      |

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|  |                  |                  |                  |                  |
|--|------------------|------------------|------------------|------------------|
| Marketing  | 3,795            | 4,074            | 7,554            | 8,046            |
| Legal and professional   | 7,181            | 4,707            | 12,583           | 8,647            |
| Communications and technology  | 4,361            | 3,347            | 8,285            | 6,469            |
| FDIC insurance assessment  | 2,544            | 699              | 5,269            | 1,777            |
| Allowance and other carrying costs for OREO  | 11               | 482              | 56               | 912              |
| Other  | 6,907            | 6,099            | 13,549           | 11,859           |
| <b>Total non-interest expense</b>  | <b>69,768</b>    | <b>68,734</b>    | <b>139,089</b>   | <b>124,434</b>   |
| <b>Income from continuing operations before income taxes</b>                                     | <b>52,172</b>    | <b>36,614</b>    | <b>96,522</b>    | <b>88,237</b>    |
| Income tax expense   | 18,754           | 12,542           | 34,843           | 31,021           |
| <b>Income from continuing operations</b>   | <b>33,418</b>    | <b>24,072</b>    | <b>61,679</b>    | <b>57,216</b>    |
| <b>Income from discontinued operations (after-tax)</b>   | <b>3</b>         | <b>1</b>         | <b>7</b>         |                  |
| <b>Net income</b>  | <b>33,421</b>    | <b>24,073</b>    | <b>61,686</b>    | <b>57,216</b>    |
| <b>Preferred stock dividends</b>   | <b>2,437</b>     | <b>2,438</b>     | <b>4,875</b>     | <b>2,519</b>     |
| <b>Net income available to common stockholders</b>   | <b>\$ 30,984</b> | <b>\$ 21,635</b> | <b>\$ 56,811</b> | <b>\$ 54,697</b> |
| <b>Other comprehensive income (loss)</b>   |                  |                  |                  |                  |
| Change in net unrealized gain on available-for-sale securities arising during period, before-tax | \$ 43            | \$ (1,028)       | \$ (118)         | \$ (1,752)       |
| Income tax benefit (expense) related to net unrealized gain on available-for-sale securities     | 15               | (360)            | (41)             | (613)            |
| Other comprehensive income (loss), net of tax  | 28               | (668)            | (77)             | (1,139)          |
| <b>Comprehensive income</b>  | <b>\$ 33,449</b> | <b>\$ 23,405</b> | <b>\$ 61,609</b> | <b>\$ 56,077</b> |
| <b>Basic earnings per common share</b>   |                  |                  |                  |                  |
| Income from continuing operations  | \$ 0.72          | \$ 0.53          | \$ 1.33          | \$ 1.34          |
| Net income   | \$ 0.72          | \$ 0.53          | \$ 1.33          | \$ 1.34          |
| <b>Diluted earnings per common share</b>   |                  |                  |                  |                  |
| Income from continuing operations  | \$ 0.71          | \$ 0.52          | \$ 1.30          | \$ 1.31          |
| Net income   | \$ 0.71          | \$ 0.52          | \$ 1.30          | \$ 1.31          |

See accompanying notes to consolidated financial statements.

**Table of Contents****TEXAS CAPITAL BANCSHARES, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands except share data)

|   | June 30,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|---|---------------------------------|-------------------------|
| <b>Assets</b>   |                                 |                         |
| Cash and due from banks   | \$ 116,525                      | \$ 92,484               |
| Interest-bearing deposits   | 240,617                         | 61,337                  |
| Federal funds sold and securities purchased under resale agreements |                                 | 90                      |
| Securities, available-for-sale                                      | 49,330                          | 63,214                  |
| Loans held for sale from discontinued operations                    | 290                             | 294                     |
| Loans held for investment, mortgage finance                         | 3,700,253                       | 2,784,265               |
| Loans held for investment (net of unearned income)                  | 9,152,715                       | 8,486,309               |
| Less: Allowance for loan losses                                     | 91,114                          | 87,604                  |
| Loans held for investment, net                                      | 12,761,854                      | 11,182,970              |
| Premises and equipment, net   | 15,762                          | 11,482                  |
| Accrued interest receivable and other assets                        | 327,510                         | 281,534                 |
| Goodwill and intangible assets, net                                 | 20,938                          | 21,286                  |
| Total assets  | \$ 13,532,826                   | \$ 11,714,691           |
| <b>Liabilities and Stockholders Equity</b>                          |                                 |                         |
| Liabilities:  |                                 |                         |
| Deposits:   |                                 |                         |
| Non-interest-bearing  | \$ 4,181,774                    | \$ 3,347,567            |
| Interest-bearing  | 6,233,357                       | 5,579,505               |
| Interest-bearing in foreign branches                                | 342,185                         | 330,307                 |
| Total deposits  | 10,757,316                      | 9,257,379               |
| Accrued interest payable  | 4,671                           | 749                     |
| Other liabilities   | 108,069                         | 110,177                 |
| Federal funds purchased and repurchase agreements                   | 300,532                         | 170,604                 |
| Other borrowings  | 700,016                         | 855,026                 |
| Subordinated notes  | 286,000                         | 111,000                 |
| Trust preferred subordinated debentures                             | 113,406                         | 113,406                 |
| Total liabilities   | 12,270,010                      | 10,618,341              |
| Stockholders equity:  |                                 |                         |
| Preferred stock, \$.01 par value, \$1,000 liquidation value:        | 150,000                         | 150,000                 |
| Authorized shares 10,000,000  |                                 |                         |

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Issued shares 6,000,000 shares issued at June 30, 2014 and December 31, 2013, respectively

Common stock, \$.01 par value:

Authorized shares 100,000,000

Issued shares 43,105,861 and 41,036,787 at June 30, 2014 and December 31, 2013, respectively

|   |                   |                   |
|---|-------------------|-------------------|
|   | 431               | 410               |
| Additional paid-in capital  | 557,919           | 448,208           |
| Retained earnings   | 552,923           | 496,112           |
| Treasury stock (shares at cost: 417 at June 30, 2014 and December 31, 2013) | (8)               | (8)               |
| Accumulated other comprehensive income, net of taxes                        | 1,551             | 1,628             |
| <br>Total stockholders equity   | <br>1,262,816     | <br>1,096,350     |
| <br>Total liabilities and stockholders equity                               | <br>\$ 13,532,826 | <br>\$ 11,714,691 |

See accompanying notes to consolidated financial statements.



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## TEXAS CAPITAL BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands except share data)

|   | Preferred Stock |         | Common Stock |        |                            | Treasury Stock    |        | Accumulated Other Comprehensive Income (Loss), Net of Taxes |          | Total      |
|---|-----------------|---------|--------------|--------|----------------------------|-------------------|--------|---|----------|------------|
|   | Shares          | Amount  | Shares       | Amount | Additional Paid-in Capital | Retained Earnings | Shares | Amount  |          |            |
| Balance at December 31, 2012  |                 | \$      | 40,727,996   | \$ 407 | \$ 450,116                 | \$ 382,455        | (417)  | \$ (8)  | \$ 3,272 | \$ 836,242 |
| Comprehensive income:   |                 |         |              |        |                            |                   |        |   |          |            |
| Net income (unaudited)  |                 |         |              |        |                            | 57,216            |        |   |          | 57,216     |
| Change in unrealized gain on available-for-sale securities, net of taxes of \$613 (unaudited) |                 |         |              |        |                            |                   |        |   | (1,139)  | (1,139)    |
| Total comprehensive income (unaudited)  |                 |         |              |        |                            |                   |        |   |          | 56,077     |
| Tax expense related to exercise of stock-based awards (unaudited)                             |                 |         |              |        |                            | (659)             |        |   |          | (659)      |
| Stock-based compensation expense recognized in earnings (unaudited)                           |                 |         |              |        |                            | 1,843             |        |   |          | 1,843      |
| Issuance of preferred stock   | 6,000,000       | 150,000 |              |        | (5,013)                    |                   |        |   |          | 144,987    |

|  |           |            |            |        |            |            |         |        |          |              |
|--|-----------|------------|------------|--------|------------|------------|---------|--------|----------|--------------|
| (unaudited)  |           |            |            |        |            |            |         |        |          |              |
| Preferred stock dividend   |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            | (2,519) |        |          | (2,519)      |
| Issuance of stock related to stock-based awards                                  |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            | 134,902    | 1      | (1,017)    |            |         |        |          | (1,016)      |
| Balance at June 30, 2013   |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  | 6,000,000 | \$ 150,000 | 40,862,898 | \$ 408 | \$ 445,270 | \$ 437,152 | (417)   | \$ (8) | \$ 2,133 | \$ 1,034,955 |
| Balance at December 31, 2013   |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  | 6,000,000 | \$ 150,000 | 41,036,787 | \$ 410 | \$ 448,208 | \$ 496,112 | (417)   | \$ (8) | \$ 1,628 | \$ 1,096,350 |
| Comprehensive income:  |           |            |            |        |            |            |         |        |          |              |
| Net income   |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            | 61,686  |        |          | 61,686       |
| Change in unrealized gain on available-for-sale securities, net of taxes of \$41 |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            |         |        | (77)     | (77)         |
| Total comprehensive income   |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            |         |        |          | 61,609       |
| Tax benefit related to exercise of stock-based awards                            |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            | 1,479   |        |          | 1,479        |
| Stock-based compensation expense recognized in earnings                          |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            | 2,528   |        |          | 2,528        |
| Preferred stock dividend   |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            |            |        |            |            | (4,875) |        |          | (4,875)      |
| Issuance of stock related to stock-based awards                                  |           |            |            |        |            |            |         |        |          |              |
| (unaudited)  |           |            | 94,845     | 1      | (824)      |            |         |        |          | (823)        |

|  |           |            |            |        |            |            |       |       |          |              |         |
|--|-----------|------------|------------|--------|------------|------------|-------|-------|----------|--------------|---------|
| (unaudited)  |           |            |            |        |            |            |       |       |          |              |         |
| Issuance of<br>common stock<br>(unaudited)                           |           |            | 1,875,000  | 19     | 106,529    |            |       |       |          |              | 106,548 |
| Issuance of<br>common stock<br>related to<br>warrants<br>(unaudited) |           |            | 99,229     | 1      | (1)        |            |       |       |          |              |         |
| Balance at<br>June 30, 2014<br>(unaudited)                           | 6,000,000 | \$ 150,000 | 43,105,861 | \$ 431 | \$ 557,919 | \$ 552,923 | (417) | \$(8) | \$ 1,551 | \$ 1,262,816 |         |

See accompanying notes to consolidated financial statements

**Table of Contents****TEXAS CAPITAL BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

(In thousands)

|   | Six months ended June 30, |              |
|---|---------------------------|--------------|
|   | 2014                      | 2013         |
| <b>Operating activities</b>   |                           |              |
| Net income from continuing operations   | \$ 61,679                 | \$ 57,216    |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                           |              |
| Provision for credit losses   | 9,000                     | 9,000        |
| Depreciation and amortization   | 6,693                     | 2,494        |
| Amortization and accretion on securities  |                           | 14           |
| Bank owned life insurance (BOLI) income   | (1,030)                   | (961)        |
| Stock-based compensation expense  | 7,233                     | 11,250       |
| Tax benefit (expense) from stock-based award exercises                                      | 1,479                     | (659)        |
| Excess tax benefits (expense) from stock-based compensation arrangements                    | (4,227)                   | 1,882        |
| Loss on sale of assets  | (709)                     | (439)        |
| Changes in operating assets and liabilities:  |                           |              |
| Accrued interest receivable and other assets  | (51,807)                  | 33,892       |
| Accrued interest payable and other liabilities  | (2,850)                   | 2,237        |
| Net cash provided by operating activities of continuing operations                          | 25,461                    | 115,926      |
| Net cash provided by operating activities of discontinued operations                        | 11                        | 4            |
| Net cash provided by operating activities   | 25,472                    | 115,930      |
| <b>Investing activities</b>   |                           |              |
| Maturities and calls of available-for-sale securities                                       | 8,474                     | 12,245       |
| Principal payments received on available-for-sale securities                                | 5,292                     | 10,323       |
| Originations of mortgage finance loans  | (23,694,564)              | (27,736,248) |
| Proceeds from pay-offs of mortgage finance loans  | 22,778,576                | 28,073,286   |
| Net increase in loans held for investment, excluding mortgage finance loans                 | (671,896)                 | (729,034)    |
| Purchase of premises and equipment, net   | (6,193)                   | (2,292)      |
| Proceeds from sale of foreclosed assets   | 5,763                     | 3,660        |
| Cash paid for acquisition   |                           | (2,445)      |
| Net cash used in investing activities of continuing operations                              | (1,574,548)               | (370,505)    |
| <b>Financing activities</b>   |                           |              |
| Net increase in deposits  | 1,499,937                 | 539,794      |
| Net expense from issuance of stock related to stock-based awards                            | (823)                     | (1,016)      |
| Net proceeds from issuance of common stock  | 106,548                   |              |
| Proceeds from issuance of preferred stock   |                           | 144,987      |
| Preferred dividends paid  | (4,875)                   | (2,085)      |
| Net decrease in other borrowings  | (149,473)                 | (346,867)    |

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|  |            |            |
|--|------------|------------|
| Excess tax benefits (expense) from stock-based compensation arrangements | 4,227      | (1,882)    |
| Net increase in Federal funds purchased                                  | 124,391    | 34,336     |
| Net proceeds from issuance of subordinated notes                         | 172,375    |            |
| Net cash provided by financing activities of continuing operations       | 1,752,307  | 367,267    |
| Net increase in cash and cash equivalents                                | 203,231    | 112,692    |
| Cash and cash equivalents at beginning of period                         | 153,911    | 206,348    |
| Cash and cash equivalents at end of period                               | \$ 357,142 | \$ 319,040 |
| Supplemental disclosures of cash flow information:                       |            |            |
| Cash paid during the period for interest                                 | \$ 13,780  | \$ 11,808  |
| Cash paid during the period for income taxes                             | 33,702     | 38,112     |
| Transfers from loans/leases to OREO and other repossessed assets         | 851        | 912        |
| See accompanying notes to consolidated financial statements.             |            |            |

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**TEXAS CAPITAL BANCSHARES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED**

**(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and Nature of Business**

Texas Capital Bancshares, Inc. (the Company), a Delaware corporation, was incorporated in November 1996 and commenced banking operations in December 1998. The consolidated financial statements of the Company include the accounts of Texas Capital Bancshares, Inc. and its wholly owned subsidiary, Texas Capital Bank, National Association (the Bank). We serve the needs of commercial businesses and successful professionals and entrepreneurs located in Texas as well as operate several lines of business serving a regional or national clientele of commercial borrowers. We are primarily a secured lender, with our greatest concentration of loans in Texas.

**Basis of Presentation**

Our accounting and reporting policies conform to accounting principles generally accepted in the United States (GAAP) and to generally accepted practices within the banking industry. Certain prior period balances have been reclassified to conform to the current period presentation.

The consolidated interim financial statements have been prepared without audit. Certain information and footnote disclosures presented in accordance with GAAP have been condensed or omitted. In the opinion of management, the interim financial statements include all normal and recurring adjustments and the disclosures made are adequate to make interim financial information not misleading. The consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2013, included in our Annual Report on Form 10-K filed with the SEC on February 20, 2014 (the 2013 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

**Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly susceptible to significant change in the near term.

**Correction of an Error in the Financial Statements**

We determined during the fourth quarter of 2013 that purchases and sales of mortgage finance loan interests that had been reported on our consolidated statements of cash flows as cash flows from operating activities should have been reported as investing activities because the related asset balances should have been reported as held for investment rather than held for sale on our consolidated balance sheets.

We have corrected the classification of these assets on the consolidated balance sheets to reflect them as held for investment. We have corrected the previously presented cash flows for these loans and in doing so the consolidated statements of cash flows for the six months ended June 30, 2013 were adjusted to decrease net cash flows from operating activities by \$337.0 million, with a corresponding increase in net cash flows from investing activities. The change does not impact our reported earnings as we do not believe any reserve for loan losses relating to the mortgage finance portfolio is necessary based upon the risk profile of the assets and the less than one basis point loss experience of the program over the last ten years. This reclassification does not change total loans or total assets on our consolidated balance sheets. We have evaluated the effect of the incorrect presentation, both qualitatively and quantitatively, and concluded that it did not materially misstate our previously issued financial statements.

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### **Cash and Cash Equivalents**

Cash equivalents include amounts due from banks, interest-bearing deposits and Federal funds sold.

### **Securities**

Securities are classified as trading, available-for-sale or held-to-maturity. Management classifies securities at the time of purchase and re-assesses such designation at each balance sheet date; however, transfers between categories from this re-assessment are rare.

#### *Trading Account*

Securities acquired for resale in anticipation of short-term market movements are classified as trading, with realized and unrealized gains and losses recognized in income. To date, we have not had any activity in our trading account.

#### *Held-to-Maturity and Available-for-Sale*

Debt securities are classified as held-to-maturity when we have the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. Debt securities not classified as held-to-maturity or trading and marketable equity securities not classified as trading are classified as available-for-sale.

Available-for-sale securities are stated at fair value, with the unrealized gains and losses reported in a separate component of accumulated other comprehensive income (loss), net of tax. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from securities. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

All securities are available-for-sale as of June 30, 2014 and December 31, 2013.

### **Loans**

#### *Loans Held for Investment*

Loans held for investment (which include equipment leases accounted for as financing leases) are stated at the amount of unpaid principal reduced by deferred income (net of costs). Interest on loans is recognized using the simple-interest method on the daily balances of the principal amounts outstanding. Loan origination fees, net of direct loan origination costs, and commitment fees, are deferred and amortized as an adjustment to yield over the life of the loan, or over the commitment period, as applicable.

A loan held for investment is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. Reserves on impaired loans are 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 underlying collateral. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

The accrual of interest on loans is discontinued when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan



is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectibility is questionable, then cash payments are applied to principal. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

Loans held for investment includes legal ownership interests in mortgage loans that we purchase through our mortgage warehouse lending division. The ownership interests are purchased from unaffiliated mortgage originators who are seeking additional funding through sale of the undivided ownership interests to facilitate their ability to originate loans. The mortgage originator has no obligation to offer and we have no obligation to

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purchase these interests. The originator closes mortgage loans consistent with underwriting standards established by approved investors, and, at the time of the sale to the investor, our ownership interest and that of the originator are delivered by us to the investor selected by the originator and approved by us. We typically purchase up to a 99% ownership interest in each mortgage with the originator owning the remaining percentage. These mortgage ownership interests are held by us for an interim period, usually less than 30 days and more typically 10-20 days. Because of conditions in agreements with originators designed to reduce transaction risks, under Accounting Standards Codification 860, *Transfers and Servicing of Financial Assets* ( ASC 860 ), the ownership interests do not qualify as participating interests. Under ASC 860, the ownership interests are deemed to be loans to the originators and payments we receive from investors are deemed to be payments made by or on behalf of the originator to repay the loan deemed made to the originator. Because we have an actual, legal ownership interest in the underlying residential mortgage loan, these interests are not extensions of credit to the originators that are secured by the mortgage loans as collateral.

Due to market conditions or events of default by the investor or the originator, we could be required to purchase the remaining interests in the mortgage loans and hold them beyond the expected 10-20 days. Mortgage loans acquired under these conditions could require future allocations of the allowance for loan losses or be subject to charge off in the event the loans become impaired. Mortgage loan interests purchased and disposed of as expected receive no allocation of the allowance for loan losses due to the minimal loss experience with these assets.

### **Allowance for Loan Losses**

The allowance for loan losses is established through a provision for loan losses charged against income. The allowance for loan losses includes specific reserves for impaired loans and a general reserve for estimated losses inherent in the loan portfolio at the balance sheet date, but not yet identified with specific loans. Loans deemed to be uncollectible are charged against the allowance when management believes that the collectibility of the principal is unlikely and subsequent recoveries, if any, are credited to the allowance. Management's periodic evaluation of the adequacy of the allowance is based on an assessment of the current loan portfolio, including known inherent risks, adverse situations that may affect the borrowers' ability to repay, the estimated value of any underlying collateral and current economic conditions.

### **Other Real Estate Owned**

Other real estate owned ( OREO ), which is included in other assets on the balance sheet, consists of real estate that has been foreclosed. Real estate that has been foreclosed is recorded at the fair value of the real estate, less selling costs, through a charge to the allowance for loan losses, if necessary. Subsequent write-downs required for declines in value are recorded through a valuation allowance, or taken directly to the asset, charged to other non-interest expense.

### **Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from three to ten years. Gains or losses on disposals of premises and equipment are included in results of operations.

### **Marketing and Software**

Marketing costs are expensed as incurred. Ongoing maintenance and enhancements of websites are expensed as incurred. Costs incurred in connection with development or purchase of internal use software are capitalized and amortized over a period not to exceed five years. Internal use software costs are included in other assets in the

consolidated financial statements.

### **Goodwill and Other Intangible Assets**

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Our intangible assets relate primarily to loan customer relationships. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. Intangible assets are tested for impairment annually or whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

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### **Segment Reporting**

We have determined that all of our lending divisions and subsidiaries meet the aggregation criteria of ASC 280, *Segment Reporting*, since all offer similar products and services, operate with similar processes, and have similar customers.

### **Stock-based Compensation**

We account for all stock-based compensation transactions in accordance with ASC 718, *Compensation – Stock Compensation* ( ASC 718 ), which requires that stock compensation transactions be recognized as compensation expense in the statement of operations based on their fair values on the measurement date, which is the date of the grant.

### **Accumulated Other Comprehensive Income**

Unrealized gains or losses on our available-for-sale securities (after applicable income tax expense or benefit) are included in accumulated other comprehensive income, net. Other comprehensive income (loss), net of tax, for the six months ended June 30, 2014 and 2013 is reported in the accompanying consolidated statements of stockholders' equity and consolidated statements of income and other comprehensive income.

### **Income Taxes**

The Company and its subsidiary file a consolidated federal income tax return. We utilize the liability method in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based upon the difference between the values of the assets and liabilities as reflected in the financial statements and their related tax basis using enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. As changes in tax law or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. A valuation reserve is provided against deferred tax assets unless it is more likely than not that such deferred tax assets will be realized.

### **Basic and Diluted Earnings Per Common Share**

Basic earnings per common share is based on net income available to common stockholders divided by the weighted-average number of common shares outstanding during the period excluding non-vested stock awards. Diluted earnings per common share include the dilutive effect of stock options and non-vested stock awards using the treasury stock method. A reconciliation of the weighted-average shares used in calculating basic earnings per common share and the weighted average common shares used in calculating diluted earnings per common share for the reported periods is provided in Note 2 – Earnings Per Common Share.

### **Fair Values of Financial Instruments**

ASC 820, *Fair Value Measurements and Disclosures* ( ASC 820 ), defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements. In general, fair values of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.



**Table of Contents****(2) EARNINGS PER COMMON SHARE**

The following table presents the computation of basic and diluted earnings per share (in thousands except per share data):

|  | Three months ended June 30, |            | Six months ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2014                        | 2013       | 2014                      | 2013       |
| <b>Numerator:</b>  |                             |            |                           |            |
| Net income from continuing operations  | \$ 33,418                   | \$ 24,072  | \$ 61,679                 | \$ 57,216  |
| Preferred stock dividends  | 2,437                       | 2,438      | 4,875                     | 2,519      |
| Net income from continuing operations available to common stockholders                               | 30,981                      | 21,634     | 56,804                    | 54,697     |
| Income from discontinued operations  | 3                           | 1          | 7                         |            |
| Net income   | \$ 30,984                   | \$ 21,635  | \$ 56,811                 | \$ 54,697  |
| <b>Denominator:</b>  |                             |            |                           |            |
| Denominator for basic earnings per share weighted average shares                                     | 43,075,213                  | 40,813,918 | 42,735,580                | 40,784,769 |
| Effect of employee stock-based awards <sup>(1)</sup>   | 336,993                     | 415,049    | 359,794                   | 436,219    |
| Effect of warrants to purchase common stock  | 432,809                     | 494,558    | 486,113                   | 496,464    |
| Denominator for dilutive earnings per share adjusted weighted average shares and assumed conversions | 43,845,015                  | 41,723,525 | 43,581,487                | 41,717,452 |
| Basic earnings per common share from continuing operations   | \$ 0.72                     | \$ 0.53    | \$ 1.33                   | \$ 1.34    |
| Basic earnings per common share  | \$ 0.72                     | \$ 0.53    | \$ 1.33                   | \$ 1.34    |
| Diluted earnings per share from continuing operations  | \$ 0.71                     | \$ 0.52    | \$ 1.30                   | \$ 1.31    |
| Diluted earnings per common share  | \$ 0.71                     | \$ 0.52    | \$ 1.30                   | \$ 1.31    |

(1) Stock options, SARs and RSUs outstanding of 46,000 at June 30, 2014 and 99,500 at June 30, 2013 have not been included in diluted earnings per share because to do so would have been anti-dilutive for the periods

presented.

### **(3) SECURITIES**

Securities are identified as either held-to-maturity or available-for-sale based upon various factors, including asset/liability management strategies, liquidity and profitability objectives, and regulatory requirements. Held-to-maturity securities are carried at cost, adjusted for amortization of premiums or accretion of discounts. Available-for-sale securities are securities that may be sold prior to maturity based upon asset/liability management decisions. Securities identified as available-for-sale are carried at fair value. Unrealized gains or losses on available-for-sale securities are recorded as accumulated other comprehensive income in stockholders' equity, net of taxes. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

At June 30, 2014, our net unrealized gain on the available-for-sale securities portfolio was \$2.4 million compared to \$2.5 million at December 31, 2013. As a percent of outstanding balances, the unrealized gain was 5.08% and 4.13% at June 30, 2014 and December 31, 2013, respectively. The increase in the percent of outstanding balances at June 30, 2014 related to change in market value.

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The following is a summary of securities (in thousands):

|  | June 30, 2014     |                              |                               | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| <b>Available-for-Sale Securities:</b>  |                   |                              |                               |                            |
| Residential mortgage-backed securities | \$ 33,491         | \$ 2,511                     | \$                            | \$ 36,002                  |
| Municipals                             | 5,930             | 22                           |                               | 5,952                      |
| Equity securities <sup>(1)</sup>       | 7,522             | 11                           | (157)                         | 7,376                      |
|  | \$ 46,943         | \$ 2,544                     | \$ (157)                      | \$ 49,330                  |

|  | December 31, 2013 |                              |                               | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| <b>Available-for-Sale Securities:</b>  |                   |                              |                               |                            |
| Residential mortgage-backed securities | \$ 38,786         | \$ 2,676                     | \$                            | \$ 41,462                  |
| Municipals                             | 14,401            | 104                          |                               | 14,505                     |
| Equity securities <sup>(1)</sup>       | 7,522             |                              | (275)                         | 7,247                      |
|  | \$ 60,709         | \$ 2,780                     | \$ (275)                      | \$ 63,214                  |

(1) Equity securities consist of Community Reinvestment Act funds.

The amortized cost and estimated fair value of securities are presented below by contractual maturity (in thousands, except percentage data):

|  | June 30, 2014            |  |  |                    | Total     |
|--|--------------------------|--|--|--------------------|-----------|
|  | Less Than<br>One<br>Year | After<br>One<br>Through<br>Five<br>Years | After<br>Five<br>Through<br>Ten<br>Years | After Ten<br>Years |           |
| <b>Available-for-sale:</b>                             |                          |  |  |                    |           |
| Residential mortgage-backed securities: <sup>(1)</sup> |                          |  |  |                    |           |
| Amortized cost   | \$ 13                    | \$ 11,711                                | \$ 6,504                                 | \$ 15,263          | \$ 33,491 |
| Estimated fair value                                   | 13                       | 12,447                                   | 7,266                                    | 16,276             | 36,002    |
| Weighted average yield <sup>(3)</sup>                  | 6.50%                    | 4.80%                                    | 5.53%                                    | 2.36%              | 3.83%     |
| Municipals: <sup>(2)</sup>                             |                          |  |  |                    |           |
| Amortized cost   | 3,614                    | 2,316                                    |  |                    | 5,930     |



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|                                       |       |       |           |
|---------------------------------------|-------|-------|-----------|
| Estimated fair value                  | 3,627 | 2,325 | 5,952     |
| Weighted average yield <sup>(3)</sup> | 5.85% | 5.75% | 5.92%     |
| Equity securities: <sup>(4)</sup>     |       |       |           |
| Amortized cost                        | 7,522 |       | 7,522     |
| Estimated fair value                  | 7,376 |       | 7,376     |
| Total available-for-sale securities:  |       |       |           |
| Amortized cost                        |       |       | \$ 46,943 |
| Estimated fair value                  |       |       | \$ 49,330 |

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|  | December 31, 2013     |                                    |                                    |                    | Total     |
|--|-----------------------|------------------------------------|------------------------------------|--------------------|-----------|
|  | Less Than<br>One Year | After One<br>Through<br>Five Years | After Five<br>Through<br>Ten Years | After Ten<br>Years |           |
| <b>Available-for-sale:</b>                                   |                       |                                    |                                    |                    |           |
| <b>Residential mortgage-backed securities:<sup>(1)</sup></b> |                       |                                    |                                    |                    |           |
| Amortized cost   | \$ 238                | \$ 14,720                          | \$ 7,718                           | \$ 16,110          | \$ 38,786 |
| Estimated fair value   | 252                   | 15,641                             | 8,456                              | 17,113             | 41,462    |
| Weighted average yield <sup>(3)</sup>                        | 4.32%                 | 4.78%                              | 5.56%                              | 2.40%              | 3.94%     |
| <b>Municipals:<sup>(2)</sup></b>                             |                       |                                    |                                    |                    |           |
| Amortized cost   | 7,749                 | 6,652                              |                                    |                    | 14,401    |
| Estimated fair value   | 7,818                 | 6,687                              |                                    |                    | 14,505    |
| Weighted average yield <sup>(3)</sup>                        | 5.76%                 | 5.71%                              |                                    |                    | 5.73%     |
| <b>Equity securities:<sup>(4)</sup></b>                      |                       |                                    |                                    |                    |           |
| Amortized cost   | 7,522                 |                                    |                                    |                    | 7,522     |
| Estimated fair value   | 7,247                 |                                    |                                    |                    | 7,247     |
| <b>Total available-for-sale securities:</b>                  |                       |                                    |                                    |                    |           |
| Amortized cost   |                       |                                    |                                    |                    | \$ 60,709 |
| Estimated fair value   |                       |                                    |                                    |                    | \$ 63,214 |

(1) Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

(2) Yields have been adjusted to a tax equivalent basis assuming a 35% federal tax rate.

(3) Yields are calculated based on amortized cost.

(4) These equity securities do not have a stated maturity.

Securities with carrying values of approximately \$37.5 million were pledged to secure certain borrowings and deposits at June 30, 2014. Of the pledged securities at June 30, 2014, approximately \$10.0 million were pledged for certain deposits, and approximately \$27.5 million were pledged for repurchase agreements.

The following table discloses, as of June 30, 2014 and December 31, 2013, our investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months (in thousands):

| June 30, 2014     | Less Than 12<br>Months |                    | 12 Months or<br>Longer |                    | Total         |                    |
|-------------------|------------------------|--------------------|------------------------|--------------------|---------------|--------------------|
|                   | Fair<br>Value          | Unrealized<br>Loss | Fair<br>Value          | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| Equity securities | \$                     | \$                 | \$ 6,343               | \$ (157)           | \$ 6,343      | \$ (157)           |
| December 31, 2013 | Less Than 12<br>Months |                    | 12 Months or<br>Longer |                    | Total         |                    |

|                   | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
|-------------------|------------|-----------------|------------|-----------------|------------|-----------------|
| Equity securities | \$ 7,247   | \$ (275)        | \$         | \$              | \$ 7,247   | \$ (275)        |

At June 30, 2014, there was one security with an unrealized loss position. This security is a publicly traded equity fund and is subject to market pricing volatility. We do not believe this unrealized loss is other than temporary. We have evaluated the near-term prospects of the investment in relation to the severity and duration of the impairment and based on that evaluation have the ability and intent to hold the investment until recovery of fair value. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on this security.

Unrealized gains or losses on our available-for-sale securities (after applicable income tax expense or benefit) are included in accumulated other comprehensive income (loss), net. Comprehensive income for the six months ended June 30, 2014 and 2013 included a net after-tax loss of \$77,000 and \$1.1 million, respectively, due to changes in the net unrealized gains/losses on securities available-for-sale.

**Table of Contents****(4) LOANS AND ALLOWANCE FOR LOAN LOSSES**

At June 30, 2014 and December 31, 2013, loans were as follows (in thousands):

|   | June 30,<br>2014     | December<br>31,<br>2013 |
|---|----------------------|-------------------------|
| Commercial  | \$ 5,295,368         | \$ 5,020,565            |
| Mortgage finance                                  | 3,700,253            | 2,784,265               |
| Construction                                      | 1,567,667            | 1,262,905               |
| Real estate                                       | 2,231,630            | 2,146,228               |
| Consumer  | 15,847               | 15,350                  |
| Leases  | 95,914               | 93,160                  |
| <b>Gross loans held for investment</b>            | <b>12,906,679</b>    | <b>11,322,473</b>       |
| Deferred income (net of direct origination costs) | (53,711)             | (51,899)                |
| Allowance for loan losses                         | (91,114)             | (87,604)                |
| <b>Total</b>                                      | <b>\$ 12,761,854</b> | <b>\$ 11,182,970</b>    |

*Commercial Loans and Leases.* Our commercial loan and lease portfolio is comprised of lines of credit for working capital and term loans and leases to finance equipment and other business assets. Our energy production loans are generally collateralized with proven reserves based on appropriate valuation standards. Our commercial loans and leases are underwritten after carefully evaluating and understanding the borrower's ability to operate profitably. Our underwriting standards are designed to promote relationship banking rather than making loans on a transactional basis. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually and are supported by accounts receivable, inventory, equipment and other assets of our clients' businesses.

*Mortgage Finance Loans.* Our mortgage finance loans consist of ownership interests purchased in single-family residential mortgages funded through our warehouse lending group. These interests are typically on our balance sheet for 10 to 20 days or less. We have agreements with mortgage lenders and purchase interests in individual loans they originate. All loans are underwritten consistent with established programs for permanent financing with financially sound investors. Substantially all loans are conforming loans. Balances are stated net of participations sold.

*Construction Loans.* Our construction loan portfolio consists primarily of single- and multi-family residential properties and commercial projects used in manufacturing, warehousing, service or retail businesses. Our construction loans generally have terms of one to three years. We typically make construction loans to developers, builders and contractors that have an established record of successful project completion and loan repayment and have a substantial equity investment in the borrowers. However, construction loans are generally based upon estimates of costs and value associated with the completed project. Sources of repayment for these types of loans may be pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from us until permanent financing is obtained. The nature of these loans makes ultimate repayment extremely sensitive to overall economic conditions. Borrowers may not be able to correct conditions of default in loans, increasing risk of exposure to classification, non-performing status, reserve allocation and actual credit loss and foreclosure. These loans typically have floating rates.

*Real Estate Loans.* A portion of our real estate loan portfolio is comprised of loans secured by properties other than market risk or investment-type real estate. Market risk loans are real estate loans where the primary source of repayment is expected to come from the sale, permanent financing or lease of the real property collateral. We generally provide temporary financing for commercial and residential property. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Our real estate loans generally have maximum terms of five to seven years, and we provide loans with both floating and fixed rates. We generally avoid long-term loans for commercial real estate held for investment. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Appraised values may be highly variable due to market conditions and the impact of the inability of potential purchasers and lessees to obtain financing and lack of transactions at comparable values.

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### **Portfolio Geographic Concentration**

As of June 30, 2014, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. The risks created by this concentration have been considered by management in the determination of the appropriateness of the allowance for loan losses. Management believes the allowance for loan losses is appropriate to cover probable losses inherent in the loan portfolio at each balance sheet date.

At June 30, 2014 and December 31, 2013, we had a blanket floating lien based on certain real estate loans used as collateral for Federal Home Loan Bank ( FHLB ) borrowings.

### **Summary of Loan Loss Experience**

The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an appropriate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than \$500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit, and any needed reserve is recorded in other liabilities. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management's judgment, should be charged off.

We have several pass credit grades that are assigned to loans based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to watch credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring. Within our criticized/classified credit grades are special mention, substandard, and doubtful. Special mention loans are those that are currently protected by the current sound worth and paying capacity of the borrower, but that are potentially weak and constitute an additional credit risk. The loan has the potential to deteriorate to a substandard grade due to the existence of financial or administrative deficiencies. Substandard loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Some substandard loans are insufficiently protected by the current sound worth and paying capacity of the borrower and of the collateral pledged and may be considered impaired. Substandard loans can be accruing or can be on non-accrual depending on the circumstances of the individual loans. Loans classified as doubtful have all the weaknesses inherent in substandard loans with the added characteristics 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. All doubtful loans are on nonaccrual.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors for such things as general economic conditions, changes in credit policies and lending standards. Historical loss rates are adjusted to account for current environmental conditions which we believe are likely to cause loss rates to be higher or lower than past experience. Each quarter we produce an adjustment range for environmental factors unique to us and our market.

Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve reflects the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered appropriate, given management's assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company's market areas and other factors.

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The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. The review of the reserve adequacy is performed by executive management and presented to a committee of our board of directors for their review. The committee reports to the board as part of the board's review on quarterly basis of the Company's consolidated financial statements.

The following tables summarize the credit risk profile of our loan portfolio by internally assigned grades and non-accrual status as of June 30, 2014 and December 31, 2013 (in thousands):

June 30, 2014

|  | Commercial          | Mortgage<br>Finance | Construction        | Real Estate         | Consumer         | Leases           | Total                |
|--|---------------------|---------------------|---------------------|---------------------|------------------|------------------|----------------------|
| <b>Grade:</b>                          |                     |                     |                     |                     |                  |                  |                      |
| Pass                                   | \$ 5,171,053        | \$ 3,700,253        | \$ 1,567,667        | \$ 2,195,165        | \$ 15,790        | \$ 91,205        | \$ 12,741,133        |
| Special mention                        | 38,450              |                     |                     | 9,218               |                  | 183              | 47,851               |
| Substandard-accruing                   | 60,320              |                     |                     | 11,249              | 57               | 4,504            | 76,130               |
| Non-accrual                            | 25,545              |                     |                     | 15,998              |                  | 22               | 41,565               |
| <b>Total loans held for investment</b> | <b>\$ 5,295,368</b> | <b>\$ 3,700,253</b> | <b>\$ 1,567,667</b> | <b>\$ 2,231,630</b> | <b>\$ 15,847</b> | <b>\$ 95,914</b> | <b>\$ 12,906,679</b> |

December 31, 2013

|  | Commercial          | Mortgage<br>Finance | Construction        | Real Estate         | Consumer         | Leases           | Total                |
|--|---------------------|---------------------|---------------------|---------------------|------------------|------------------|----------------------|
| <b>Grade:</b>                          |                     |                     |                     |                     |                  |                  |                      |
| Pass                                   | \$ 4,908,944        | \$ 2,784,265        | \$ 1,261,995        | \$ 2,099,450        | \$ 15,251        | \$ 89,317        | \$ 11,159,222        |
| Special mention                        | 24,132              |                     | 102                 | 6,338               |                  | 51               | 30,623               |
| Substandard-accruing                   | 74,593              |                     | 103                 | 21,770              | 45               | 3,742            | 100,253              |
| Non-accrual                            | 12,896              |                     | 705                 | 18,670              | 54               | 50               | 32,375               |
| <b>Total loans held for investment</b> | <b>\$ 5,020,565</b> | <b>\$ 2,784,265</b> | <b>\$ 1,262,905</b> | <b>\$ 2,146,228</b> | <b>\$ 15,350</b> | <b>\$ 93,160</b> | <b>\$ 11,322,473</b> |



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The following table details activity in the reserve for loan losses by portfolio segment for the six months ended June 30, 2014 and June 30, 2013. Allocation of a portion of the reserve to one category of loans does not preclude its availability to absorb losses in other categories.

June 30, 2014

| (in thousands)                              | Mortgage   |         | Real         |           | Leases | Unallocated | Total    |           |
|---|------------|---------|--------------|-----------|--------|-------------|----------|-----------|
|   | Commercial | Finance | Construction | Estate    |        |             |          | Consumer  |
| Beginning balance                           | \$ 39,868  | \$      | \$ 14,553    | \$ 24,210 | \$ 149 | \$ 3,105    | \$ 5,719 | \$ 87,604 |
| Provision for loan losses                   | 13,714     |         | 199          | (3,891)   | 114    | (1,930)     | (139)    | 8,067     |
| Charge-offs                                 | 7,526      |         |              | 296       | 101    |             |          | 7,923     |
| Recoveries                                  | 2,239      |         |              | 47        | 31     | 1,049       |          | 3,366     |
| Net charge-offs (recoveries)                | 5,287      |         |              | 249       | 70     | (1,049)     |          | 4,557     |
| Ending balance                              | \$ 48,295  | \$      | \$ 14,752    | \$ 20,070 | \$ 193 | \$ 2,224    | \$ 5,580 | \$ 91,114 |
| Period end amount allocated to:             |            |         |              |           |        |             |          |           |
| Loans individually evaluated for impairment | \$ 6,293   | \$      | \$           | \$ 722    | \$     | \$ 3        | \$       | \$ 7,018  |
| Loans collectively evaluated for impairment | 42,002     |         | 14,752       | 19,348    | 193    | 2,221       | 5,580    | 84,096    |
| Ending balance                              | \$ 48,295  | \$      | \$ 14,752    | \$ 20,070 | \$ 193 | \$ 2,224    | \$ 5,580 | \$ 91,114 |

June 30, 2013

| (in thousands)                              | Mortgage   |         | Real         |           | Leases | Unallocated | Total    |           |
|---|------------|---------|--------------|-----------|--------|-------------|----------|-----------|
|   | Commercial | Finance | Construction | Estate    |        |             |          | Consumer  |
| Beginning balance                           | \$ 21,547  | \$      | \$ 12,097    | \$ 30,893 | \$ 226 | \$ 2,460    | \$ 7,114 | \$ 74,337 |
| Provision for loan losses                   | 13,139     |         | 615          | (2,905)   | 11     | 343         | (2,528)  | 8,675     |
| Charge-offs                                 | 4,474      |         |              | 131       | 45     |             |          | 4,650     |
| Recoveries                                  | 745        |         |              | 15        | 45     | 261         |          | 1,066     |
| Net charge-offs (recoveries)                | 3,729      |         |              | 116       |        | (261)       |          | 3,584     |
| Ending balance                              | \$ 30,957  | \$      | \$ 12,712    | \$ 27,872 | \$ 237 | \$ 3,064    | \$ 4,586 | \$ 79,428 |
| Period end amount allocated to:             |            |         |              |           |        |             |          |           |
| Loans individually evaluated for impairment | \$ 2,934   | \$      | \$           | \$ 548    | \$ 1   | \$ 10       | \$       | \$ 3,493  |
| Loans collectively evaluated for impairment | 28,023     |         | 12,712       | 27,324    | 236    | 3,054       | 4,586    | 75,935    |

|                |           |    |           |          |        |          |          |          |
|----------------|-----------|----|-----------|----------|--------|----------|----------|----------|
| Ending balance | \$ 30,957 | \$ | \$ 12,712 | \$27,872 | \$ 237 | \$ 3,064 | \$ 4,586 | \$79,428 |
|----------------|-----------|----|-----------|----------|--------|----------|----------|----------|

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Our recorded investment in loans as of June 30, 2014, December 31, 2013 and June 30, 2013 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of our impairment methodology was as follows (in thousands):

June 30, 2014

|   | Commercial          | Mortgage<br>Finance | Construction        | Real Estate         | Consumer         | Leases           | Total                |
|---|---------------------|---------------------|---------------------|---------------------|------------------|------------------|----------------------|
| Loans individually evaluated for impairment | \$ 27,679           | \$                  | \$                  | \$ 19,790           | \$               | \$ 22            | \$ 47,491            |
| Loans collectively evaluated for impairment | 5,267,689           | 3,700,253           | 1,567,667           | 2,211,840           | 15,847           | 95,892           | 12,859,188           |
| <b>Total</b>                                | <b>\$ 5,295,368</b> | <b>\$ 3,700,253</b> | <b>\$ 1,567,667</b> | <b>\$ 2,231,630</b> | <b>\$ 15,847</b> | <b>\$ 95,914</b> | <b>\$ 12,906,679</b> |

December 31, 2013

|   | Commercial          | Mortgage<br>Finance | Construction        | Real Estate         | Consumer         | Leases           | Total                |
|---|---------------------|---------------------|---------------------|---------------------|------------------|------------------|----------------------|
| Loans individually evaluated for impairment | \$ 15,139           | \$                  | \$ 705              | \$ 24,028           | \$ 54            | \$ 50            | \$ 39,976            |
| Loans collectively evaluated for impairment | 5,005,426           | 2,784,265           | 1,262,200           | 2,122,200           | 15,296           | 93,110           | 11,282,497           |
| <b>Total</b>                                | <b>\$ 5,020,565</b> | <b>\$ 2,784,265</b> | <b>\$ 1,262,905</b> | <b>\$ 2,146,228</b> | <b>\$ 15,350</b> | <b>\$ 93,160</b> | <b>\$ 11,322,473</b> |

June 30, 2013

|   | Commercial          | Mortgage<br>Finance | Construction      | Real Estate         | Consumer         | Leases           | Total                |
|---|---------------------|---------------------|-------------------|---------------------|------------------|------------------|----------------------|
| Loans individually evaluated for impairment | \$ 19,475           | \$                  | \$                | \$ 23,666           | \$ 9             | \$ 65            | \$ 43,215            |
| Loans collectively evaluated for impairment | 4,451,387           | 2,838,234           | 969,071           | 1,991,378           | 24,017           | 77,046           | 10,351,133           |
| <b>Total</b>                                | <b>\$ 4,470,862</b> | <b>\$ 2,838,234</b> | <b>\$ 969,071</b> | <b>\$ 2,015,044</b> | <b>\$ 24,026</b> | <b>\$ 77,111</b> | <b>\$ 10,394,348</b> |

We have traditionally maintained an unallocated reserve component to allow for uncertainty in economic and other conditions affecting the quality of the loan portfolio. The unallocated portion of our loan loss reserve has remained consistent since December 31, 2013. We believe the level of unallocated reserves at June 30, 2014 is warranted due to the continued uncertain economic environment which has produced losses, including those resulting from fraud by

borrowers, that are not necessarily correlated with historical loss trends or general economic conditions. Our methodology used to calculate the allowance considers historical losses, however, the historical loss rates for specific product types or credit risk grades may not fully incorporate the effects of continued weakness in the economy.

Generally we place loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of June 30, 2014, \$480,000 of our non-accrual loans were earning on a cash basis. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The table below summarizes our non-accrual loans by type and purpose as of June 30, 2014 and December 31, 2013 (in thousands):

|                         | June 30,<br>2014 | December 31,<br>2013 |
|-------------------------|------------------|----------------------|
| Commercial              |                  |                      |
| Business loans          | \$ 24,245        | \$ 12,896            |
| Energy                  | 1,300            |                      |
| Construction            |                  |                      |
| Market risk             |                  | 705                  |
| Real estate             |                  |                      |
| Market risk             | 9,539            | 15,607               |
| Commercial              | 4,079            | 508                  |
| Secured by 1-4 family   | 2,380            | 2,555                |
| Consumer                |                  | 54                   |
| Leases                  | 22               | 50                   |
| Total non-accrual loans | \$ 41,565        | \$ 32,375            |

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As of June 30, 2014, non-accrual loans included in the table above included \$16.2 million related to loans that met the criteria for restructured compared to \$17.8 million at December 31, 2013.

A loan held for investment is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. In accordance with *ASC 310 Receivables*, we have also included all restructured loans in our impaired loan totals. The following tables detail our impaired loans, by portfolio class as of June 30, 2014 and December 31, 2013 (in thousands):

June 30, 2014

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| <b>With no related allowance recorded:</b>             |                        |                                |                      |                                   |                                  |
| <b>Commercial</b>                                      |                        |                                |                      |                                   |                                  |
| Business loans   | \$ 9,226               | \$ 11,475                      | \$                   | \$ 5,412                          | \$                               |
| Energy   | 425                    | 425                            |                      | 609                               |                                  |
| <b>Construction</b>                                    |                        |                                |                      |                                   |                                  |
| Market risk  |                        |                                |                      | 235                               |                                  |
| <b>Real estate</b>                                     |                        |                                |                      |                                   |                                  |
| Market risk  | 8,089                  | 8,089                          |                      | 9,936                             |                                  |
| Commercial   | 3,595                  | 3,595                          |                      | 2,023                             |                                  |
| Secured by 1-4 family                                  | 1,320                  | 1,320                          |                      | 1,320                             |                                  |
| <b>Consumer</b>  |                        |                                |                      |                                   |                                  |
| <b>Leases</b>  |                        |                                |                      |                                   |                                  |
| <b>Total impaired loans with no allowance recorded</b> | <b>\$ 22,655</b>       | <b>\$ 24,904</b>               | <b>\$</b>            | <b>\$ 19,535</b>                  | <b>\$</b>                        |
| <b>With an allowance recorded:</b>                     |                        |                                |                      |                                   |                                  |
| <b>Commercial</b>                                      |                        |                                |                      |                                   |                                  |
| Business loans   | \$ 17,153              | \$ 17,853                      | \$ 6,162             | \$ 17,163                         | \$                               |
| Energy   | 875                    | 875                            | 131                  | 987                               |                                  |
| <b>Construction</b>                                    |                        |                                |                      |                                   |                                  |
| <b>Market risk</b>                                     |                        |                                |                      |                                   |                                  |
| <b>Real estate</b>                                     |                        |                                |                      |                                   |                                  |
| Market risk  | 4,103                  | 4,103                          | 360                  | 5,332                             |                                  |
| Commercial   | 484                    | 484                            | 73                   | 918                               |                                  |
| Secured by 1-4 family                                  | 2,199                  | 2,231                          | 289                  | 2,335                             |                                  |
| <b>Consumer</b>  |                        |                                |                      |                                   |                                  |
| Leases   | 22                     | 22                             | 3                    | 41                                |                                  |
| <b>Total impaired loans with an allowance recorded</b> | <b>\$ 24,836</b>       | <b>\$ 25,568</b>               | <b>\$ 7,018</b>      | <b>\$ 26,798</b>                  | <b>\$</b>                        |
| <b>Combined:</b>                                       |                        |                                |                      |                                   |                                  |
| <b>Commercial</b>                                      |                        |                                |                      |                                   |                                  |
| Business loans   | \$ 26,379              | \$ 29,328                      | \$ 6,162             | \$ 22,575                         | \$                               |

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|                             |                  |                  |                 |                  |
|-----------------------------|------------------|------------------|-----------------|------------------|
| Energy                      | 1,300            | 1,300            | 131             | 1,596            |
| Construction                |                  |                  |                 |                  |
| Market risk                 |                  |                  |                 | 235              |
| Real estate                 |                  |                  |                 |                  |
| Market risk                 | 12,192           | 12,192           | 360             | 15,268           |
| Commercial                  | 4,079            | 4,079            | 73              | 2,941            |
| Secured by 1-4 family       | 3,519            | 3,551            | 289             | 3,655            |
| Consumer                    |                  |                  |                 | 22               |
| Leases                      | 22               | 22               | 3               | 41               |
| <b>Total impaired loans</b> | <b>\$ 47,491</b> | <b>\$ 50,472</b> | <b>\$ 7,018</b> | <b>\$ 46,333</b> |

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December 31, 2013

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| <b>With no related allowance recorded:</b>             |                        |                                |                      |                                   |                                  |
| <b>Commercial</b>                                      |                        |                                |                      |                                   |                                  |
| Business loans   | \$ 2,005               | \$ 2,005                       | \$                   | \$ 4,265                          | \$                               |
| Energy   | 1,614                  | 3,443                          |                      | 969                               |                                  |
| <b>Construction</b>                                    |                        |                                |                      |                                   |                                  |
| Market risk  | 705                    | 705                            |                      | 3,111                             | 114                              |
| <b>Real estate</b>                                     |                        |                                |                      |                                   |                                  |
| Market risk  | 13,524                 | 13,524                         |                      | 9,796                             |                                  |
| Commercial   | 508                    | 508                            |                      | 5,458                             |                                  |
| Secured by 1-4 family                                  | 1,320                  | 1,320                          |                      | 2,464                             |                                  |
| <b>Consumer</b>  |                        |                                |                      |                                   |                                  |
| <b>Leases</b>  |                        |                                |                      |                                   |                                  |
| <b>Total impaired loans with no allowance recorded</b> | <b>\$ 19,676</b>       | <b>\$ 21,505</b>               | <b>\$</b>            | <b>\$ 26,063</b>                  | <b>\$ 114</b>                    |
| <b>With an allowance recorded:</b>                     |                        |                                |                      |                                   |                                  |
| <b>Commercial</b>                                      |                        |                                |                      |                                   |                                  |
| Business loans   | \$ 11,060              | \$ 12,425                      | \$ 1,946             | \$ 14,240                         | \$                               |
| Energy   | 460                    | 460                            | 69                   | 913                               |                                  |
| <b>Construction</b>                                    |                        |                                |                      |                                   |                                  |
| Market risk  |                        |                                |                      | 160                               |                                  |
| <b>Real estate</b>                                     |                        |                                |                      |                                   |                                  |
| Market risk  | 6,289                  | 6,289                          | 822                  | 7,912                             |                                  |
| Commercial   |                        |                                |                      | 477                               |                                  |
| Secured by 1-4 family                                  | 2,387                  | 2,387                          | 321                  | 914                               |                                  |
| Consumer   | 54                     | 54                             | 8                    | 43                                |                                  |
| Leases   | 50                     | 50                             | 8                    | 72                                |                                  |
| <b>Total impaired loans with an allowance recorded</b> | <b>\$ 20,300</b>       | <b>\$ 21,665</b>               | <b>\$ 3,174</b>      | <b>\$ 24,731</b>                  | <b>\$</b>                        |
| <b>Combined:</b>                                       |                        |                                |                      |                                   |                                  |
| <b>Commercial</b>                                      |                        |                                |                      |                                   |                                  |
| Business loans   | \$ 13,065              | \$ 14,430                      | \$ 1,946             | \$ 18,505                         | \$                               |
| Energy   | 2,074                  | 3,903                          | 69                   | 1,882                             |                                  |
| <b>Construction</b>                                    |                        |                                |                      |                                   |                                  |
| Market risk  | 705                    | 705                            |                      | 3,271                             | 114                              |
| <b>Real estate</b>                                     |                        |                                |                      |                                   |                                  |
| Market risk  | 19,813                 | 19,813                         | 822                  | 17,708                            |                                  |
| Commercial   | 508                    | 508                            |                      | 5,935                             |                                  |
| Secured by 1-4 family                                  | 3,707                  | 3,707                          | 321                  | 3,378                             |                                  |
| Consumer   | 54                     | 54                             | 8                    | 43                                |                                  |
| Leases   | 50                     | 50                             | 8                    | 72                                |                                  |
| <b>Total impaired loans</b>                            | <b>\$ 39,976</b>       | <b>\$ 43,170</b>               | <b>\$ 3,174</b>      | <b>\$ 50,794</b>                  | <b>\$ 114</b>                    |





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Average impaired loans outstanding during the six months ended June 30, 2014 and 2013 totaled \$46.3 million and \$56.9 million, respectively.

The table below provides an age analysis of our past due loans that are still accruing as of June 30, 2014 (in thousands):

|  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>Than 90<br>Days and<br>Accruing <sup>(1)</sup> | Total Past<br>Due | Current              | Total                |
|--|------------------------|------------------------|---|-------------------|----------------------|----------------------|
| <b>Commercial</b>                      |                        |                        |   |                   |                      |                      |
| Business loans                         | \$ 16,215              | \$ 4,333               | \$ 4,793  | \$ 25,341         | \$ 4,282,751         | \$ 4,308,092         |
| Energy                                 | 2,170                  |                        |   | 2,170             | 959,561              | 961,731              |
| Mortgage finance loans                 |                        |                        |   |                   | 3,700,253            | 3,700,253            |
| <b>Construction</b>                    |                        |                        |   |                   |                      |                      |
| Market risk                            | 883                    |                        |   | 883               | 1,545,656            | 1,546,539            |
| Secured by 1-4 family                  |                        |                        |   |                   | 21,128               | 21,128               |
| <b>Real estate</b>                     |                        |                        |   |                   |                      |                      |
| Market risk                            | 8,328                  |                        |   | 8,328             | 1,645,288            | 1,653,616            |
| Commercial                             | 6,001                  |                        |   | 6,001             | 464,534              | 470,535              |
| Secured by 1-4 family                  | 261                    |                        |   | 261               | 91,220               | 91,481               |
| Consumer                               |                        |                        |   |                   | 15,847               | 15,847               |
| Leases                                 |                        |                        |   |                   | 95,892               | 95,892               |
| <b>Total loans held for investment</b> | <b>\$ 33,858</b>       | <b>\$ 4,333</b>        | <b>\$ 4,793</b>   | <b>\$ 42,984</b>  | <b>\$ 12,822,130</b> | <b>\$ 12,865,114</b> |

(1) Loans past due 90 days and still accruing includes premium finance loans of \$4.6 million. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower's financial difficulties, we have granted a concession that we would not otherwise consider for borrowers of similar credit quality. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or forgiveness of either principal or accrued interest. As of June 30, 2014 and December 31, 2013, we had \$249,000 and \$1.9 million, respectively, in loans considered restructured that are not on non-accrual. These loans did not have unfunded commitments at June 30, 2014 or December 31, 2013. Of the non-accrual loans at June 30, 2014 and December 31, 2013, \$16.2 million and \$17.8 million, respectively, met the criteria for restructured. These loans had no unfunded commitments at their respective balance sheet dates. A loan continues to qualify as restructured until a consistent payment history or change in borrower's financial condition has been evidenced, generally no less than twelve months. Assuming that the restructuring agreement specifies an interest rate at the time of the restructuring that is greater than or equal to the rate that we are willing to accept for a new extension of credit with comparable risk, then the loan no longer has to be considered a restructuring if it is in compliance with modified terms in calendar years after the year of the restructure.



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The following tables summarize, for the six months ended June 30, 2014 and 2013, loans that were restructured during 2014 and 2013 (in thousands):

| June 30, 2014                        | Number of<br>Restructured Loans    | Pre-Restructuring<br>Outstanding Recorded<br>Investment    | Post-Restructuring<br>Outstanding Recorded<br>Investment    |
|--------------------------------------|------------------------------------|--|---|
| Real estate commercial               | 1                                  | \$ 1,441   | \$ 1,430  |
| Total new restructured loans in 2014 | 1                                  | \$ 1,441   | \$ 1,430  |
| June 30, 2013                        | Number of<br>Restructured<br>Loans | Pre-Restructuring<br>Outstanding<br>Recorded<br>Investment | Post-Restructuring<br>Outstanding<br>Recorded<br>Investment |
| Commercial business loans            | 1                                  | \$ 1,945   | \$ 1,898  |
| Total new restructured loans in 2013 | 1                                  | \$ 1,945   | \$ 1,898  |

The restructured loans generally include terms to temporarily place loans on interest only, extend the payment terms or reduce the interest rate. We did not forgive any principal on the above loans. The restructuring of the loans did not have a significant impact on our allowance for loan losses at June 30, 2014 or 2013.

The following table provides information on how restructured loans were modified during the six months ended June 30, 2014 and 2013 (in thousands):

|   | Six months ended June 30, |                 |
|---|---------------------------|-----------------|
|   | 2014                      | 2013            |
| Extended maturity   | \$ 1,430                  | \$              |
| Combination of maturity extension and payment schedule adjustment |                           | 1,898           |
| <b>Total</b>  | <b>\$ 1,430</b>           | <b>\$ 1,898</b> |

As of June 30, 2014 and 2013, we did not have any loans that were restructured within the last 12 months that subsequently defaulted.

**(5) OREO AND VALUATION ALLOWANCE FOR LOSSES ON OREO**

The table below presents a summary of the activity related to OREO (in thousands):

|                              | Three months ended June 30, |           | Six months ended June 30, |           |
|------------------------------|-----------------------------|-----------|---------------------------|-----------|
|                              | 2014                        | 2013      | 2014                      | 2013      |
| Beginning balance            | \$ 2,420                    | \$ 14,426 | \$ 5,110                  | \$ 15,991 |
| Additions                    |                             | 912       | 851                       | 912       |
| Sales                        | (1,735)                     | (1,902)   | (5,276)                   | (3,396)   |
| Valuation allowance for OREO |                             | (164)     |                           | (164)     |
| Direct write-downs           |                             | (219)     |                           | (290)     |
| Ending balance               | \$ 685                      | \$ 13,053 | \$ 685                    | \$ 13,053 |

#### **(6) FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit which involve varying degrees of credit risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is

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represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the borrower.

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 many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit-worthiness on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The table below summarizes our off-balance sheet financial instruments whose contract amounts represented credit risk (in thousands):

|                              | June 30, 2014 | December 31, 2013 |
|------------------------------|---------------|-------------------|
| Commitments to extend credit | \$ 4,497,052  | \$ 3,674,391      |
| Standby letters of credit    | 173,531       | 145,662           |

**(7) REGULATORY MATTERS**

The Company and the 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 and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets, each as defined in the regulations. Management believes, as of June 30, 2014, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

Financial institutions are categorized as well capitalized or adequately capitalized, based on minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios. As shown in the table below, the Company's capital ratios exceed the regulatory definition of adequately capitalized as of June 30, 2014 and December 31, 2013. Based upon the information in its most recently filed call report, the Bank meets the capital ratios necessary to be well capitalized. The regulatory authorities can apply changes in classification of assets and such change may retroactively subject the Company to change in capital ratios. Any such change could result in reducing one or more capital ratios below well-capitalized status. In addition, a change may result in imposition of additional assessments by the FDIC or could result in regulatory actions that could have a material effect on condition and results of operations.

The table below summarizes our capital ratios:

|                     | June 30,<br>2014 | December 31,<br>2013 |
|---------------------|------------------|----------------------|
| <b>Company</b>      |                  |                      |
| Risk-based capital: |                  |                      |
| Tier 1 capital      | 9.09%            | 9.15%                |
| Total capital       | 11.67%           | 10.73%               |
| Leverage            | 10.94%           | 10.87%               |

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Dividends that may be paid by subsidiary banks are routinely restricted by various regulatory authorities. The amount that can be paid in any calendar year without prior approval of the Bank's regulatory agencies cannot exceed the lesser of the net profits (as defined) for that year plus the net profits for the preceding two calendar years, or retained earnings. The Basel III Capital Rules, effective for us on January 1, 2015, will further limit the amount of dividends that may be paid by our bank. No dividends were declared or paid on common stock during the six months ended June 30, 2014 or 2013.

On March 28, 2013, we completed a sale of 6.0 million shares of 6.5% non-cumulative preferred stock, par value \$0.01, with a liquidation preference of \$25 per share, in a public offering. Dividends on the preferred stock are not cumulative and will be paid when declared by our board of directors to the extent that we have lawfully available funds to pay dividends. If declared, dividends will accrue and be payable quarterly, in arrears, on the liquidation preference amount, on a non-cumulative basis, at a rate of 6.50% per annum. We paid \$4.9 million in dividends on the preferred stock for the six months ended June 30, 2014. Holders of preferred stock will not have voting rights, except with respect to authorizing or increasing the authorized amount of senior stock, certain changes in the terms of the preferred stock, certain dividend non-payments and as otherwise required by applicable law. Net proceeds from the sale totaled \$145.0 million. The additional equity was used for general corporate purposes, including funding regulatory capital infusions into the Bank.

During January 2014, we completed an offering of 1.9 million shares of our common stock. Net proceeds from the sale totaled \$106.5 million. On January 31, 2014, the Bank issued \$175.0 million of subordinated notes in an offering to institutional investors exempt from registration under Section 3(a)(2) of the Securities Act of 1933 and 12 C.F.R. Part 16. Net proceeds from the transaction were \$172.4 million. The notes mature in January 2026 and bear interest at a rate of 5.25% per annum, payable semi-annually. The notes are unsecured and are subordinate to the Bank's obligations to its deposits, its obligations under banker's acceptances and letters of credit, certain obligations to Federal Reserve Banks and the FDIC and the Bank's obligations to its other creditors, except any obligations which expressly rank on a parity with or junior to the notes. The notes are expected to qualify as Tier 2 capital for regulatory capital purposes, subject to applicable limitations. The net proceeds of both offerings were available to the Company for general corporate purposes, including retirement of \$15.0 million of short-term debt that was outstanding at December 31, 2013, and additional capital to support continued loan growth.

**(8) STOCK-BASED COMPENSATION**

The fair value of our stock option and stock appreciation right (SAR) grants are estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide the best single measure of the fair value of our employee stock options.

Stock-based compensation consists of SARs and RSUs granted from 2007 through 2013.

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| (in thousands)                                       | Three months ended June 30, |        | Six months ended June 30, |          |
|--|-----------------------------|--------|---------------------------|----------|
|  | 2014                        | 2013   | 2014                      | 2013     |
| <b>Stock- based compensation expense recognized:</b> |                             |        |                           |          |
| SARs   | \$ 148                      | \$ 134 | \$ 291                    | \$ 282   |
| RSUs   | 1,118                       | 804    | 2,237                     | 1,561    |
| Total compensation expense recognized                | \$ 1,266                    | \$ 938 | \$ 2,528                  | \$ 1,843 |

| (in thousands)  | June 30, 2014 |               |
|---|---------------|---------------|
|   | Options       | SARs and RSUs |
| Unrecognized compensation expense related to unvested awards                      | \$            | \$ 12,252     |
| Weighted average period over which expense is expected to be recognized, in years | N/A           | 3.6           |

In connection with the 2010 Long-term Incentive Plan, the Company has issued cash-based performance units. A summary of the compensation cost for these units is as follows (in thousands):

| Cash-based performance units | Three months ended June 30, |          | Six months ended June 30, |          |
|------------------------------|-----------------------------|----------|---------------------------|----------|
|                              | 2014                        | 2013     | 2014                      | 2013     |
|                              | \$ 1,312                    | \$ 8,368 | \$ 4,705                  | \$ 9,407 |

**(9) DISCONTINUED OPERATIONS**

Subsequent to the end of the first quarter of 2007, we and the purchaser of our residential mortgage loan division ( RML ) agreed to terminate and settle the contractual arrangements related to the sale of the division, which had been completed as of the end of the third quarter of 2006. Historical operating results of RML are reflected as discontinued operations in the financial statements.

We hold approximately \$290,000 in loans held for sale from discontinued operations that are carried at the estimated market value at quarter-end, which is less than the original cost. We plan to sell these loans, but timing and price to be realized cannot be determined at this time due to market conditions. In addition, we continue to address requests from investors related to repurchasing loans previously sold. While the balances as of June 30, 2014 include a liability for exposure to additional contingencies, including the risk of having to repurchase loans previously sold, we recognize that market conditions may result in additional exposure to loss and the extension of time necessary to complete the discontinued mortgage operation.

**(10) FAIR VALUE DISCLOSURES**

ASC 820, *Fair Value Measurements and Disclosures* ( ASC 820 ), defines fair value, establishes a framework for measuring fair value under GAAP and requires enhanced disclosures about fair value measurements. Fair value is defined under ASC 820 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date.



We determine the fair market values of our assets and liabilities measured at fair value on a recurring and nonrecurring basis using the fair value hierarchy as prescribed in ASC 820. The standard describes three levels of inputs that may be used to measure fair value as provided below.

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include U.S. government and agency mortgage-backed debt securities,

municipal bonds, and Community Reinvestment Act funds. This category includes derivative assets and liabilities where values are obtained from independent pricing services.

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Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include 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 values requires significant management judgment or estimation. This category includes impaired loans and OREO where collateral values have been based on third party appraisals; however, due to current economic conditions, comparative sales data typically used in appraisals may be unavailable or more subjective due to lack of market activity.

Assets and liabilities measured at fair value at June 30, 2014 and December 31, 2013 are as follows (in thousands):

| June 30, 2014                                 | Fair Value Measurements |           |         |
|---|-------------------------|-----------|---------|
|   | Level 1                 | Level 2   | Level 3 |
| Available for sale securities: <sup>(1)</sup> |                         |           |         |
| Residential mortgage-backed securities        | \$                      | \$ 36,002 | \$      |
| Municipals                                    |                         | 5,952     |         |
| Equity securities <sup>(2)</sup>              |                         | 7,376     |         |
| Loans <sup>(3) (5)</sup>                      |                         |           | 24,068  |
| OREO <sup>(4) (5)</sup>                       |                         |           | 685     |
| Derivative assets <sup>(6)</sup>              |                         | 24,453    |         |
| Derivative liabilities <sup>(6)</sup>         |                         | (24,453)  |         |
| December 31, 2013                             |                         |           |         |
| Available for sale securities: <sup>(1)</sup> |                         |           |         |
| Residential mortgage-backed securities        | \$                      | \$ 41,462 | \$      |
| Municipals                                    |                         | 14,505    |         |
| Equity securities <sup>(2)</sup>              |                         | 7,247     |         |
| Loans <sup>(3) (5)</sup>                      |                         |           | 13,474  |
| OREO <sup>(4) (5)</sup>                       |                         |           | 5,110   |
| Derivative assets <sup>(6)</sup>              |                         | 9,317     |         |
| Derivative liabilities <sup>(6)</sup>         |                         | (9,317)   |         |

(1) Securities are measured at fair value on a recurring basis, generally monthly.

(2) Equity securities consist of Community Reinvestment Act funds.

(3) Includes impaired loans that have been measured for impairment at the fair value of the loan's collateral.

(4) OREO is transferred from loans to OREO at fair value less selling costs.

(5) Fair value of loans and OREO is measured on a nonrecurring basis, generally annually or more often as warranted by market and economic conditions.

(6) Derivative assets and liabilities are measured at fair value on a recurring basis, generally quarterly.

**Level 3 Valuations**

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. Currently, we measure fair value for certain loans and OREO on a nonrecurring basis as described below.

*Loans*

During the three months and six months ended June 30, 2014, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses based upon the fair value of the underlying collateral. The \$24.1 million total above includes impaired loans at June 30, 2014 with a carrying value of \$29.2 million that were reduced by specific allowance allocations totaling \$5.1 million for a total reported fair value of \$24.1 million based on collateral valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals.

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Certain foreclosed assets, upon initial recognition, are valued based on third party appraisals less estimated selling costs. At June 30, 2014, OREO had a carrying value of \$685,000 with no specific valuation allowance. The fair value of OREO was computed based on third party appraisals, which are Level 3 valuation inputs.

**Fair Value of Financial Instruments**

Generally accepted accounting principles require disclosure of fair value information about financial instruments, whether or not recognized on the balance sheet, for which it is practical to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. This disclosure does not and is not intended to represent the fair value of the Company.

A summary of the carrying amounts and estimated fair values of financial instruments is as follows (in thousands):

|  | June 30, 2014   |                      | December 31, 2013 |                      |
|--|-----------------|----------------------|-------------------|----------------------|
|  | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| Cash and cash equivalents                        | \$ 357,142      | \$ 357,142           | \$ 153,911        | \$ 153,911           |
| Securities, available-for-sale                   | 49,330          | 49,330               | 63,214            | 63,214               |
| Loans held for sale from discontinued operations | 290             | 290                  | 294               | 294                  |
| Loans held for investment, net                   | 12,761,854      | 12,766,383           | 11,182,970        | 11,179,145           |
| Derivative assets                                | 24,453          | 24,453               | 9,317             | 9,317                |
| Deposits   | 10,757,316      | 10,757,495           | 9,257,379         | 9,257,574            |
| Federal funds purchased                          | 273,041         | 273,041              | 148,650           | 148,650              |
| Customer repurchase agreements                   | 27,491          | 27,491               | 21,954            | 21,954               |
| Other borrowings                                 | 700,016         | 700,016              | 855,026           | 855,026              |
| Subordinated notes                               | 286,000         | 286,066              | 111,000           | 96,647               |
| Trust preferred subordinated debentures          | 113,406         | 113,406              | 113,406           | 113,406              |
| Derivative liabilities                           | 24,453          | 24,453               | 9,317             | 9,317                |

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

*Cash and cash equivalents*

The carrying amounts reported in the consolidated balance sheet for cash and cash equivalents approximate their fair value, which is characterized as a Level 1 asset in the fair value hierarchy.

*Securities*

The fair value of investment securities is based on prices obtained from independent pricing services which are based on quoted market prices for the same or similar securities, which is characterized as a Level 2 asset in the fair value hierarchy. We have obtained documentation from the primary pricing service we use about their processes and

controls over pricing. In addition, on a quarterly basis we independently verify the prices that we receive from the service provider using two additional independent pricing sources. Any significant differences are investigated and resolved.

*Loans, net*

Loans are characterized as Level 3 assets in the fair value hierarchy. For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are generally based on carrying values. The fair value for all other loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest approximates its fair value. The carrying amount of loans held for sale approximates fair value.

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### *Derivatives*

The estimated fair value of the interest rate swaps are obtained from independent pricing services based on quote market prices for the same or similar derivative contracts and are characterized as a Level 2 asset in the fair value hierarchy. On a quarterly basis, we independently verify the fair value using an additional independent pricing source.

### *Deposits*

Deposits are characterized as Level 3 liabilities in the fair value hierarchy. The carrying amounts for variable-rate money market accounts approximate their fair value. Fixed-term certificates of deposit fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

### *Federal funds purchased, customer repurchase agreements, other borrowings, subordinated notes and trust preferred subordinated debentures*

The carrying value reported in the consolidated balance sheet for Federal funds purchased, customer repurchase agreements and other short-term, floating rate borrowings approximates their fair value, which is characterized as a Level 1 asset in the fair value hierarchy. The fair value of any fixed rate short-term borrowings and trust preferred subordinated debentures are estimated using a discounted cash flow calculation that applies interest rates currently being offered on similar borrowings, which is characterized as a Level 3 liability in the fair value hierarchy. The subordinated notes are publicly traded and are valued based on market prices, which is characterized as a Level 2 liability in the fair value hierarchy.

## **(11) DERIVATIVE FINANCIAL INSTRUMENTS**

The fair value of derivative positions outstanding is included in other assets and other liabilities in the accompanying consolidated balance sheets.

During 2014 and 2013, we entered into certain interest rate derivative positions that are not designated as hedging instruments. These derivative positions relate to transactions in which we enter into an interest rate swap, cap and/or floor with a customer while at the same time entering into an offsetting interest rate swap, cap and/or floor with another financial institution. In connection with each swap transaction, we agree to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, we agree to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows our customer to effectively convert a variable rate loan to a fixed rate. Because we act as an intermediary for our customer, changes in the fair value of the underlying derivative contracts substantially offset each other and do not have a material impact on our results of operations.

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The notional amounts and estimated fair values of interest rate derivative positions outstanding at June 30, 2014 and December 31, 2013 are presented in the following tables (in thousands):

|  | June 30, 2014   |                      | December 31, 2013 |                      |
|--|-----------------|----------------------|-------------------|----------------------|
|  | Notional Amount | Estimated Fair Value | Notional Amount   | Estimated Fair Value |
| <b>Non-hedging interest rate derivative:</b> |                 |                      |                   |                      |
| Commercial loan/lease interest rate swaps    | \$ 835,562      | \$ 23,422            | \$ 764,939        | \$ 8,652             |
| Commercial loan/lease interest rate swaps    | (835,562)       | (23,422)             | (764,939)         | (8,652)              |
| Commercial loan/lease interest rate caps     | (54,428)        | (1,031)              | (58,706)          | (665)                |
| Commercial loan/lease interest rate caps     | 54,428          | 1,031                | 58,706            | 665                  |

The weighted-average receive and pay interest rates for interest rate swaps outstanding at June 30, 2014 were as follows:

|                                 | June 30, 2014                           |                                     | December 31, 2013                       |                                     |
|---------------------------------|---|-------------------------------------|---|-------------------------------------|
|                                 | Weighted-Average Interest Rate Received | Weighted-Average Interest Rate Paid | Weighted-Average Interest Rate Received | Weighted-Average Interest Rate Paid |
| Non-hedging interest rate swaps | 4.84%                                   | 2.85%                               | 2.99%                                   | 4.89%                               |

The weighted-average strike rate for outstanding interest rate caps was 1.51% at June 30, 2014 and 1.87% at December 31, 2013.

Our credit exposure on interest rate swaps and caps is limited to the net favorable value and interest payments of all swaps and caps by each counterparty. In such cases collateral may be required from the counterparties involved if the net value of the swaps and caps exceeds a nominal amount considered to be immaterial. Our credit exposure, net of any collateral pledged, relating to interest rate swaps and caps was approximately \$24.5 million at June 30, 2014 and approximately \$9.3 million at December 31, 2013, all of which relates to bank customers. Collateral levels are monitored and adjusted on a regular basis for changes in interest rate swap and cap values. At June 30, 2014 and December 31, 2013, we had \$23.5 million and \$10.7 million, respectively, in cash collateral pledged for these derivatives included in interest-bearing deposits.

**(12) STOCKHOLDERS EQUITY**

On March 28, 2013, we completed a sale of 6.0 million shares of 6.5% non-cumulative preferred stock, par value \$0.01, with a liquidation preference of \$25 per share, in a public offering. Dividends on the preferred stock are not cumulative and will be paid if and when declared by our board of directors to the extent that we have lawfully available funds to pay dividends. If declared, dividends will accrue and be payable quarterly, in arrears, on the liquidation preference amount, on a non-cumulative basis, at a rate of 6.50% per annum. For the six months ended June 30, 2014, we paid \$4.9 million in dividends on the preferred stock. Holders of preferred stock do not have voting rights, except with respect to authorizing or increasing the authorized amount of senior stock, certain changes in the terms of the preferred stock, certain dividend non-payments and as otherwise required by applicable law. Net proceeds from the sale totaled \$145.0 million. The proceeds were used for general corporate purposes, including funding regulatory capital infusions into the Bank.

During January 2014, we completed an offering of 1.9 million shares of our common stock. Net proceeds from the sale totaled \$106.5 million. The net proceeds of the offering were available to the Company for general corporate purposes, including retirement of \$15.0 million of short-term debt that was outstanding at December 31, 2013, and additional capital to support continued loan growth.

**(13) NEW ACCOUNTING PRONOUNCEMENTS**

*ASU 2014-04 Receivables (Topic 310) Troubled Debt Restructurings by Creditors* ( *ASU 2014-04* ) amends Topic 310 *Receivables* to clarify the terms defining when an in substance repossession or foreclosure occurs, which determines when the receivable should be derecognized and the real estate property is recognized. ASU 2013-04 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. It is not expected to have a significant impact on our financial statements.



**Table of Contents****QUARTERLY FINANCIAL SUMMARY UNAUDITED**

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

|  | For the three months ended<br>June 30, 2014 |                                    |                | For the three months ended<br>June 30, 2013 |                                    |                |
|--|---|------------------------------------|----------------|---|------------------------------------|----------------|
|  | Average<br>Balance                          | Revenue/<br>Expense <sup>(1)</sup> | Yield/<br>Rate | Average<br>Balance                          | Revenue/<br>Expense <sup>(1)</sup> | Yield/<br>Rate |
| <b>Assets</b>  |   |                                    |                |   |                                    |                |
| Securities taxable                                   | \$ 44,216                                   | \$ 410                             | 3.72%          | \$ 60,063                                   | \$ 594                             | 3.97%          |
| Securities non-taxable <sup>(2)</sup>                | 6,271                                       | 94                                 | 6.01%          | 18,843                                      | 275                                | 5.85%          |
| Federal funds sold                                   | 14,997                                      | 8                                  | 0.21%          | 54,448                                      | 13                                 | 0.10%          |
| Deposits in other banks                              | 183,061                                     | 100                                | 0.22%          | 91,177                                      | 60                                 | 0.26%          |
| Loans held for investment, mortgage<br>finance loans | 2,822,560                                   | 23,231                             | 3.30%          | 2,406,246                                   | 22,440                             | 3.74%          |
| Loans held for investment                            | 8,984,230                                   | 101,003                            | 4.51%          | 7,152,323                                   | 83,978                             | 4.71%          |
| Less reserve for loan losses                         | 90,105                                      |                                    |                | 75,006                                      |                                    |                |
| Loans, net of reserve                                | 11,716,685                                  | 124,234                            | 4.25%          | 9,483,563                                   | 106,418                            | 4.50%          |
| Total earning assets                                 | 11,965,230                                  | 124,846                            | 4.19%          | 9,708,094                                   | 107,360                            | 4.44%          |
| Cash and other assets                                | 396,938                                     |                                    |                | 402,898                                     |                                    |                |
| Total assets   | \$ 12,362,168                               |                                    |                | \$ 10,110,992                               |                                    |                |
| <b>Liabilities and Stockholders Equity</b>           |   |                                    |                |   |                                    |                |
| Transaction deposits                                 | \$ 895,827                                  | \$ 170                             | 0.08%          | \$ 1,051,199                                | \$ 233                             | 0.09%          |
| Savings deposits                                     | 4,679,140                                   | 3,395                              | 0.29%          | 3,340,420                                   | 2,292                              | 0.28%          |
| Time deposits  | 401,024                                     | 390                                | 0.39%          | 397,868                                     | 407                                | 0.41%          |
| Deposits in foreign branches                         | 350,043                                     | 291                                | 0.33%          | 340,713                                     | 296                                | 0.35%          |
| Total interest bearing deposits                      | 6,326,034                                   | 4,246                              | 0.27%          | 5,130,200                                   | 3,228                              | 0.25%          |
| Other borrowings                                     | 666,405                                     | 300                                | 0.18%          | 727,158                                     | 354                                | 0.20%          |
| Subordinated notes                                   | 286,000                                     | 4,241                              | 5.95%          | 111,000                                     | 1,829                              | 6.61%          |
| Trust preferred subordinated debentures              | 113,406                                     | 619                                | 2.19%          | 113,406                                     | 633                                | 2.24%          |
| Total interest bearing liabilities                   | 7,391,845                                   | 9,406                              | 0.51%          | 6,081,764                                   | 6,044                              | 0.40%          |
| Demand deposits                                      | 3,629,941                                   |                                    |                | 2,914,341                                   |                                    |                |
| Other liabilities                                    | 98,595                                      |                                    |                | 91,608                                      |                                    |                |
| Stockholders equity                                  | 1,241,787                                   |                                    |                | 1,023,279                                   |                                    |                |
| Total liabilities and stockholders equity            | \$ 12,362,168                               |                                    |                | \$ 10,110,992                               |                                    |                |
| Net interest income <sup>(2)</sup>                   |   | \$ 115,440                         |                |   | \$ 101,316                         |                |

|  |    |       |       |       |       |
|--|----|-------|-------|-------|-------|
| Net interest margin                                  |    | 3.87% |       | 4.19% |       |
| Net interest spread                                  |    | 3.67% |       | 4.04% |       |
| Loan spread  |    | 4.08% |       | 4.34% |       |
| Additional information from discontinued operations: |    |       |       |       |       |
| Loans held for sale                                  | \$ | 291   | \$    | 299   |       |
| Borrowed funds                                       |    | 291   |       | 299   |       |
| Net interest income                                  |    | \$    | 7     | \$    | 6     |
| Net interest margin consolidated                     |    |       | 3.87% |       | 4.19% |

- (1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.
- (2) Taxable equivalent rates used where applicable.

**Table of Contents****QUARTERLY FINANCIAL SUMMARY UNAUDITED**

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

|  | For the six months ended<br>June 30, 2014 |                                    |                | For the six months ended<br>June 30, 2013 |                                    |                |
|--|---|------------------------------------|----------------|---|------------------------------------|----------------|
|  | Average<br>Balance                        | Revenue/<br>Expense <sup>(1)</sup> | Yield/<br>Rate | Average<br>Balance                        | Revenue/<br>Expense <sup>(1)</sup> | Yield/<br>Rate |
| <b>Assets</b>                              |   |                                    |                |   |                                    |                |
| Securities taxable                         | \$ 45,614                                 | \$ 852                             | 3.77%          | \$ 65,611                                 | \$ 1,323                           | 4.07%          |
| Securities non-taxable <sup>(2)</sup>      | 8,401                                     | 245                                | 5.88%          | 20,499                                    | 598                                | 5.88%          |
| Federal funds sold                         | 44,209                                    | 48                                 | 0.22%          | 39,698                                    | 19                                 | 0.10%          |
| Deposits in other banks                    | 206,548                                   | 259                                | 0.25%          | 84,982                                    | 112                                | 0.27%          |
| Loans held for sale                        | 2,427,109                                 | 40,013                             | 3.32%          | 2,384,566                                 | 45,081                             | 3.81%          |
| Loans held for investment                  | 8,851,835                                 | 200,093                            | 4.56%          | 6,998,400                                 | 164,519                            | 4.74%          |
| Less reserve for loan losses               | 88,902                                    |                                    |                | 74,726                                    |                                    |                |
| Loans, net of reserve                      | 11,190,042                                | 240,106                            | 4.33%          | 9,308,240                                 | 209,600                            | 4.54%          |
| Total earning assets                       | 11,494,814                                | 241,510                            | 4.24%          | 9,519,030                                 | 211,652                            | 4.48%          |
| Cash and other assets                      | 389,608                                   |                                    |                | 402,299                                   |                                    |                |
| Total assets                               | \$ 11,884,422                             |                                    |                | \$ 9,921,329                              |                                    |                |
| <b>Liabilities and Stockholders Equity</b> |   |                                    |                |   |                                    |                |
| Transaction deposits                       | \$ 839,378                                | \$ 250                             | 0.06%          | \$ 1,027,598                              | \$ 486                             | 0.10%          |
| Savings deposits                           | 4,635,559                                 | 6,699                              | 0.29%          | 3,293,806                                 | 4,589                              | 0.28%          |
| Time deposits                              | 388,364                                   | 741                                | 0.38%          | 400,476                                   | 821                                | 0.41%          |
| Deposits in foreign branches               | 352,934                                   | 586                                | 0.33%          | 338,004                                   | 577                                | 0.34%          |
| Total interest bearing deposits            | 6,216,235                                 | 8,276                              | 0.27%          | 5,059,884                                 | 6,473                              | 0.26%          |
| Other borrowings                           | 480,740                                   | 471                                | 0.20%          | 883,497                                   | 783                                | 0.18%          |
| Subordinated notes                         | 256,995                                   | 7,720                              | 6.06%          | 111,000                                   | 3,658                              | 6.65%          |
| Trust preferred subordinated debentures    | 113,406                                   | 1,235                              | 2.20%          | 113,406                                   | 1,267                              | 2.25%          |
| Total interest bearing liabilities         | 7,067,376                                 | 17,702                             | 0.51%          | 6,167,787                                 | 12,181                             | 0.40%          |
| Demand deposits                            | 3,506,407                                 |                                    |                | 2,723,196                                 |                                    |                |
| Other liabilities                          | 101,040                                   |                                    |                | 91,076                                    |                                    |                |
| Stockholders equity                        | 1,209,599                                 |                                    |                | 939,270                                   |                                    |                |
| Total liabilities and stockholders equity  | \$ 11,884,422                             |                                    |                | \$ 9,921,329                              |                                    |                |
| Net interest income <sup>(2)</sup>         |   | \$ 223,808                         |                |   | \$ 199,471                         |                |

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|  |    |       |       |       |       |
|--|----|-------|-------|-------|-------|
| Net interest margin                                  |    | 3.93% |       | 4.23% |       |
| Net interest spread                                  |    | 3.73% |       | 4.08% |       |
| Loan spread  |    | 4.16% |       | 4.37% |       |
| Additional information from discontinued operations: |    |       |       |       |       |
| Loans held for sale                                  | \$ | 292   | \$    | 300   |       |
| Borrowed funds                                       |    | 292   |       | 300   |       |
| Net interest income                                  |    | \$    | 14    | \$    | 12    |
| Net interest margin consolidated                     |    |       | 3.93% |       | 4.23% |

- (1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.
- (2) Taxable equivalent rates used where applicable.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

***Forward-Looking Statements***

Statements and financial analysis contained in this report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements may be contained in our future filings with SEC, in press releases, and in oral and written statements made by us or with our approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Forward-looking statements describe our future plans, strategies and expectations and are based on certain assumptions. Words such as believes, anticipates, plans, goals, objectives, expects, intends, seeks, likely, targeted, continue, remain, will, should, may and other similar expressions are used to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements are subject to various risks and uncertainties, which change over time, are based on management's expectations and assumptions at the time the statements are made and are not guarantees of future results. Important factors that could cause actual results to differ materially from the forward-looking statements are disclosed under the heading Risk Factors in our 2013 Form 10-K and include, but are not limited to, the following:

Deterioration of the credit quality of our loan portfolio, increased default rates and loan losses or adverse changes in the industry concentrations of our loan portfolio.

Developments adversely affecting our commercial, entrepreneur and professional customers.

Changes in the value of commercial and residential real estate securing our loans or in the demand for credit to support the purchase and ownership of such assets.

The failure of assumptions supporting our allowance for loan losses causing it to become inadequate as loan quality decreases and losses and charge-offs increase.

A failure to effectively manage our interest rate risk resulting from unexpectedly large or sudden changes in interest rates or rate or maturity imbalances in our assets and liabilities, where such changes could affect the results of operations.

Failure to execute our business strategy, including any inability to expand into new markets and lines of business in Texas, regionally and nationally.

Loss of access to capital market transactions and other sources of funding, or a failure to effectively balance our funding sources with cash demands by depositors and borrowers.

Failure to successfully develop and launch new lines of business and new products and services within the expected time frames and budgets, or failure to anticipate and appropriately manage the associated risks.

The failure to attract and retain key personnel or the loss of key individuals or groups of employees.

Changes in the U.S. economy in general or the Texas economy specifically resulting in deterioration of credit quality or reduced demand for credit or other financial services we offer.

Legislative and regulatory changes imposing further restrictions and costs on our business, a failure to remain well capitalized or regulatory enforcement actions against us.

An increase in the incidence or severity of fraud, illegal payments, security breaches and other illegal acts impacting our bank and our customers.

Structural changes in the markets for origination, sale and servicing of residential mortgages.

Increased or more effective competition from banks and other financial service providers in our markets.

Material failures of our accounting estimates and risk management processes based on management judgment, or the supporting analytical and forecasting models.

Unavailability of funds obtained from capital transactions or from our bank to fund our obligations.

Failures of counterparties or third party vendors to perform their obligations.

Failures or breaches of our information systems that are not effectively managed.

Severe weather, natural disasters, acts of war or terrorism and other external events.

Incurrence of material costs and liabilities associated with claims and litigation.

Failure of our risk management strategies and procedures, including failure or circumvention of our controls.

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Actual outcomes and results may differ materially from what is expressed in our forward-looking statements and from our historical financial results due to the factors discussed elsewhere in this report or disclosed in our other SEC filings. Forward-looking statements included herein should not be relied upon as representing our expectations or beliefs as of any date subsequent to the date of this report. Except as required by law, we undertake no obligation to update or revise any forward-looking statements contained in this report or our other SEC filings, whether as a result of new information, future events or otherwise. The factors discussed herein are not intended to be a complete summary of all risks and uncertainties that may affect our businesses. Though we strive to monitor and mitigate risk, we cannot anticipate all potential economic, operational and financial developments that may adversely impact our operations and our financial results. Forward-looking statements should not be viewed as predictions and should not be the primary basis upon which investors evaluate an investment in our securities.

**Overview of Our Business Operations**

We commenced our banking operations in December 1998. An important aspect of our growth strategy has been our ability to service and effectively manage a large number of loans and deposit accounts in multiple markets in Texas. Accordingly, we have created an operations infrastructure sufficient to support state-wide lending and banking operations that we continue to build out as needed to serve a larger customer base and specialized industries.

The following discussion and analysis presents the significant factors affecting our financial condition as of June 30, 2014 and December 31, 2013 and results of operations for three and six months in the periods ended June 30, 2014 and 2013. This discussion should be read in conjunction with our consolidated financial statements and notes to the financial statements appearing in Part I, Item 1 of this report.

Except as otherwise noted, all amounts and disclosures throughout this document reflect continuing operations. See Part I, Item 1 herein for a discussion of discontinued operations and at Note 9 Discontinued Operations.

***Results of Operations*****Summary of Performance**

We reported net income of \$33.4 million and net income available to common stockholders of \$31.0 million, or \$0.71 per diluted common share, for the second quarter of 2014 compared to net income of \$24.1 million and net income available to common stockholders of \$21.6 million, or \$0.52 per diluted common share, for the second quarter of 2013. Return on average common equity ( ROE ) was 11.38% and return on average assets was 1.08% for the second quarter of 2014, compared to 9.94% and 0.95%, respectively, for the second quarter of 2013. Net income and net income available to common stockholders for the six months ended June 30, 2014 totaled \$61.7 million and \$56.8 million, respectively, or \$1.30 per diluted common share, compared to net income and net income available to common stockholders of \$57.2 million and \$54.7 million, respectively, or \$1.31 per diluted common share, for the same period in 2013. Return on average common equity was 10.81% and return on average assets was 1.05% for the six months ended June 30, 2014, compared to 11.74% and 1.36%, respectively, for the six months ended June 30, 2013. During January 2014, we completed an equity offering of 1.9 million shares, which increased diluted shares. We also completed a \$175.0 million subordinated debt offering, which resulted in an additional \$3.9 million in interest expense for the six months ended June 30, 2014. The sale of 1.9 million common shares during the first quarter of 2014 increased common equity by \$106.5 million and had the effect of reducing ROE.

Net income increased \$9.3 million, or 39%, for the three months ended June 30, 2014 as compared to the same period in 2013. The increase was primarily the result of a \$14.2 million increase in net interest income and a \$3.0 million decrease in the provision for credit losses, offset by a \$595,000 decrease in non-interest income, a \$1.0 million

increase in non-interest expense and a \$6.2 million increase in income tax expense. Net income increased \$4.5 million, or 8%, during the six months ended June 30, 2014 primarily as the result of a \$24.5 million increase in net interest income offset by a \$1.5 million decrease in non-interest income, a \$14.7 million increase in non-interest expense and a \$3.8 million increase in income tax expense.

Details of the changes in the various components of net income are further discussed below.



**Table of Contents****Net Interest Income**

Net interest income was \$115.4 million for the second quarter of 2014, compared to \$101.2 million for the second quarter of 2013. The increase was due to an increase in average earning assets of \$2.3 billion as compared to the second quarter of 2013. The increase in average earning assets included a \$2.2 billion increase in average net loans and a \$52.4 million increase in average liquidity assets, offset by a \$28.4 million decrease in average securities. For each of the quarters ended June 30, 2014 and June 30, 2013, average net loans, liquidity assets and securities represented approximately 98%, 2% and less than 1%, respectively, of average earning assets.

Average interest-bearing liabilities for the quarter ended June 30, 2014 increased \$1.3 billion from the second quarter of 2013, which included a \$1.2 billion increase in interest-bearing deposits and a \$175.0 million increase in long-term debt as a result of the Bank's issuance of subordinated notes in January 2014, offset by a \$60.8 million decrease in other borrowings. Average demand deposits increased from \$2.9 billion at June 30, 2013 to \$3.6 billion at June 30, 2014. The average cost of total deposits and borrowed funds increased from .16% for the second quarter of 2013 to .17% for the second quarter of 2014. The total cost of interest-bearing liabilities included \$2.3 million attributable to \$175.0 million in long-term debt issued in January 2014. Including the increase in long-term debt, the cost of interest-bearing liabilities increased from .40% for the quarter ended June 30, 2013 to .51% for the same period of 2014.

Net interest income was \$223.7 million for the six months ended June 30, 2014, compared to \$199.3 million for the same period in 2013. The increase was due to an increase in average earning assets of \$2.0 billion as compared to the six months ended June 30, 2013. The increase in average earning assets included a \$1.9 billion increase in average net loans and a \$126.1 million increase in average liquidity assets, offset by a \$32.1 million decrease in average securities. For the six months ended June 30, 2014, average net loans, liquidity assets and securities represented approximately 97%, 2% and 1%, respectively, of average earning assets compared to 98%, 1% and 1%, respectively, in the same period of 2013.

Average interest-bearing liabilities for the six months ended June 30, 2014 increased \$899.6 million from the first six months of 2013, which included a \$1.2 billion increase in interest-bearing deposits and a \$146.0 million increase in subordinated notes, offset by a \$402.8 million decrease in other borrowings. Average demand deposits increased from \$2.7 billion at June 30, 2013 to \$3.5 billion at June 30, 2014. The average cost of total deposits and borrowed funds remained at .17% for the six months ended June 30, 2014 compared to the same period in the prior year. The total cost of interest-bearing liabilities included \$3.9 million attributable to \$175.0 million of long-term debt issued in January 2014. Including the increase in long-term debt, the cost of interest-bearing liabilities, including long-term debt, increased from .40% for the six months ended June 30, 2013 to .51% for the same period of 2014.

The following table presents the changes (in thousands) in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities.

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|  | Three months ended<br>June 30, 2014/2013 |  |                   | Six months ended<br>June 30, 2014/2013 |  |                    |
|--|--|--|-------------------|--|--|--------------------|
|  | Net<br>Change                            | Change Due To <sup>(1)</sup><br>Volume | Yield/Rate        | Net<br>Change                          | Change Due To <sup>(1)</sup><br>Volume | Yield/Rate         |
| <b>Interest income:</b>                              |  |  |                   |  |  |                    |
| Securities <sup>(2)</sup>                            | \$ (365)                                 | \$ (340)                               | \$ (25)           | \$ (824)                               | \$ (756)                               | \$ (68)            |
| Loans held for investment, mortgage<br>finance loans | 791                                      | 3,882                                  | (3,091)           | (5,068)                                | 804                                    | (5,872)            |
| Loans held for investment                            | 17,025                                   | 21,509                                 | (4,484)           | 35,574                                 | 43,571                                 | (7,997)            |
| Federal funds sold                                   | (5)                                      | (9)                                    | 4                 | 29                                     | 2                                      | 27                 |
| Deposits in other banks                              | 40                                       | 60                                     | (20)              | 147                                    | 160                                    | (13)               |
| <b>Total</b>   | <b>17,486</b>                            | <b>25,102</b>                          | <b>(7,616)</b>    | <b>29,858</b>                          | <b>43,781</b>                          | <b>(13,923)</b>    |
| <b>Interest expense:</b>                             |  |  |                   |  |  |                    |
| Transaction deposits                                 | (63)                                     | (34)                                   | (29)              | (236)                                  | (89)                                   | (147)              |
| Savings deposits                                     | 1,103                                    | 919                                    | 184               | 2,110                                  | 1,869                                  | 241                |
| Time deposits  | (17)                                     | 3                                      | (20)              | (80)                                   | (25)                                   | (55)               |
| Deposits in foreign branches                         | (5)                                      | 8                                      | (13)              | 9                                      | 25                                     | (16)               |
| Borrowed funds                                       | (54)                                     | (30)                                   | (24)              | (312)                                  | (357)                                  | 45                 |
| Long-term debt                                       | 2,398                                    | 2,884                                  | (486)             | 4,030                                  | 4,811                                  | (781)              |
| <b>Total</b>   | <b>3,362</b>                             | <b>3,750</b>                           | <b>(388)</b>      | <b>5,521</b>                           | <b>6,234</b>                           | <b>(713)</b>       |
| <b>Net interest income</b>                           | <b>\$ 14,124</b>                         | <b>\$ 21,352</b>                       | <b>\$ (7,228)</b> | <b>\$ 24,337</b>                       | <b>\$ 37,547</b>                       | <b>\$ (13,210)</b> |

(1) Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.

(2) Taxable equivalent rates used where applicable and assume a 35% tax rate.

Net interest margin, the ratio of net interest income to average earning assets, was 3.87% for the second quarter of 2014 compared to 4.19% for the second quarter of 2013. The year over year decrease is due to the growth in loans with lower yields, the impact of the subordinated note offering and the \$52.4 million increase in average balances of liquidity assets, which includes Federal funds sold and deposits from other banks. Funding costs, including demand deposits and borrowed funds, increased to .17% for the second quarter of 2014 compared to .16% for the second quarter of 2013. The spread on total earning assets, net of the cost of deposits and borrowed funds, was 4.02% for the second quarter of 2014 compared to 4.28% for the second quarter of 2013. The decrease resulted from the reduction in yields on total loans, primarily due to the increased proportion of mortgage finance loans to total loans. Total funding costs, including all deposits, long-term debt and stockholders' equity increased to .31% for the second quarter of 2014 compared to .24% for the second quarter of 2013. Average long-term debt increased by \$175.0 million from the second quarter of 2013 and the average interest rate on long-term debt for the second quarter of 2014 was 4.88% compared to 4.40% for the same period of 2013.

**Non-interest Income**

The components of non-interest income were as follows (in thousands):

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|   | Three months ended June 30, |                  | Six months ended June 30, |                  |
|---|-----------------------------|------------------|---------------------------|------------------|
|   | 2014                        | 2013             | 2014                      | 2013             |
| Service charges on deposit accounts     | \$ 1,764                    | \$ 1,749         | \$ 3,460                  | \$ 3,450         |
| Trust fee income                        | 1,242                       | 1,269            | 2,524                     | 2,510            |
| Bank owned life insurance (BOLI) income | 521                         | 463              | 1,030                     | 961              |
| Brokered loan fees                      | 3,357                       | 4,778            | 6,181                     | 9,522            |
| Swap fees                               | 410                         | 981              | 1,634                     | 2,633            |
| Other                                   | 3,239                       | 1,888            | 6,060                     | 3,333            |
| <b>Total non-interest income</b>        | <b>\$ 10,533</b>            | <b>\$ 11,128</b> | <b>\$ 20,889</b>          | <b>\$ 22,409</b> |

Non-interest income decreased \$595,000 during the three months ended June 30, 2014 compared to the same period of 2013. This decrease was primarily due to a \$1.4 million decrease in brokered loan fees as a result of lower per loan fees during the second quarter of 2014. Swap fee income decreased \$571,000 during the three months ended June 30, 2014 compared to the same period of 2013. These fees fluctuate from quarter to quarter based on the number and volume of transactions closed during the quarter. Swap fees are fees related to

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customer swap transactions and are received from the institution that is our counterparty on the transaction. Offsetting these decreases was a \$1.4 million increase in other non-interest income. Other non-interest income includes such items as letter of credit fees and other general operating income, none of which account for 1% or more of total interest income and non-interest income.

Non-interest income decreased \$1.5 million during the six months ended June 30, 2014 compared to the same period of 2013. This decrease was primarily due to a \$3.3 million decrease in brokered loan fees as a result of lower per loan fees. Swap fee income decreased \$999,000 during the six months ended June 30, 2014 compared to the same period of 2013. These fees fluctuate from quarter to quarter based on the number and volume of transactions closed during the quarter. Swap fees are fees related to customer swap transactions and are received from the institution that is our counterparty on the transaction. Offsetting these decreases was a \$2.7 million increase in other non-interest income. Other non-interest income includes such items as letter of credit fees and other general operating income, none of which account for 1% or more of total interest income and non-interest income.

While management expects continued growth in certain components of non-interest income, the future rate of growth could be affected by increased competition from nationwide and regional financial institutions. In order to achieve continued growth in non-interest income, we may need to introduce new products or enter into new lines of business or expand existing lines of business. Any new product introduction or new market entry could place additional demands on capital and managerial resources.

**Non-interest Expense**

The components of non-interest expense were as follows (in thousands):

|   | Three months ended June 30, |                  | Six months ended June 30, |                   |
|---|-----------------------------|------------------|---------------------------|-------------------|
|   | 2014                        | 2013             | 2014                      | 2013              |
| Salaries and employee benefits              | \$ 39,896                   | \$ 45,191        | \$ 81,952                 | \$ 78,732         |
| Net occupancy expense                       | 5,073                       | 4,135            | 9,841                     | 7,992             |
| Marketing                                   | 3,795                       | 4,074            | 7,554                     | 8,046             |
| Legal and professional                      | 7,181                       | 4,707            | 12,583                    | 8,647             |
| Communications and technology               | 4,361                       | 3,347            | 8,285                     | 6,469             |
| FDIC insurance assessment                   | 2,544                       | 699              | 5,269                     | 1,777             |
| Allowance and other carrying costs for OREO | 11                          | 482              | 56                        | 912               |
| Other <sup>(1)</sup>                        | 6,907                       | 6,099            | 13,549                    | 11,859            |
| <b>Total non-interest expense</b>           | <b>\$ 69,768</b>            | <b>\$ 68,734</b> | <b>\$ 139,089</b>         | <b>\$ 124,434</b> |

(1) Other expense includes such items as courier expenses, regulatory assessments other than FDIC insurance, due from bank charges and other general operating expenses, none of which account for 1% or more of total interest income and non-interest income.

Non-interest expense for the second quarter of 2014 increased \$1.1 million, or 1%, to \$69.8 million from \$68.7 million in the second quarter of 2013. The increase is primarily attributable to a \$2.5 million increase in legal and professional expense. Our legal and professional expense will continue to fluctuate and could increase in the future with growth and as we respond to continued regulatory changes and strategic initiatives. We expect to continue to see

a decrease in the cost of resolving problem assets under improving economic conditions.

Salaries and employee benefits for the second quarter of 2014 decreased \$5.3 million as the second quarter of 2013 included expenses of \$7.7 million related to the succession announced last year that were non-recurring.

Net occupancy expense for the three months ended June 30, 2014 increased \$1.0 million as a result of general business growth and continued build-out needed to support that growth.

Communications and technology expense for the three months ended June 30, 2014 increased \$1.0 million due to general business growth.

FDIC insurance assessment expense for the three months ended June 30, 2014 increased \$1.8 million compared to the same quarter in 2013 as a result of the difference in rates applied to banks with over \$10 billion in assets.

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Non-interest expense for the six months ended June 30, 2014 increased \$14.7 million, or 12%, to \$139.1 million from \$124.4 million compared to the same period in 2013. The increase is primarily attributable to a \$3.9 million increase in legal and professional expense. Our legal and professional expense will continue to fluctuate and could increase in the future with growth and as we respond to continued regulatory changes and strategic initiatives. We expect to continue to see a decrease in the cost of resolving problem assets under improving economic conditions.

Salaries and employee benefits for the six months ended June 30, 2014 increased \$3.2 million due to general business growth, offset by the expenses of \$7.7 million related to the succession announced last year that were non-recurring.

Net occupancy expense for the six months ended June 30, 2014 increased \$1.8 million as a result of general business growth and continued build-out needed to support that growth.

Communications and technology expense for the six months ended June 30, 2014 increased \$1.8 million due to general business growth.

FDIC insurance assessment expense for the six months ended June 30, 2014 increased \$3.5 million compared to the same period in 2013 as a result of the difference in rates applied to banks with over \$10 billion in assets.

***Analysis of Financial Condition*****Loan Portfolio**

Total loans net of allowance for loan losses at June 30, 2014 increased \$1.6 billion from December 31, 2013 to \$12.8 billion. Our business plan focuses primarily on lending to middle market businesses and successful professionals and entrepreneurs, and as such, commercial, real estate and construction loans have comprised a majority of our loan portfolio. Consumer loans generally have represented 1% or less of the portfolio. Mortgage finance loans relate to our mortgage warehouse lending operations in which we invest in mortgage loan ownership interests that are typically sold within 10 to 20 days. Volumes fluctuate based on the level of market demand in the product and the number of days between purchase and sale of the loans, as well as overall market interest rates.

We originate a substantial majority of all loans held for investment. We also participate in syndicated loan relationships, both as a participant and as an agent. As of June 30, 2014, we had \$1.4 billion in syndicated loans, \$409.5 million of which we acted as agent. All syndicated loans, whether we act as agent or participant, are underwritten to the same standards as all other loans we originate. In addition, as of June 30, 2014, none of our syndicated loans were on non-accrual.

Loans were as follows as of the dates indicated (in thousands):

|                  | June 30,<br>2014 | December 31,<br>2013 |
|------------------|------------------|----------------------|
| Commercial       | \$ 5,295,368     | \$ 5,020,565         |
| Mortgage finance | 3,700,253        | 2,784,265            |
| Construction     | 1,567,667        | 1,262,905            |
| Real estate      | 2,231,630        | 2,146,228            |
| Consumer         | 15,847           | 15,350               |
| Leases           | 95,914           | 93,160               |

|   |               |               |
|---|---------------|---------------|
| Gross loans held for investment                   | 12,906,679    | 11,322,473    |
| Deferred income (net of direct origination costs) | (53,711)      | (51,899)      |
| Allowance for loan losses                         | (91,114)      | (87,604)      |
| Total loans held for investment, net              | \$ 12,761,854 | \$ 11,182,970 |

*Commercial Loans and Leases.* Our commercial loan and lease portfolio is comprised of lines of credit for working capital and term loans and leases to finance equipment and other business assets. Our energy production loans are generally collateralized with proven reserves based on appropriate valuation standards.

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Our commercial loans and leases are underwritten after carefully evaluating and understanding the borrower's ability to operate profitably. Our underwriting standards are designed to promote relationship banking rather than making loans on a transactional basis. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually and are supported by accounts receivable, inventory, equipment and other assets of our clients' businesses.

*Mortgage finance loans.* Our mortgage finance loans consist of ownership interests purchased in single-family residential mortgages funded through our warehouse lending group. These loans are typically on our balance sheet for 10 to 20 days or less. We have agreements with mortgage lenders and purchase interests in individual loans they originate. All loans are underwritten consistent with established programs for permanent financing with financially sound investors. Substantially all loans are conforming loans. Mortgage finance loans as of June 30, 2014 are net of \$93.8 million of participations sold.

*Construction Loans.* Our construction loan portfolio consists primarily of single- and multi-family residential properties and commercial projects used in manufacturing, warehousing, service or retail businesses. Our construction loans generally have terms of one to three years. We typically make construction loans to developers, builders and contractors that have an established record of successful project completion and loan repayment and have a substantial equity investment in the borrower's equity. However, construction loans are generally based upon estimates of costs and value associated with the completed project. Sources of repayment for these types of loans may be pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from us until permanent financing is obtained. The nature of these loans makes ultimate repayment extremely sensitive to overall economic conditions. Borrowers may not be able to correct conditions of default in loans, increasing risk of exposure to classification, non-performing status, reserve allocation and actual credit loss and foreclosure. These loans typically have floating rates and commitment fees.

*Real Estate Loans.* A portion of our real estate loan portfolio is comprised of loans secured by properties other than market risk or investment-type real estate. Market risk loans are real estate loans where the primary source of repayment is expected to come from the sale or lease of the real property collateral. We generally provide temporary financing for commercial and residential property. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Our real estate loans generally have maximum terms of five to seven years, and we provide loans with both floating and fixed rates. We generally avoid long-term loans for commercial real estate held for investment. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Appraised values may be highly variable due to market conditions and the impact of the inability of potential purchasers and lessees to obtain financing and lack of transactions at comparable values.

## **Portfolio Geographic Concentration**

As of June 30, 2014, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. The risks created by this concentration have been considered by management in the determination of the appropriateness of the allowance for loan losses. Management believes the allowance for loan losses is appropriate to cover estimated losses on loans at each balance sheet date.

## **Summary of Loan Loss Experience**

The provision for credit losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management's assessment of the loan portfolio in light of current economic conditions and market trends. We recorded a provision of \$4.0 million during the second quarter of 2014 compared to \$5.0 million in the first quarter of 2014 and



\$7.0 million in the second quarter of 2013. Despite experiencing improvements in credit quality, we have seen levels of reserves and provision increase due to growth in the portfolio. We continue to maintain an unallocated reserve component to allow for continued uncertainty in the economic environment which has produced losses, including those resulting from fraud by borrowers, that are not necessarily correlated with historical loss trends or general economic conditions. Our methodology used to calculate the allowance considers historical losses, however, the historical loss rates for specific product types or credit risk grades may not fully incorporate the effects of continued weakness in the economy.

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The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an appropriate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than \$500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management's judgment, should be charged off.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors, including general economic conditions, changes in credit policies and lending standards. Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered appropriate, given management's assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company's market areas and other factors.

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. The review of the reserve adequacy is performed by executive management and presented to a committee of our board of directors for their review. The committee reports to the board as part of the board's review on quarterly basis of the Company's consolidated financial statements.

The combined reserve for credit losses, which includes a liability for losses on unfunded commitments, totaled \$96.7 million at June 30, 2014, \$92.3 million at December 31, 2013 and \$83.6 million at June 30, 2013. Due to the growth in loans, the total reserve percentage decreased to 1.06% at June 30, 2014 from 1.09% and 1.11% of loans excluding mortgage finance loans at December 31, 2013 and June 30, 2013, respectively. The combined reserve percentage has trended down as we recognize losses on loans for which there were specific or general allocations of reserves and see improvement in our overall credit quality. The overall reserve for loan losses continues to result from consistent application of the loan loss reserve methodology as described above. At June 30, 2014, we believe the reserve is sufficient to cover all expected losses in the portfolio and has been derived from consistent application of the methodology described above. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change or prove to be inaccurate, our estimate of inherent losses in the portfolio could also change or become insufficient, which would affect the level of future provisions for loan losses.



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Activity in the reserve for loan losses is presented in the following table (in thousands):

|  | Six months ended Year ended Six months ended |                      |                  |
|--|--|----------------------|------------------|
|  | June 30,<br>2014                             | December 31,<br>2013 | June 30,<br>2013 |
| <b>Reserve for loan losses:</b>  |  |                      |                  |
| Beginning balance  | \$ 87,604                                    | \$ 74,337            | \$ 74,337        |
| <b>Loans charged-off:</b>  |  |                      |                  |
| Commercial   | 7,526  | 6,575                | 4,474            |
| Real estate  | 296  | 144                  | 131              |
| Consumer   | 101  | 45                   | 45               |
| Leases   |  | 2                    |                  |
| <b>Total charge-offs</b>   | <b>7,923</b>                                 | <b>6,766</b>         | <b>4,650</b>     |
| <b>Recoveries:</b>   |  |                      |                  |
| Commercial   | 3,150  | 1,203                | 745              |
| Real estate  | 43   | 270                  | 15               |
| Consumer   | 31   | 73                   | 45               |
| Leases   | 142  | 322                  | 261              |
| <b>Total recoveries</b>  | <b>3,366</b>                                 | <b>1,868</b>         | <b>1,066</b>     |
| <b>Net charge-offs</b>   | <b>4,557</b>                                 | <b>4,898</b>         | <b>3,584</b>     |
| Provision for loan losses  | 8,067  | 18,165               | 8,675            |
| <b>Ending balance</b>  | <b>\$ 91,114</b>                             | <b>\$ 87,604</b>     | <b>\$ 79,428</b> |
| <b>Reserve for off-balance sheet credit losses:</b>  |  |                      |                  |
| Beginning balance  | \$ 4,690                                     | \$ 3,855             | \$ 3,855         |
| Provision for off-balance sheet credit losses  | 933  | 835                  | 325              |
| <b>Ending balance</b>  | <b>\$ 5,623</b>                              | <b>\$ 4,690</b>      | <b>\$ 4,180</b>  |
| <b>Total reserve for credit losses</b>   | <b>\$ 96,737</b>                             | <b>\$ 92,294</b>     | <b>\$ 83,608</b> |
| <b>Total provision for credit losses</b>   | <b>\$ 9,000</b>                              | <b>\$ 19,000</b>     | <b>\$ 9,000</b>  |
| Reserve for loan losses to loans   | 0.71%  | 0.78%                | 0.77%            |
| Reserve for loan losses to loans excluding mortgage finance loans <sup>(2)</sup>                   | 1.00%  | 1.03%                | 1.06%            |
| Net charge-offs to average loans <sup>(1)</sup>  | 0.08%  | 0.05%                | 0.08%            |
| Net charge-offs to average loans excluding mortgage finance loans <sup>(1) (2)</sup>               | 0.10%  | 0.07%                | 0.10%            |
| Total provision for credit losses to average loans   | 0.16%  | 0.19%                | 0.19%            |
| Total provision for credit losses to average loans excluding mortgage finance loans <sup>(2)</sup> | 0.21%  | 0.25%                | 0.26%            |
| Recoveries to total charge-offs  | 42.48%                                       | 27.61%               | 22.92%           |
| Reserve for off-balance sheet credit losses to off-balance sheet credit commitments                | 0.12%  | 0.12%                | 0.14%            |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Combined reserves for credit losses to loans held for investment   | 0.75%     | 0.82%     | 0.81%     |
| Combined reserves for credit losses to loans held for investment excluding mortgage finance loans <sup>(2)</sup> | 1.06%     | 1.09%     | 1.11%     |
| Non-performing assets:   |           |           |           |
| Non-accrual loans <sup>(5)</sup>   | \$ 41,565 | \$ 32,375 | \$ 38,450 |
| OREO <sup>(4)</sup>  | 685       | 5,110     | 13,053    |
| Other repossessed assets   |           |           | 19        |
| Total  | \$ 42,250 | \$ 37,485 | \$ 51,522 |
| Restructured loans   | \$ 249    | \$ 1,935  | \$ 4,765  |
| Loans past due 90 days and still accruing <sup>(3)</sup>   | 4,793     | 9,325     | 7,633     |
| Reserve as a percent of non-performing loans   | 2.2x      | 2.7x      | 2.1x      |

(1) Interim period ratios are annualized.

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- (2) Mortgage finance loans were previously classified as loans held for sale but have been reclassified as loans held for investment as described in Note 1 Operations and Summary of Significant Accounting Policies. The indicated ratios are presented excluding the mortgage finance loans because the risk profile of our mortgage finance loans is different than our other loans held for investment. No provision is allocated to these loans based on the internal risk grade assigned.
- (3) At June 30, 2014, December 31, 2013 and June 30, 2013, loans past due 90 days and still accruing includes premium finance loans of \$4.6 million, \$3.8 million and \$4.2 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.
- (4) At June 30, 2014, we did not have a valuation allowance recorded against the OREO balance. At December 31, 2013 and June 30, 2013, OREO balance is net of a \$5.6 million and a \$4.6 million valuation allowance, respectively.
- (5) As of June 30, 2014, December 31, 2013 and June 30, 2013, non-accrual loans included \$16.2 million, \$17.8 million and \$16.4 million, respectively, in loans that met the criteria for restructured.

**Non-performing Assets**

Non-performing assets include non-accrual loans and leases and repossessed assets. The table below summarizes our non-accrual loans by type and OREO (in thousands):

|                                    | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|------------------------------------|------------------|----------------------|------------------|
| Non-accrual loans:                 |                  |                      |                  |
| Commercial                         | \$ 25,545        | \$ 12,896            | \$ 17,577        |
| Construction                       |                  | 705                  |                  |
| Real estate                        | 15,998           | 18,670               | 20,799           |
| Consumer                           |                  | 54                   | 9                |
| Leases                             | 22               | 50                   | 65               |
| <b>Total non-accrual loans</b>     | <b>41,565</b>    | <b>32,375</b>        | <b>38,450</b>    |
| Repossessed assets:                |                  |                      |                  |
| OREO                               | 685              | 5,110                | 13,053           |
| Other repossessed assets           |                  |                      | 19               |
| <b>Total repossessed assets</b>    | <b>685</b>       | <b>5,110</b>         | <b>13,072</b>    |
| <b>Total non-performing assets</b> | <b>\$ 42,250</b> | <b>\$ 37,485</b>     | <b>\$ 51,522</b> |

The table below summarizes the non-accrual loans as segregated by loan type and type of property securing the credit as of June 30, 2014 (in thousands):

|   |        |
|---|--------|
| Non-accrual loans:                        |        |
| Commercial                                |        |
| Lines of credit secured by the following: |        |
| Oil and gas properties                    | \$ 820 |

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|  |                  |
|--|------------------|
| Assets of the borrowers  | 22,409           |
| Other  | 2,316            |
| <b>Total commercial</b>  | <b>25,545</b>    |
| Real estate  |                  |
| Secured by:  |                  |
| Commercial property  | 9,482            |
| Unimproved land and/or undeveloped residential lots                  | 3,945            |
| Other  | 2,571            |
| <b>Total real estate</b>   | <b>15,998</b>    |
| Leases (commercial leases primarily secured by assets of the lessor) | 22               |
| <b>Total non-accrual loans</b>                                       | <b>\$ 41,565</b> |

Generally, we place loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of June 30, 2014, \$480,000 of our non-accrual loans were earning on a cash basis. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

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A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the original loan agreement. All loans classified as restructured loans are also considered impaired. Reserves on impaired loans are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral.

At June 30, 2014, we had \$4.8 million in loans past due 90 days and still accruing interest. At June 30, 2014, \$4.6 million of the loans past due 90 days and still accruing are premium finance loans. These loans are primarily secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower's financial difficulties, we have granted a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or forgiveness of either principal or accrued interest. As of June 30, 2014, we had \$249,000 in loans considered restructured that are not on non-accrual. Of the non-accrual loans at June 30, 2014, \$16.2 million met the criteria for restructured. A loan continues to qualify as restructured until a consistent payment history or change in borrower's financial condition has been evidenced, generally no less than twelve months. Assuming that the restructuring agreement specifies an interest rate at the time of the restructuring that is greater than or equal to the rate that we are willing to accept for a new extension of credit with comparable risk, the loan no longer has to be considered a restructuring if it is in compliance with modified terms in calendar years after the year of the restructuring.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which we have concerns about the borrower's ability to comply with repayment terms because of the borrower's potential financial difficulties. We monitor these loans closely and review their performance on a regular basis. At June 30, 2014 and 2013, we had \$14.8 million and \$9.3 million, respectively, in loans of this type which were not included in either non-accrual or 90 days past due categories.

The table below presents a summary of the activity related to OREO (in thousands):

|                              | Three months ended June 30, |           | Six months ended June 30, |           |
|------------------------------|-----------------------------|-----------|---------------------------|-----------|
|                              | 2014                        | 2013      | 2014                      | 2013      |
| Beginning balance            | \$ 2,420                    | \$ 14,426 | \$ 5,110                  | \$ 15,991 |
| Additions                    |                             | 912       | 851                       | 912       |
| Sales                        | (1,735)                     | (1,902)   | (5,276)                   | (3,396)   |
| Valuation allowance for OREO |                             | (164)     |                           | (164)     |
| Direct write-downs           |                             | (219)     |                           | (290)     |
| Ending balance               | \$ 685                      | \$ 13,053 | \$ 685                    | \$ 13,053 |

The following table summarizes the assets held in OREO at June 30, 2014 (in thousands):



|                                       |               |
|---------------------------------------|---------------|
| Undeveloped land and residential lots | \$ 487        |
| Other                                 | 198           |
| <b>Total OREO</b>                     | <b>\$ 685</b> |

When foreclosure occurs, fair value, which is generally based on appraised values, may result in partial charge-off of a loan upon taking property, and so long as property is retained, subsequent reductions in appraised values will result in valuation adjustments taken as non-interest expense. In addition, if the decline in value is believed to be permanent and not just driven by market conditions, a direct write-down to the OREO balance may be taken. We generally pursue sales of OREO when conditions warrant, but we may choose to hold certain properties for a longer term, which can result in additional exposure related to the appraised values during that holding period. During the six months ended June 30, 2014 we did not record a valuation expense compared to \$454,000 recorded during the same period of 2013. Of the \$454,000 recorded for the six months ended June 30, 2013, \$164,000 related to direct write-downs and \$290,000 related to increasing the valuation allowance.

**Table of Contents****Liquidity and Capital Resources**

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our Balance Sheet Management Committee ( BSMC ), and which take into account the demonstrated marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. For the year ended December 31, 2013 and for the six months ended June 30, 2014, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from Federal funds purchased and Federal Home Loan Bank ( FHLB ) borrowings.

Our liquidity needs for support of growth in loans held for investment have been fulfilled through growth in our core customer deposits. Our goal is to obtain as much of our funding for loans held for investment and other earnings assets as possible from deposits of these core customers. These deposits are generated principally through development of long-term relationships with customers and stockholders, with a significant focus on treasury management products. In addition to deposits from our core customers, we also have access to deposits through brokered customer relationships. For regulatory purposes, these relationship brokered deposits are now categorized as brokered deposits; however, since these deposits arise from a customer relationship, we consider these deposits to be core deposits for our reporting purposes. We also have access to incremental deposits through brokered retail certificates of deposit, or CDs. These traditional brokered deposits are generally of short maturities, 30 to 90 days, and are used to supplement temporary differences in the growth in loans, including growth in loans held for sale or other specific categories of loans, compared to customer deposits. The following table summarizes our period-end and average year-to-date core customer deposits and brokered deposits (in millions):

|  | June 30,<br>2014 | December 31,<br>2013 | June 30,<br>2013 |
|--|------------------|----------------------|------------------|
| Deposits from core customers   | \$ 8,642.9       | \$ 7,840.1           | \$ 6,900.9       |
| Deposits from core customers as a percent of total deposits  | 80.4%            | 84.7%                | 86.5%            |
| Relationship brokered deposits   | \$ 1,863.0       | \$ 1,417.3           | \$ 1,079.7       |
| Relationship brokered deposits as a percent of total deposits  | 17.3%            | 15.3%                | 13.5%            |
| Traditional brokered deposits  | \$ 251.4         | \$                   | \$               |
| Traditional brokered deposits as a percent of total deposits   | 2.3%             | 0.0%                 | 0.0%             |
| Average deposits from core customers <sup>(1)</sup>  | \$ 8,062.9       | \$ 7,040.4           | \$ 6,715.8       |
| Average deposits from core customers as a percent of total quarterly average deposits <sup>(1)</sup>   | 83.0%            | 84.1%                | 86.3%            |
| Average relationship brokered deposits <sup>(1)</sup>  | \$ 1,618.0       | \$ 1,334.5           | \$ 1,067.2       |
| Average relationship brokered deposits as a percent of total quarterly average deposits <sup>(1)</sup> | 16.6%            | 15.9%                | 13.7%            |
| Average traditional brokered deposits <sup>(1)</sup>   | \$ 41.7          | \$                   | \$               |
| Average traditional brokered deposits as a percent of total quarterly average deposits <sup>(1)</sup>  | 0.4%             | 0.0%                 | 0.0%             |

(1) Annual averages presented for December 31, 2013.

We have access to, and have periodically utilized, sources of brokered deposits of not less than an additional \$3.2 billion. Customer deposits (total deposits, including relationship brokered deposits, minus brokered CDs) increased by \$997.1 million from December 31, 2013 and increased \$2.3 billion from June 30, 2013.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. Such borrowings are generally used to fund our loans held for sale, due to their liquidity, short duration and interest spreads available. These borrowing sources typically include Federal funds purchased from our downstream

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correspondent bank relationships (which consist of banks that are smaller than our bank) and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), customer repurchase agreements, treasury, tax and loan notes, and advances from the FHLB and the Federal Reserve. The following table summarizes our borrowings as of June 30, 2014 (in thousands):

|   |              |
|---|--------------|
| Federal funds purchased   | \$ 273,041   |
| Repurchase agreements   | 27,491       |
| FHLB borrowings   | 700,016      |
| Subordinated notes  | 286,000      |
| Trust preferred subordinated debentures                         | 113,406      |
| <br>  |              |
| Total borrowings  | \$ 1,399,954 |
| <br>  |              |
| Maximum borrowings outstanding at any month-end during the year | \$ 1,709,096 |

The following table summarizes our other borrowing capacities in excess of balances outstanding at June 30, 2014 (in thousands):

|  |              |
|--|--------------|
| FHLB borrowing capacity relating to loans                  | \$ 1,147,413 |
| FHLB borrowing capacity relating to securities             | 3,561        |
| <br>   |              |
| Total FHLB borrowing capacity                              | \$ 1,150,974 |
| <br>   |              |
| Unused Federal funds lines available from commercial banks | \$ 925,000   |

At June 30, 2014, we had a non-revolving amortizing line of credit with \$100.0 million of unused capacity. This line of credit matures on December 15, 2014. The loan proceeds may be used for general corporate purposes including funding regulatory capital infusions into the Bank. The loan agreement contains customary financial covenants and restrictions. At June 30, 2014, no borrowings were outstanding compared to \$15.0 million outstanding at December 31, 2013.

Our equity capital, including \$150 million in preferred stock, averaged \$1.2 billion for the six months ended June 30, 2014, as compared to \$939.3 million for the same period in 2013 when the average balance of preferred stock outstanding was \$78.7 million. We have not paid any cash dividends on our common stock since we commenced operations and have no plans to do so in the near future.

On January 29, 2014, we completed a sale of 1.9 million shares of our common stock in a public offering. Net proceeds from the sale totaled \$106.5 million. On January 31, 2014, the Bank issued \$175.0 million of subordinated notes in an offering to institutional investors exempt from registration under Section 3(a)(2) of the Securities Act of 1933 and 12 C.F.R. Part 16. Net proceeds from the transaction were \$172.4 million. The notes mature in January 2026 and bear interest at a rate of 5.25% per annum, payable semi-annually. The notes are unsecured and are subordinate to the Bank's obligations to its deposit-holders, its obligations under banker's acceptances and letters of credit, certain obligations to Federal Reserve Banks and the FDIC and the Bank's obligations to its other creditors, except any

obligations which expressly rank on a parity with or junior to the notes. The notes are expected to qualify as Tier 2 capital for regulatory capital purposes, subject to applicable limitations. The net proceeds of both offerings were available to the Company for general corporate purposes, including retirement of \$15.0 million of short-term debt that was outstanding at December 31, 2013, and additional capital to support continued loan growth.

Our capital ratios remain above the levels required to be well capitalized. We believe that periodic capital raising transactions, along with the addition of loan and deposit relationships, will allow us to continue to grow organically.

**Table of Contents****Commitments and Contractual Obligations**

The following table presents significant fixed and determinable contractual obligations to third parties by payment date. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. As of June 30, 2014, our significant fixed and determinable contractual obligations to third parties, excluding interest, were as follows (in thousands):

|  | Within One<br>Year   | After One but<br>Within<br>Three<br>Years | After Three but<br>Within Five<br>Years | After<br>Five<br>Years | Total             |
|--|----------------------|---|---|------------------------|-------------------|
| Deposits without a stated maturity         | \$ 9,801,592         | \$  | \$                                      | \$                     | \$ 9,801,592      |
| Time deposits                              | 937,724              | 15,170                                    | 2,756                                   | 74                     | 955,724           |
| repurchase agreements                      | 300,532              |   |   |                        | 300,532           |
| FHLB borrowings                            | 700,016              |   |   |                        | 700,016           |
| Operating lease obligations <sup>(1)</sup> | 14,111               | 28,884                                    | 28,556                                  | 56,477                 | 128,028           |
| Subordinated notes                         |                      |   |   | 286,000                | 286,000           |
| <b>Total contractual obligations</b>       | <b>\$ 11,753,975</b> | <b>\$</b>                                 | <b>\$</b>                               | <b>\$ 113,406</b>      | <b>\$ 113,406</b> |

(1) Non-balance sheet item.

**Critical Accounting Policies**

SEC guidance requires disclosure of critical accounting policies. The SEC defines critical accounting policies as those that are most important to the presentation of a company's financial condition and results, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

We follow financial accounting and reporting policies that are in accordance with accounting principles generally accepted in the United States. The more significant of these policies are summarized in Note 1 to the consolidated financial statements. Not all these significant accounting policies require management to make difficult, subjective or complex judgments. However, the policy noted below could be deemed to meet the SEC's definition of a critical accounting policy.

Management considers the policies related to the allowance for loan losses as the most critical to the financial statement presentation. The total allowance for loan losses includes activity related to allowances calculated in accordance with ASC 310, *Receivables*, and ASC 450, *Contingencies*. The allowance for loan losses is established through a provision for loan losses charged to current earnings. The amount maintained in the allowance reflects management's continuing evaluation of the loan losses inherent in the loan portfolio. The allowance for loan losses is comprised of specific reserves assigned to certain classified loans and general reserves. Factors contributing to the determination of specific reserves include the credit-worthiness of the borrower, and more specifically, changes in the expected future receipt of principal and interest payments and/or in the value of pledged collateral. A reserve is recorded when the carrying amount of the loan exceeds the discounted estimated cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. For purposes of

determining the general reserve, the portfolio is segregated by product types in order to recognize differing risk profiles among categories, and then further segregated by credit grades. See Summary of Loan Loss Experience above and Note 4 Loans and Allowance for Loan Losses in the accompanying notes to the consolidated financial statements included elsewhere in this report for further discussion of the risk factors considered by management in establishing the allowance for loan losses.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is a broad term for the risk of economic loss due to adverse changes in the fair value of a financial instrument. These changes may be the result of various factors, including interest rates, foreign exchange rates, commodity prices, or equity prices. Additionally, the financial instruments subject to market risk can be classified either as held for trading purposes or held for other than trading.

We are subject to market risk primarily through the effect of changes in interest rates on our portfolio of assets held for purposes other than trading. The effect of other changes, such as foreign exchange rates, commodity prices, and/or equity prices do not pose significant market risk to us.

The responsibility for managing market risk rests with the BSMC, which operates under policy guidelines established by our board of directors. The negative acceptable variation in net interest revenue due to a 200 basis point increase or decrease in interest rates is generally limited by these guidelines to +/- 5%. These guidelines also establish maximum levels for short-term borrowings, short-term assets and public and brokered deposits. They also establish minimum levels for unpledged assets, among other things. Compliance with these guidelines is the ongoing responsibility of the BSMC, with exceptions reported to our board of directors on a quarterly basis.

**Interest Rate Risk Management**

Our interest rate sensitivity is illustrated in the following table. The table reflects rate-sensitive positions as of June 30, 2014, and is not necessarily indicative of positions on other dates. The balances of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rates or mature and are aggregated to show the interest rate sensitivity gap. The mismatch between repricings or maturities within a time period is commonly referred to as the gap for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite results on the net interest margin. To reflect anticipated prepayments, certain asset and liability categories are shown in the table using estimated cash flows rather than contractual cash flows. The Company employs interest rate floors in certain variable rate loans to enhance the yield on those loans at times when market interest rates are extraordinarily low. The degree of asset sensitivity, spreads on loans and net interest margin may be reduced until rates increase by an amount sufficient to eliminate the effects of floors. The adverse effect of floors as market rates increase may also be offset by the positive gap, the extent to which rates on deposits and other funding sources lag increasing market rates and changes in composition of funding.



**Table of Contents****Interest Rate Sensitivity Gap Analysis****June 30, 2014**

(In thousands)

|   | 0-3 mo<br>Balance | 4-12 mo<br>Balance | 1-3 yr<br>Balance | 3+ yr<br>Balance | Total<br>Balance |
|---|-------------------|--------------------|-------------------|------------------|------------------|
| <b>Assets:</b>  |                   |                    |                   |                  |                  |
| Securities <sup>(1)</sup>                                       | \$ 4,000          | \$ 36,906          | 4,062             | \$ 4,362         | \$ 49,330        |
| Total variable loans  | 11,230,542        | 54,067             | 5,333             | 25               | 11,289,967       |
| Total fixed loans   | 790,344           | 409,392            | 205,670           | 211,306          | 1,616,712        |
| Total loans <sup>(2)</sup>                                      | 12,020,886        | 463,459            | 211,003           | 211,331          | 12,906,679       |
| Total interest sensitive assets                                 | \$ 12,024,886     | \$ 500,365         | \$ 215,065        | \$ 215,693       | \$ 12,956,009    |
| <b>Liabilities:</b>   |                   |                    |                   |                  |                  |
| Interest-bearing customer deposits                              | \$ 5,710,622      | \$                 | \$                | \$               | \$ 5,710,622     |
| CDs & IRAs  | 404,001           | 191,538            | 15,170            | 2,830            | 613,539          |
| Traditional brokered deposits                                   | 251,381           |                    |                   |                  | 251,381          |
| Total interest-bearing deposits                                 | 6,366,004         | 191,538            | 15,170            | 2,830            | 6,575,542        |
| Repurchase agreements, Federal funds purchased, FHLB borrowings | 1,000,548         |                    |                   |                  | 1,000,548        |
| Subordinated notes  |                   |                    |                   | 286,000          | 286,000          |
| Trust preferred subordinated debentures                         |                   |                    |                   | 113,406          | 113,406          |
| Total borrowings  | 1,000,548         |                    |                   | 399,406          | 1,399,954        |
| Total interest sensitive liabilities                            | \$ 7,366,552      | \$ 191,538         | \$ 15,170         | \$ 402,236       | \$ 7,975,496     |
| GAP   | \$ 4,658,334      | \$ 308,827         | \$ 199,895        | \$ (186,543)     | \$               |
| Cumulative GAP  | 4,658,334         | 4,967,161          | 5,167,056         | 4,980,513        | 4,980,513        |
| Demand deposits   |                   |                    |                   |                  | \$ 4,181,774     |
| Stockholders equity   |                   |                    |                   |                  | 1,262,816        |
| Total   |                   |                    |                   |                  | \$ 5,444,590     |

(1) Securities based on fair market value.

(2) Loans are stated at gross.

The table above sets forth the balances as of June 30, 2014 for interest bearing assets, interest bearing liabilities, and the total of non-interest bearing deposits and stockholders equity. While a gap interest table is useful in analyzing interest rate sensitivity, an interest rate sensitivity simulation provides a better illustration of the sensitivity of earnings

to changes in interest rates. Earnings are also affected by the effects of changing interest rates on the value of funding derived from demand deposits and stockholders' equity. We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate risk exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates and loan and deposit account balances over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

The most likely rate scenario is based on the consensus forecast of future interest rates published by independent sources. These forecasts incorporate future spot rates and relevant spreads of instruments that are actively traded in the open market. The Federal Reserve's Federal funds target affects short-term borrowing; the prime lending rate and the LIBOR are the basis for most of our variable-rate loan pricing. The 10-year mortgage rate is also monitored because of its effect on prepayment speeds for mortgage-backed securities. We believe these are our primary interest rate exposures. We are not currently using derivatives to manage our interest rate exposure.

The two shock test scenarios assume a sustained parallel 100 and 200 basis point increase in interest rates. As short-term rates have remained low through 2014, we do not believe that analysis of an assumed decrease in interest rates would provide meaningful results. We will continue to evaluate these scenarios as interest rates change, until short-term rates rise above 3.0%.

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Our interest rate risk exposure model incorporates assumptions regarding the level of interest rate or balance changes on indeterminable maturity deposits (demand deposits, interest-bearing transaction accounts and savings accounts) for a given level of market rate changes. These assumptions have been developed through a combination of historical analysis and future expected pricing behavior. Changes in prepayment behavior of mortgage-backed securities, residential and commercial mortgage loans in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. The impact of planned growth and new business activities is factored into the simulation model. This modeling indicated interest rate sensitivity as follows (in thousands):

|                               | Anticipated Impact Over the Next Twelve Months<br>as Compared to Most Likely Scenario |                 |
|-------------------------------|---|-----------------|
|                               | 100 bp<br>Increase  | 200 bp Increase |
|                               | June 30, 2014   |                 |
| Change in net interest income | \$ 54,031   | \$ 119,028      |

The simulations used to manage market risk are based on numerous assumptions regarding the effect of changes in interest rates on the timing and extent of repricing characteristics, future cash flows, and customer behavior. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results may differ from simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies, among other factors.

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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the supervision and participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, we have concluded that, as of the end of such period, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are subject to various claims and legal actions related to operating activities that arise in the ordinary course of business. Management does not currently expect the ultimate disposition of these matters to have a material adverse impact on our financial statements.

**ITEM 1A. RISK FACTORS**

There have been no material change in the risk factors previously disclosed in the Company's 2013 Form 10-K for the fiscal year ended December 31, 2013.

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**ITEM 6. EXHIBITS**

on 302 of the Sarbanes-Oxley Act of 2002, filed herewith.

on 302 of the Sarbanes-Oxley Act of 2002, filed herewith.

as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.

as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.

March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income, (ii) Consolidated

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**SIGNATURES**

Pursuant to the requirements 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.

TEXAS CAPITAL BANCSHARES, INC.

Date: July 24, 2014

/s/ Peter B. Bartholow  
Peter B. Bartholow  
Chief Financial Officer  
(Duly authorized officer and principal financial officer)

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**EXHIBIT INDEX**

| Exhibit<br>Number |   |
|-------------------|---|
| 10.1              | Form of Indemnification Agreement for directors and officers of Texas Capital Bancshares, Inc. and its subsidiaries.  |
| 31.1              | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.  |
| 31.2              | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.  |
| 32.1              | Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.   |
| 32.2              | Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.   |
| 101               | The following materials from Texas Capital Bancshares, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements |