First Internet Bancorp
Form 10-Q
November 12, 2014

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

FORM 10-Q

(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period September 30, 2014
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From ________ to ________.

Commission File Number 001-35750

First Internet Bancorp
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| Indiana<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 20-3489991<br>(I.R.S. Employer<br>Identification No.) |
| 8888 Keystone Crossing, Suite 1700<br>Indianapolis, Indiana<br>(Address of Principal Executive Offices) | 46240<br>(Zip Code) |

(317) 532-7900
(Registrant’s Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in 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 þ |

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

As of November 7, 2014, the registrant had 4,439,575 shares of common stock issued and outstanding.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q may contain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance, or business of First Internet Bancorp (“we,” “our,” “us” or the “Company”). Forward-looking statements are generally identifiable by the use of words such as “believe,” “expect,” “anticipate,” “plan,” “intend,” “estimate,” “may,” “will,” “would,” “could,” “should,” or other similar expressions. Forward-lo statements are not a guarantee of future performance or results, are based on information available at the time the statements are made, and involve known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the information in the forward-looking statements. Factors that may cause such differences include: failures of or interruptions in the communications and information systems on which we rely to conduct our business; our plans to grow our commercial real estate and commercial and industrial loan portfolios; competition with national, regional, and community financial institutions; the loss of any key members of senior management; fluctuations in interest rates; general economic conditions and risks relating to the regulation of financial institutions. Additional factors that may affect our results include those discussed in our most recent Annual Report on Form 10-K under the heading “Risk Factors” and in other reports filed with the Securities and Exchange Commission (“SEC”). All statements in this Quarterly Report on Form 10-Q, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

PART I

ITEM 1. FINANCIAL STATEMENTS

First Internet Bancorp
Condensed Consolidated Balance Sheets
(Amounts in thousands except share data)

| | September 30, 2014 (Unaudited) | December 31, 2013 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $1,137 | $2,578 |
| Interest-bearing demand deposits | 38,470 | 51,112 |
| Total cash and cash equivalents | 39,607 | 53,690 |
| Interest-bearing time deposits | 2,000 | 2,500 |
| Securities available-for-sale, at fair value (amortized cost of $129,573 and $185,091, respectively) | 128,203 | 181,409 |
| Loans held-for-sale (includes $25,701 and $24,254 at fair value, respectively) | 27,547 | 28,610 |
| Loans receivable | 695,929 | 501,153 |
| Allowance for loan losses | (5,464) | (5,426) |
| Net loans receivable | 690,465 | 495,727 |
| Accrued interest receivable | 2,803 | 2,904 |
| Federal Home Loan Bank of Indianapolis stock | 2,943 | 2,943 |
| Cash surrender value of bank-owned life insurance | 12,226 | 11,935 |
| Premises and equipment, net | 7,075 | 7,134 |
| Goodwill | 4,687 | 4,687 |
| Other real estate owned | 4,545 | 4,381 |
| Accrued income and other assets | 4,782 | 6,422 |
| Total assets | $926,883 | $802,342 |
| Liabilities and Shareholders’ Equity | | |
| Liabilities | | |
| Non-interest bearing deposits | $20,359 | $19,386 |
| Interest-bearing deposits | 717,611 | 653,709 |
| Total deposits | 737,970 | 673,095 |
| Advances from Federal Home Loan Bank | 86,871 | 31,793 |
| Subordinated debt | 2,852 | 2,789 |
| Accrued interest payable | 82 | 102 |
| Accrued expenses and other liabilities | 4,334 | 3,655 |
| Total liabilities | 832,109 | 711,434 |
| Commitments and Contingencies | | |
| Shareholders’ Equity | | |
| Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding - none | — | — |
| Voting common stock, no par value; 45,000,000 shares authorized; 4,439,575 and 4,448,326 shares issued and outstanding, respectively | 71,705 | 71,378 |
| Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding - none | — | — |
| Retained earnings | 23,951 | 21,902 |
| Accumulated other comprehensive loss | (882) | (2,372) |

| | | |
|---|---|---|
| Total shareholders' equity | 94,774 | 90,908 |
| Total liabilities and shareholders' equity | $926,883 | $802,342 |

See Notes to Condensed Consolidated Financial Statements

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First Internet Bancorp
Condensed Consolidated Statements of Income – Unaudited
(Amounts in thousands except share and per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Interest Income | | | | |
| Loans | $7,218 | $5,170 | $19,918 | $15,073 |
| Securities – taxable | 684 | 771 | 2,421 | 2,063 |
| Securities – non-taxable | — | 447 | 58 | 1,146 |
| Other earning assets | 45 | 54 | 195 | 148 |
| Total interest income | 7,947 | 6,442 | 22,592 | 18,430 |
| Interest Expense | | | | |
| Deposits | 1,958 | 1,758 | 5,740 | 5,042 |
| Other borrowed funds | 316 | 329 | 940 | 904 |
| Total interest expense | 2,274 | 2,087 | 6,680 | 5,946 |
| Net Interest Income | 5,673 | 4,355 | 15,912 | 12,484 |
| Provision (Credit) for Loan Losses | (112) | (57) | (38) | 101 |
| Net Interest Income After Provision (Credit) for Loan Losses | 5,785 | 4,412 | 15,950 | 12,383 |
| Noninterest Income | | | | |
| Service charges and fees | 179 | 177 | 533 | 515 |
| Mortgage banking activities | 1,638 | 1,299 | 3,767 | 7,767 |
| Other-than-temporary impairment | | | | |
| Total loss related to other-than-temporarily impaired securities | — | — | — | (129) |
| Portion of loss recognized in other comprehensive income | — | — | — | 80 |
| Other-than-temporary impairment loss recognized in net income | — | — | — | (49) |
| Gain (loss) on sale of securities | 54 | 97 | 538 | (69) |
| Loss on asset disposals | (28) | (34) | (59) | (121) |
| Other | 100 | 102 | 297 | 304 |
| Total noninterest income | 1,943 | 1,641 | 5,076 | 8,347 |
| Noninterest Expense | | | | |
| Salaries and employee benefits | 3,346 | 2,512 | 9,422 | 7,737 |
| Marketing, advertising, and promotion | 403 | 562 | 1,179 | 1,389 |
| Consulting and professional services | 431 | 577 | 1,383 | 1,791 |
| Data processing | 246 | 247 | 722 | 693 |
| Loan expenses | 208 | 209 | 458 | 574 |
| Premises and equipment | 548 | 534 | 1,816 | 1,468 |
| Deposit insurance premium | 155 | 85 | 437 | 313 |
| Other | 448 | 414 | 1,366 | 1,263 |
| Total noninterest expense | 5,785 | 5,140 | 16,783 | 15,228 |
| Income Before Income Taxes | 1,943 | 913 | 4,243 | 5,502 |
| Income Tax Provision | 661 | 186 | 1,384 | 1,575 |
| Net Income | $1,282 | $727 | $2,859 | $3,927 |
| Income Per Share of Common Stock | | | | |
| Basic | $0.29 | $0.25 | $0.64 | $1.36 |
| Diluted | $0.28 | $0.25 | $0.63 | $1.36 |
| Weighted-Average Number of Common Shares Outstanding | | | | |
| Basic | 4,497,762 | 2,890,369 | 4,496,228 | 2,888,274 |
| Diluted | 4,511,291 | 2,903,816 | 4,505,801 | 2,889,039 |

| | | | | |
|---|---|---|---|---|
| Dividends Declared Per Share | $0.06 | $0.06 | $0.18 | $0.16 |

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Comprehensive Income – Unaudited
(Dollar amounts in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | $1,282 | $727 | $2,859 | $3,927 |
| Other comprehensive income | | | | |
| Net unrealized holding gains (losses) on securities available-for-sale | (1,451) | (21) | 2,099 | (5,344) |
| Reclassification adjustment for (gains) losses realized | (54) | (97) | (538) | 69 |
| Net unrealized holding gains (losses) on securities available-for-sale for which an other-than-temporary impairment has been recognized in income | — | — | 751 | (129) |
| Reclassification adjustment for other-than-temporary impairment loss recognized in income | — | — | — | 49 |
| Other comprehensive income (loss) before income tax | (1,505) | (118) | 2,312 | (5,355) |
| Income tax provision (benefit) | (536) | (41) | 822 | (1,874) |
| Other comprehensive income (loss) | (969) | (77) | 1,490 | (3,481) |
| Comprehensive income | $313 | $650 | $4,349 | $446 |

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Shareholders’ Equity - Unaudited
Nine Months Ended September 30, 2014
(Dollar amounts in thousands except per share data)

| | Voting and Nonvoting Common Stock | Accumulated Other Comprehensive Loss | Retained Earnings | Total Shareholders’ Equity |
|---|---|---|---|---|
| Balance, January 1, 2014 | $71,378 | $(2,372) | $21,902 | $90,908 |
| Net income | — | — | 2,859 | 2,859 |
| Other comprehensive income | — | 1,490 | — | 1,490 |
| Dividends declared ($0.18 per share) | — | — | (810) | (810) |
| Recognition of the fair value of share-based compensation | 443 | — | — | 443 |
| Common stock redeemed for the net settlement of share-based awards | (71) | — | — | (71) |
| Other | (45) | — | — | (45) |
| Balance, September 30, 2014 | $71,705 | $(882) | $23,951 | $94,774 |

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Cash Flows – Unaudited
(Dollar amounts in thousands)

| | Nine Months Ended September 30, 2014 | 2013 |
|---|---|---|
| Operating Activities | | |
| Net income | $2,859 | $3,927 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,432 | 1,774 |
| Increase in cash surrender value of bank-owned life insurance | (291) | (296) |
| Provision (credit) for loan losses | (38) | 101 |
| Share-based compensation expense | 443 | 274 |
| Loss on other-than-temporary impairment of securities | — | 49 |
| Loss (gain) from sale of available-for-sale securities | (538) | 69 |
| Loans originated for sale | (285,686) | (606,768) |
| Proceeds from sale of loans | 290,454 | 659,441 |
| Gain on loans sold | (3,278) | (7,208) |
| Unrealized gain on loans held-for-sale | (427) | (540) |
| Gain on derivatives | (62) | (19) |
| Net change in: | | |
| Accrued interest receivable | 101 | (614) |
| Accrued income and other assets | 530 | 1,161 |
| Accrued expenses and other liabilities | 638 | 923 |
| Net cash provided by operating activities | 6,137 | 52,274 |
| Investing Activities | | |
| Net change in loans | (88,148) | (29,105) |
| Proceeds from sale of other real estate owned | 235 | — |
| Net change in interest bearing deposits | 500 | (2,500) |
| Maturities of securities available-for-sale | 14,394 | 27,319 |
| Proceeds from sale of securities available-for-sale | 137,816 | 41,680 |
| Purchase of securities available-for-sale | (96,803) | (135,627) |
| Purchase of premises and equipment | (683) | (6,563) |
| Loans purchased | (106,480) | (53,342) |
| Net cash used in investing activities | (139,169) | (158,138) |
| Financing Activities | | |
| Net increase in deposits | 64,875 | 105,962 |
| Cash dividends paid | (794) | (282) |
| Proceeds from issuance of subordinated debt and related warrants | — | 3,000 |
| Proceeds from advances from Federal Home Loan Bank | 95,000 | 13,000 |
| Repayment of advances from Federal Home Loan Bank | (40,000) | (22,000) |
| Other, net | (132) | — |
| Net cash provided by financing activities | 118,949 | 99,680 |
| Net Decrease in Cash and Cash Equivalents | (14,083) | (6,184) |
| Cash and Cash Equivalents, Beginning of Period | 53,690 | 32,513 |
| Cash and Cash Equivalents, End of Period | $39,607 | $26,329 |
| Supplemental Disclosures of Cash Flows Information | | |
| Cash paid during the period for interest | $6,700 | $5,985 |
| Cash paid during the period for taxes | 1,225 | 723 |

| | | |
|---|---|---|
| Loans transferred to real estate owned | — | 507 |
| Cash dividends declared, not paid | 265 | 169 |

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Notes to Condensed Consolidated Financial Statements – Unaudited
(Dollar amounts in thousands except per share data)

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information or footnotes necessary for a complete presentation of financial condition, results of operations, or cash flows in accordance with U.S. GAAP. In our opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results expected for the year ending December 31, 2014 or any other period. The September 30, 2014 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the First Internet Bancorp Annual Report on Form 10-K for the year ended December 31, 2013.

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments, or assumptions that could have a material effect on the carrying value of certain assets and liabilities. These estimates, judgments, and assumptions affect the amounts reported in the condensed consolidated financial statements and the disclosures provided. The determination of the allowance for loan losses, valuations and impairments of investment securities, and the accounting for income tax expense are highly dependent upon management's estimates, judgments, and assumptions where changes in any of these could have a significant impact on the financial statements.

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations, and cash flows of the Company.

The condensed consolidated financial statements include the accounts of First Internet Bancorp (the "Company"), its wholly-owned subsidiary, First Internet Bank of Indiana (the "Bank"), and the Bank's wholly-owned subsidiary, JKH Realty Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain reclassifications have been made to the 2013 financial statements to conform to the 2014 financial statement presentation. These reclassifications had no effect on net income.

On June 21, 2013, the Company completed a three-for-two (3:2) split of its common stock by the payment of a stock dividend of one-half of one share on each outstanding share of common stock. Except as otherwise indicated, all of the share and per-share information referenced throughout this report has been adjusted to reflect this stock split.

Note 2: Earnings Per Share

Earnings per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the period.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the three and nine months ended September 30, 2014 and 2013:

| | Three Months Ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| Basic earnings per share | | |
| Net income available to common shareholders | $1,282 | $727 |
| Weighted-average common shares | 4,497,762 | 2,890,369 |
| Basic earnings per common share | $0.29 | $0.25 |
| Diluted earnings per share | | |
| Net income applicable to diluted earnings per share | $1,282 | $727 |
| Weighted-average common shares | 4,497,762 | 2,890,369 |
| Dilutive effect of warrants | — | 13,447 |
| Dilutive effect of equity compensation | 13,529 | — |
| Weighted-average common and incremental shares | 4,511,291 | 2,903,816 |
| Diluted earnings per common share | $0.28 | $0.25 |
| Number of warrants excluded from the calculation of diluted earnings per share as the exercise prices were greater than the average market price of the Company's common stock during the period | 48,750 | — |

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| Basic earnings per share | | |
| Net income available to common shareholders | $2,859 | $3,927 |
| Weighted-average common shares | 4,496,228 | 2,888,274 |
| Basic earnings per common share | $0.64 | $1.36 |
| Diluted earnings per share | | |
| Net income applicable to diluted earnings per share | $2,859 | $3,927 |
| Weighted-average common shares | 4,496,228 | 2,888,274 |
| Dilutive effect of warrants | 3,871 | 765 |
| Dilutive effect of equity compensation | 5,702 | — |
| Weighted-average common and incremental shares | 4,505,801 | 2,889,039 |
| Diluted earnings per common share | $0.63 | $1.36 |
| Number of warrants excluded from the calculation of diluted earnings per share as the exercise prices were greater than the average market price of the Company's common stock during the period | — | — |

Note 3: Securities

Securities at September 30, 2014 and December 31, 2013 are as follows:

| | September 30, 2014 | | | |
|---|---|---|---|---|
| | Amortized | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | Value |
| Securities available-for-sale | | | | |
| U.S. Government-sponsored enterprises | $16,049 | $122 | $(446) | $15,725 |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 111,524 | 50 | (1,085) | 110,489 |
| Other securities | 2,000 | — | (11) | 1,989 |
| Total available-for-sale | $129,573 | $172 | $(1,542) | $128,203 |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | Value |
| Securities available-for-sale | | | | |
| U.S. Government-sponsored enterprises | $57,569 | $470 | $(1,762) | $56,277 |
| Municipal securities | 46,126 | 1,080 | (883) | 46,323 |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 75,058 | 696 | (1,813) | 73,941 |
| Mortgage-backed and asset-backed securities – private labeled | 1,313 | 9 | (90) | 1,232 |
| Other securities | 5,025 | — | (1,389) | 3,636 |
| Total available-for-sale | $185,091 | $2,255 | $(5,937) | $181,409 |

The carrying value of securities at September 30, 2014 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Available-for-Sale | |
|---|---|---|
| | Amortized | Fair |
| | Cost | Value |
| Within one year | $2,000 | $1,989 |
| One to five years | — | — |
| Five to ten years | 814 | 803 |
| After ten years | 15,235 | 14,922 |
| | 18,049 | 17,714 |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 111,524 | 110,489 |
| Totals | $129,573 | $128,203 |

Gross gains of $450 and $104, and gross losses of $396 and $7 resulting from sales of available-for-sale securities were realized for the three months ended September 30, 2014 and 2013, respectively. In the nine months ended September 30, 2014 and 2013, gross gains of $2,749 and $278 and gross losses of $2,211 and $347 were recognized, respectively.

Certain investments in debt securities are reported in the condensed consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at September 30, 2014 and December 31, 2013 was $107,243 and $109,946, which is approximately 84% and 61%, respectively, of the Company's available-for-sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

Except as discussed below, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period in which the other-than-temporary impairment ("OTTI") is identified.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or Longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Securities available for sale: | | | | | | |
| U.S. Government-sponsored enterprises | $803 | $(11) | $8,729 | $(435) | $9,532 | $(446) |
| Mortgage-backed and asset-backed securities - government-sponsored enterprises | 74,317 | (365) | 21,405 | (720) | 95,722 | (1,085) |
| Other securities | 1,989 | (11) | — | — | 1,989 | (11) |
| | $77,109 | $(387) | $30,134 | $(1,155) | $107,243 | $(1,542) |

| | December 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or Longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Securities available for sale: | | | | | | |
| U.S. Government-sponsored enterprises | $43,085 | $(1,761) | $14 | $(1) | $43,099 | $(1,762) |
| Municipal securities | 14,105 | (882) | 351 | (1) | 14,456 | (883) |
| Mortgage-backed and asset-backed securities - government-sponsored enterprises | 47,875 | (1,813) | — | — | 47,875 | (1,813) |
| Mortgage-backed and asset-backed securities – private labeled | 43 | (1) | 838 | (89) | 881 | (90) |
| Other securities | 1,962 | (38) | 1,673 | (1,351) | 3,635 | (1,389) |
| | $107,070 | $(4,495) | $2,876 | $(1,442) | $109,946 | $(5,937) |

U.S. Government Sponsored Enterprise and Municipal Securities

The unrealized losses on the Company's investments in securities issued by U.S. Government-sponsored enterprises and municipal securities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments at a loss and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2014.

Mortgage-Backed Securities

The unrealized losses on the Company's investments in mortgage-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost bases over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments at a loss and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2014.

For identified mortgage-backed securities in the investment portfolio, an extensive, quarterly review is conducted to determine if an other-than-temporary impairment has occurred. Various inputs to the economic models are used to determine if an unrealized loss is other-than-temporary. The most significant inputs are voluntary prepayment rates, default rates, liquidation rates, and loss severity.

To determine if the unrealized loss for mortgage-backed securities is other-than-temporary, the Company projects total estimated defaults of the underlying assets (mortgages) and multiplies that calculated amount by an estimate of realizable value upon sale in the marketplace (severity) in order to determine the projected collateral loss. The Company also evaluates the current credit enhancement underlying the security to determine the impact on cash flows. If the Company determines that a given mortgage-backed security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

Other Securities

The Company’s unrealized loss on investments in other securities at December 31, 2013 primarily consists of two investments, both of which were sold in the second quarter of 2014.

The first investment was a $2,000 par investment in I-PreTSL I B-2 pooled trust security. The unrealized loss was primarily caused by a sector downgrade by several industry analysts. The determination of no credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment.

The second investment was a $2,000 par investment in ALESCO IV Series B2 pooled trust security for which the Company recognized an other-than-temporary impairment loss. The unrealized loss was primarily caused by: (a) a decrease in performance; and (b) a sector downgrade by several industry analysts. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment.

The Company did not recognize any credit losses in earnings during the three months ended September 30, 2014 and 2013. The credit losses recognized in earnings during the nine months ended September 30, 2014 and 2013 were as follows:

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| Mortgage-backed and asset-backed securities – private labeled | — | 49 |
| Total credit losses recognized in earnings | $— | $49 |

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Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not considered other-than-temporarily impaired.

The following tables provide information about debt securities for which only a credit loss was recognized in income and other losses are recorded in accumulated other comprehensive loss. The Company did not own any OTTI securities during the three months ended September 30, 2014.

| | Accumulated Credit Losses |
|---|---|
| Credit losses on debt securities held | |
| July 1, 2013 | $1,342 |
| Realized losses related to OTTI | (98) |
| Recoveries related to OTTI | — |
| Additions related to OTTI losses not previously recognized | — |
| Additions related to increases in previously recognized OTTI losses | — |
| September 30, 2013 | $1,244 |

| | Accumulated Credit Losses |
|---|---|
| Credit losses on debt securities held | |
| January 1, 2014 | $1,183 |
| Realized losses related to OTTI | (1,139) |
| Recoveries related to OTTI | (44) |
| Additions related to OTTI losses not previously recognized | — |
| Additions related to increases in previously recognized OTTI losses | — |
| September 30, 2014 | $— |

| | Accumulated Credit Losses |
|---|---|
| Credit losses on debt securities held | |
| January 1, 2013 | $1,737 |
| Realized losses related to OTTI | (542) |
| Recoveries related to OTTI | — |
| Additions related to OTTI losses not previously recognized | 31 |
| Additions related to increases in previously recognized OTTI losses | 18 |
| September 30, 2013 | $1,244 |

Amounts reclassified from accumulated other comprehensive loss and the affected line items in the condensed consolidated statements of income during the three and nine months ended September 30, 2014 and 2013, were as follows:

| | Amounts Reclassified from Accumulated Other Comprehensive Loss for the Three Months Ended September 30, | | Affected Line Item in the Statements of Income |
|---|---|---|---|
| | 2014 | 2013 | |
| Securities available for sale | | | |
| Gain realized in earnings | $54 | $97 | Gain (loss) on sale of securities |
| OTTI losses recognized in earnings | — | — | Other-than-temporary impairment loss recognized in net income |
| Total reclassified amount before tax | 54 | 97 | Income Before Income Taxes |
| Tax expense | 18 | 34 | Income Tax Provision |
| Total reclassifications out of accumulated other comprehensive loss | $36 | $63 | Net Income |

| | Amounts Reclassified from Accumulated Other Comprehensive Loss for the Nine Months Ended September 30, | | Affected Line Item in the Statements of Income |
|---|---|---|---|
| | 2014 | 2013 | |
| Securities available for sale | | | |
| Gain (loss) realized in earnings | $538 | $(69) | Gain (loss) on sale of securities |
| OTTI losses recognized in earnings | — | (49) | Other-than-temporary impairment loss recognized in net income |
| Total reclassified amount before tax | 538 | (118) | Income Before Income Taxes |
| Tax expense (benefit) | 183 | (41) | Income Tax Provision |
| Total reclassifications out of accumulated other comprehensive loss | $355 | $(77) | Net Income |

## Note 4: Loans Receivable

Loans that management intends to hold until maturity are reported at their outstanding principal balance adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans.

For loans recorded at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

Categories of loans include:

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Real estate loans | | |
| Residential | $282,298 | $191,007 |
| Commercial | 235,878 | 142,429 |
| Total real estate loans | 518,176 | 333,436 |
| Commercial loans | 72,099 | 55,168 |
| Consumer loans | 100,074 | 107,562 |
| Total loans | 690,349 | 496,166 |
| Deferred loan origination costs and premiums and discounts on purchased loans | 5,580 | 4,987 |
| Allowance for loan losses | (5,464) | (5,426) |
| Net loans receivable | $690,465 | $495,727 |

The risk characteristics of each loan portfolio segment are as follows:

Commercial Real Estate: These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. These loans may also incorporate a personal guarantee. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company’s commercial real estate portfolio are diverse in terms of property type and geographic location. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value, and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated market areas unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner-occupied loans.

Commercial: Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Loans are made for working capital, equipment purchases, or other purposes. Most commercial loans are secured by the assets being financed and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis.

Residential and Consumer: With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences. The properties securing the Company's residential loan portfolio are generally geographically diverse as the Company offers these loans on a nationwide basis. Repayment on residential loans can be impacted by changes in property values on residential properties. Consumer loans are secured by consumer assets such as horse trailers, recreational vehicles, or automobiles. Some consumer loans are unsecured, such as small installment loans and certain lines of credit. Repayment of consumer loans is primarily dependent upon the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.

Allowance for Loan Losses Methodology

Company policy is designed to ensure that an adequate allowance for loan losses ("ALLL") is maintained. The portfolio is segmented by loan type. The required ALLL for types of performing homogeneous loans which do not have a specific reserve is determined by applying a factor based on historical losses averaged over the past twelve months. Management believes the historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed. Management adds qualitative factors for observable trends, changes in internal practices, changes in delinquencies and impairments, and external factors. Observable factors include changes in the composition and size of portfolios, as well as loan terms or concentration levels. The Company evaluates the impact of internal changes such as management and staff experience levels or modification to loan underwriting processes. Delinquency trends are scrutinized for both volume and severity of past due, nonaccrual, classified, or graded loans as well as any changes in the value of underlying collateral. Finally, the Company considers the effect of other external factors such as national, regional, and local economic and business conditions, as well as competitive, legal, and regulatory requirements. Loans that are considered to be impaired are evaluated to determine the need for a specific allowance by applying at least one of three methodologies: present value of future cash flows; fair value of collateral less cost to sell; or the loan's observable market price. All troubled debt restructurings ("TDR") are considered impaired loans. Loans evaluated for impairment are removed from other pools to prevent double-counting.

Provision (Credit) for Loan Losses

A provision for estimated losses on loans is charged to operations based upon management's evaluation of the potential losses. Such an evaluation, which includes a review of all loans for which full collectability may not be reasonably assured considers, among other matters, the estimated net realizable value of the underlying collateral, as applicable, economic conditions, loan loss experience, and other factors that are particularly susceptible to changes that could result in a material adjustment in the near term. While management endeavors to use the best information available in making its evaluations, future allowance adjustments may be necessary if economic conditions change substantially from the assumptions used in making the evaluations.

Accounting Standards Codification ("ASC") Topic 310, Receivables, requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans' effective interest rates or the fair value of the underlying collateral and allows existing methods for recognizing interest income.

Policy for Charging Off Loans

The Company's policy is to charge off a loan at any point in time when it no longer can be considered a bankable asset, meaning collectible within the parameters of policy. A secured loan is generally charged off to the estimated fair value of the collateral, less costs to sell, no later than when it is 120 days past due as to principal or interest. An unsecured loan generally is charged off no later than when it is 180 days past due as to principal or interest.

The following tables present changes in the balance of the ALLL during the three and nine month periods ended September 30, 2014 and 2013:

| | Three Months Ended September 30, 2014 | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | Commercial Real Estate | Commercial | Consumer | Total |
| Allowance for loan losses: | | | | | |
| Balance, beginning of period | $1,203 | $2,395 | $735 | $807 | $5,140 |
| Provision (credit) charged to expense | 53 | (248) | 188 | (105) | (112) |
| Losses charged off | (5) | — | (14) | (92) | (111) |

| | | | | | |
|---|---|---|---|---|---|
| Recoveries | 7 | 459 | — | 81 | 547 |
| Balance, end of period | $1,258 | $2,606 | $909 | $691 | $5,464 |

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| | Nine Months Ended September 30, 2014 | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | Commercial Real Estate | Commercial | Consumer | Total |
| Allowance for loan losses: | | | | | |
| Balance, beginning of period | $1,219 | $2,517 | $819 | $871 | $5,426 |
| Provision (credit) charged to expense | 224 | (370) | 104 | 4 | (38) |
| Losses charged off | (216) | — | (14) | (427) | (657) |
| Recoveries | 31 | 459 | — | 243 | 733 |
| Balance, end of period | $1,258 | $2,606 | $909 | $691 | $5,464 |

| | Three Months Ended September 30, 2013 | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | Commercial Real Estate | Commercial | Consumer | Total |
| Allowance for loan losses: | | | | | |
| Balance, beginning of period | $984 | $2,918 | $547 | $1,078 | $5,527 |
| Provision (credit) charged to expense | 33 | (36) | 168 | (222) | (57) |
| Losses charged off | (18) | — | — | (175) | (193) |
| Recoveries | 73 | — | — | 109 | 182 |
| Balance, end of period | $1,072 | $2,882 | $715 | $790 | $5,459 |

| | Nine Months Ended September 30, 2013 | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | Commercial Real Estate | Commercial | Consumer | Total |
| Allowance for loan losses: | | | | | |
| Balance, beginning of period | $1,149 | $3,107 | $371 | $1,206 | $5,833 |
| Provision (credit) charged to expense | (97) | 13 | 274 | (89) | 101 |
| Losses charged off | (72) | (238) | — | (573) | (883) |
| Recoveries | 92 | — | 70 | 246 | 408 |
| Balance, end of period | $1,072 | $2,882 | $715 | $790 | $5,459 |

The following tables present the recorded investment in loans based on portfolio segment and impairment method as of September 30, 2014, and December 31, 2013:

| | September 30, 2014 | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | Commercial Real Estate | Commercial | Consumer | Total |
| Loans: | | | | | |
| Ending balance | $282,298 | $235,878 | $72,099 | $100,074 | $690,349 |
| Ending balance: individually evaluated for impairment | 1,080 | 89 | — | 283 | 1,452 |
| Ending balance: collectively evaluated for impairment | $281,218 | $235,789 | $72,099 | $99,791 | $688,897 |
| Allowance for loan losses: | | | | | |
| Ending balance | $1,258 | $2,606 | $909 | $691 | $5,464 |
| Ending balance: individually evaluated for impairment | 7 | — | — | 22 | 29 |
| Ending balance: collectively evaluated for impairment | $1,251 | $2,606 | $909 | $669 | $5,435 |

| | December 31, 2013 | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | Commercial Real Estate | Commercial | Consumer | Total |
| Loans: | | | | | |
| Ending balance | $191,007 | $142,429 | $55,168 | $107,562 | $496,166 |
| Ending balance: individually evaluated for impairment | 1,684 | 1,054 | — | 339 | 3,077 |
| Ending balance: collectively evaluated for impairment | $189,323 | $141,375 | $55,168 | $107,223 | $493,089 |
| Allowance for loan losses: | | | | | |
| Ending balance | $1,219 | $2,517 | $819 | $871 | $5,426 |
| Ending balance: individually evaluated for impairment | 116 | 98 | — | 28 | 242 |
| Ending balance: collectively evaluated for impairment | $1,103 | $2,419 | $819 | $843 | $5,184 |

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 9. A description of the general characteristics of the nine risk grades is as follows:

- “Pass” (Grades 1-5) - Higher quality loans that do not fit any of the other categories described below.
- “Special Mention” (Grade 6) - Loans that possess some credit deficiency or potential weakness which deserve close attention.
- “Substandard” (Grade 7) - Loans that possess a defined weakness or weaknesses that jeopardize the liquidation of the debt. Loans characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans that are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any.
- “Doubtful” (Grade 8) - Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event which lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard; however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.
- “Loss” (Grade 9) - Loans that are considered uncollectible and of such little value that continuing to carry them as assets is not warranted.

Nonaccrual Loans

Any loan which becomes 90 days delinquent or has the full collection of principal and interest in doubt will be considered for nonaccrual status. At the time a loan is placed on nonaccrual, all accrued but unpaid interest will be reversed from interest income. Placing the loan on nonaccrual does not relieve the borrower of the obligation to repay interest. A loan placed on nonaccrual may be restored to accrual status when all delinquent principal and interest has been brought current, and the Company expects full payment of the remaining contractual principal and interest.

The following tables present the credit risk profile of the Company’s loan portfolio based on rating category and payment activity as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | |
|---|---|---|
| | Commercial Real Estate | Commercial |
| Rating: | | |
| 1-5 Pass | $233,437 | $69,649 |
| 6 Special Mention | 815 | — |
| 7 Substandard | 1,626 | 2,450 |
| 8 Doubtful | — | — |
| Total | $235,878 | $72,099 |

| | September 30, 2014 | |
|---|---|---|
| | Residential Real Estate | Consumer |
| Performing | $282,241 | $99,921 |
| Nonaccrual | 57 | 153 |
| Total | $282,298 | $100,074 |

| | December 31, 2013 | |
|---|---|---|
| | Commercial Real Estate | Commercial |
| Rating: | | |
| 1-5 Pass | $139,052 | $54,035 |
| 6 Special Mention | 2,323 | 1,133 |
| 7 Substandard | 1,054 | — |
| 8 Doubtful | — | — |
| Total | $142,429 | $55,168 |

| | December 31, 2013 | |
|---|---|---|
| | Residential Real Estate | Consumer |
| Performing | $190,377 | $107,412 |
| Nonaccrual | 630 | 150 |
| Total | $191,007 | $107,562 |

The following tables present the Company's loan portfolio delinquency analysis as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans Receivable | Non-accrual Loans | Total Loans 90 Days or More Past Due and Accruing |
| Residential real estate | $48 | $160 | $96 | $304 | $281,994 | $282,298 | $57 | $96 |
| Commercial real estate | — | — | — | — | 235,878 | 235,878 | 89 | — |
| Commercial | — | — | — | — | 72,099 | 72,099 | — | — |
| Consumer | 296 | 93 | 55 | 444 | 99,630 | 100,074 | 153 | 5 |
| Total | $344 | $253 | $151 | $748 | $689,601 | $690,349 | $299 | $101 |

| | December 31, 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans Receivable | Non-accrual Loans | Total Loans 90 Days or More Past Due and Accruing |
| Residential real estate | $122 | $— | $603 | $725 | $190,282 | $191,007 | $630 | $— |
| Commercial real estate | — | — | 955 | 955 | 141,474 | 142,429 | 1,054 | — |
| Commercial | — | — | — | — | 55,168 | 55,168 | — | — |
| Consumer | 484 | 45 | 84 | 613 | 106,949 | 107,562 | 150 | 18 |
| Total | $606 | $45 | $1,642 | $2,293 | $493,873 | $496,166 | $1,834 | $18 |

Impaired Loans

A loan is designated as impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16) when, based on current information or events, it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Payments with delays generally not exceeding 90 days outstanding are not considered impaired. Certain nonaccrual and substantially all delinquent loans more than 90 days past due may be considered to be impaired. Generally, loans are placed on nonaccrual status at 90 days past due and accrued interest is reversed against earnings, unless the loan is well-secured and in the process of collection. The accrual of interest on impaired and nonaccrual loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due.

Impaired loans include nonperforming commercial loans but also include loans modified in TDRs where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance, or other actions intended to maximize collection.

The following table presents the Company's impaired loans as of September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| | Recorded Balance | Unpaid Principal Balance | Specific Allowance | Recorded Balance | Unpaid Principal Balance | Specific Allowance |
| Loans without a specific valuation allowance | | | | | | |
| Residential real estate loans | $1,048 | $1,057 | $— | $1,551 | $1,842 | $— |
| Commercial real estate loans | 89 | 89 | — | 956 | 2,310 | — |
| Commercial loans | — | — | — | — | — | — |
| Consumer loans | 222 | 368 | — | 271 | 326 | — |
| Total | 1,359 | 1,514 | — | 2,778 | 4,478 | — |
| Loans with a specific valuation allowance | | | | | | |
| Residential real estate loans | 32 | 32 | 7 | 133 | 141 | 116 |
| Commercial real estate loans | — | — | — | 98 | 98 | 98 |
| Commercial loans | — | — | — | — | — | — |
| Consumer loans | 61 | 64 | 22 | 68 | 80 | 28 |
| Total | 93 | 96 | 29 | 299 | 319 | 242 |
| Total impaired loans | | | | | | |
| Residential real estate loans | 1,080 | 1,089 | 7 | 1,684 | 1,983 | 116 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Commercial real estate loans | 89 | 89 | — | 1,054 | 2,408 | 98 |
| Commercial loans | — | — | — | — | — | — |
| Consumer loans | 283 | 432 | 22 | 339 | 406 | 28 |
| Total | $1,452 | $1,610 | $29 | $3,077 | $4,797 | $242 |

The table below presents average balances and interest income recognized for impaired loans during both the three and nine month periods ended September 30, 2014 and September 30, 2013:

| | September 30, 2014 | | | | September 30, 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | Three Months Ended | | Nine Months Ended | | Three Months Ended | | Nine Months Ended | |
| | Average Balance | Interest Income | Average Balance | Interest Income | Average Balance | Interest Income | Average Balance | Interest Income |
| Loans without a specific valuation allowance | | | | | | | | |
| Residential real estate loans | $1,102 | $8 | $1,267 | $20 | $1,890 | $9 | $2,018 | $23 |
| Commercial real estate loans | 568 | 1 | 810 | 4 | — | — | — | — |
| Commercial loans | — | — | — | — | — | — | — | — |
| Consumer loans | 287 | 9 | 322 | 26 | 319 | 7 | 342 | 23 |
| Total | 1,957 | 18 | 2,399 | 50 | 2,209 | 16 | 2,360 | 46 |
| Loans with a specific valuation allowance | | | | | | | | |
| Residential real estate loans | 32 | — | 32 | — | 51 | 1 | 141 | 2 |
| Commercial real estate loans | — | — | — | — | 1,953 | 1 | 2,210 | 4 |
| Commercial loans | — | — | — | — | — | — | — | — |
| Consumer loans | 80 | 2 | 77 | 3 | 58 | 2 | 84 | 4 |
| Total | 112 | 2 | 109 | 3 | 2,062 | 4 | 2,435 | 10 |
| Total impaired loans | | | | | | | | |
| Residential real estate loans | 1,134 | 8 | 1,299 | 20 | 1,941 | 10 | 2,159 | 25 |
| Commercial real estate loans | 568 | 1 | 810 | 4 | 1,953 | 1 | 2,210 | 4 |
| Commercial loans | — | — | — | — | — | — | — | — |
| Consumer loans | 367 | 11 | 399 | 29 | 377 | 9 | 426 | 27 |
| Total | $2,069 | $20 | $2,508 | $53 | $4,271 | $20 | $4,795 | $56 |

Troubled Debt Restructurings ("TDRs")

The loan portfolio includes TDRs which are loans that have been modified to grant economic concessions to borrowers who have experienced financial difficulties. These concessions typically result from loss mitigation efforts and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally not less than six consecutive months.

When loans are modified in a TDR, any possible impairment similar to other impaired loans is evaluated based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or using the current fair value of the collateral, less selling costs for collateral dependent loans. If it is determined that the value of the modified loan is less than the recorded balance of the loan, impairment is recognized through a specific allowance or charge-off to the allowance. In periods subsequent to modification, all TDRs, including those that have payment defaults, are evaluated for possible impairment, and impairment is recognized through the allowance.

In the course of working with troubled borrowers, the Company may choose to restructure the contractual terms of certain loans in an effort to work out an alternative payment schedule with the borrower in order to optimize the collectability of the loan. Any loan modified is reviewed by the Company to identify if a TDR has occurred (when the Company grants a concession to the borrower that it would not otherwise consider based on economic or legal reasons related to a borrower's financial difficulties). Terms may be modified to fit the ability of the borrower to repay in line with its current financial status or the loan may be restructured to secure additional collateral and/or guarantees to support the debt, or a combination of the two.

There were no loans classified as new TDRs during the three months ended September 30, 2014 and 2013. Loans classified as new TDRs during the nine months ended September 30, 2014 and 2013 are shown in the table below. The 2014 and 2013 modifications consisted solely of maturity date concessions.

| | New TDRs During the Nine Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | September 30, 2014 | | | September 30, 2013 | | |
| | Number of Contracts | Recorded Balance Before | Recorded Balance After | Number of Contracts | Recorded Balance Before | Recorded Balance After |
| Real estate loans: | | | | | | |
| Residential | — | $— | $— | — | $— | $— |
| Commercial | — | — | — | — | — | — |
| Total real estate loans | — | — | — | — | — | — |
| Commercial loans | — | — | — | — | — | — |
| Consumer loans | 1 | 21 | 21 | 4 | 25 | 25 |
| Total loans | 1 | $21 | $21 | 4 | $25 | $25 |

There were no TDR loans which had payment defaults during the nine months ended September 30, 2014 and 2013. Default occurs when a loan is 90 days or more past due or transferred to nonaccrual within twelve months of restructuring.

Note 5: Premises and Equipment

Premises and equipment at September 30, 2014 and December 31, 2013 consisted of the following:

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Land | $2,500 | $2,500 |
| Building and improvements | 3,019 | 2,858 |
| Furniture and equipment | 5,075 | 4,883 |
| Less: accumulated depreciation | (3,519) | (3,107) |
| | $7,075 | $7,134 |

In 2013, the Company acquired an office building with approximately 52,000 square feet of office space and related real estate located in Fishers, Indiana. The Company acquired the property for the current and future operations of the Bank for $4,083. The cost basis of the building is being depreciated on a straight-line basis over 39 years.

Note 6: Goodwill

The change in the carrying amount of goodwill for the periods ended September 30, 2014 and December 31, 2013 were:

| | |
|---|---|
| Balance as of January 1, 2013 | $4,687 |
| Changes in goodwill during the year | — |
| Balance as of December 31, 2013 | 4,687 |
| Changes in goodwill during the period | — |
| Balance as of September 30, 2014 | $4,687 |

Goodwill is tested for impairment on an annual basis as of August 31, or whenever events or changes in circumstances indicate the carrying amount of goodwill exceeds its implied fair value. No events or changes in circumstances have occurred since the August 31, 2014 annual impairment test that would suggest it was more likely than not goodwill impairment existed.

Note 7: Benefit Plans

Employment Agreement

The Company has entered into an employment agreement with its Chief Executive Officer that provides for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreement, these payments could occur in the event of a change in control of the Company, as defined, along with other specific conditions.

2013 Equity Incentive Plan

The 2013 Equity Incentive Plan (the “2013 Plan”) authorizes the issuance of 750,000 shares of the Company's common stock in the form of equity-based awards to employees, directors, and other eligible persons. The 2013 Plan replaced the 2006 Stock Option Plan, which had 595,500 shares of common stock available for issuance when the 2013 Plan became effective. Under the terms of the 2013 Plan, the pool of shares available for issuance may be used for available types of equity awards under the 2013 Plan, which includes stock options, stock appreciation rights, restricted stock awards, stock unit awards, and other stock-based awards. All employees, consultants, and advisors of the Company or any subsidiary, as well as all non-employee directors of the Company, are eligible to receive awards under the 2013 Plan.

The Company recorded $191 and $443 of share-based compensation expense for the three and nine month periods ended September 30, 2014, respectively, related to awards made under the 2013 Plan. The Company recorded $167 of share-based compensation expense in the three and nine months ended September 30, 2013.

The following table summarizes the status of the 2013 Plan awards as of September 30, 2014, and activity for the nine months ended September 30, 2014:

| | Restricted Stock Awards | Weighted-Average Grant Date Fair Value Per Share | Deferred Stock Units | Weighted-Average Grant Date Fair Value Per Share |
|---|---|---|---|---|
| Nonvested at January 1, 2014 | 46,232 | $ 25.09 | — | $ — |
| Granted | 4,445 | 22.50 | 894 | 22.50 |
| Vested | (18,746) | 24.63 | (672) | 22.50 |
| Forfeited | (10,044) | 25.09 | — | — |
| Nonvested at September 30, 2014 | 21,887 | $ 24.96 | 222 | $ 22.50 |

At September 30, 2014, there were 711,630 shares available for future grants under the 2013 Plan.

Directors Deferred Stock Plan

Until January 1, 2014, the Company had a stock compensation plan for members of the Board of Directors ("Directors Deferred Stock Plan"). The Company reserved 180,000 shares of common stock that could have been issued pursuant to the Directors Deferred Stock Plan. The plan provided directors the option to elect to receive up to 100% of their annual retainer in either common stock or deferred stock rights. Deferred stock rights were to be settled in common stock following the end of the deferral period payable on the basis of one share of common stock for each deferred stock right.

For the three and nine months ended September 30, 2013, the Company recorded $43 and $107 of expense, respectively, related to awards made from the Directors Deferred Stock Plan. Awards were granted on January 1 at fair value and vested from January 1 until December 31. The Company recognized compensation expense ratably over the vesting period based upon the fair value of the stock on the grant date. The Directors Deferred Stock Plan ended on December 31, 2013. On January 1, 2014, the Company issued tandem awards of shares of restricted stock and deferred stock units to each of its non-employee directors under the 2013 Plan. Each award had a grant date fair value of $20 and represents the non-cash component of the compensation payable for the directors' service during 2014. The economic terms of the awards are substantially the same as the non-cash retainer compensation the non-employee directors received for 2013 in the form of director deferred stock rights.

The following is an analysis of deferred stock rights related to the Directors Deferred Stock Plan for the nine months ended September 30, 2014:

| | Deferred Stock Rights |
|---|---|
| Outstanding, beginning of period | 79,676 |
| Granted | 637 |
| Exercised | — |
| Outstanding, end of period | 80,313 |

All deferred stock rights granted during the 2014 period were additional rights issued in lieu of cash dividends payable on outstanding deferred stock rights.

Note 8: Fair Value of Financial Instruments

ASC Topic 820, Fair Value Measurement, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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 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

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying condensed consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows.

Level 2 securities include U.S. Government-sponsored enterprises, mortgage and asset-backed securities and obligations of state, municipals, and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include certain other securities. Fair values are calculated using discounted cash flows. Discounted cash flows are calculated based off of the anticipated future cash flows updated to incorporate loss severities and volatility. Rating agency and industry research reports as well as default and deferral activity are reviewed and incorporated into the calculation.

Loans Held-for-Sale

The fair value of loans held-for-sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

Forward Contracts

The fair values of forward contracts on to-be-announced securities are determined using quoted prices in active markets, or benchmarked thereto (Level 1).

Interest Rate Lock Commitments

The fair value of interest rate lock commitments ("IRLCs") are determined using the projected sale price of individual loans based on changes in market interest rates, projected pull-through rates (the probability that an IRLC will ultimately result in an originated loan), the reduction in the value of the applicant's option due to the passage of time, and the remaining origination costs to be incurred based on management's estimate of market costs (Level 3).

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying condensed consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2014 and December 31, 2013:

| | | September 30, 2014 | | |
|---|---|---|---|---|
| | | Fair Value Measurements Using | | |
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| U.S. Government-sponsored enterprises | $15,725 | $— | $15,725 | $— |
| Mortgage-backed and asset-backed securities - government-sponsored enterprises | 110,489 | — | 110,489 | — |
| Other securities | 1,989 | 1,989 | — | — |
| Total available-for-sale securities | 128,203 | 1,989 | 126,214 | — |
| Loans held-for-sale (mandatory pricing agreements) | 25,701 | — | 25,701 | — |
| Forward contracts | (21) | (21) | — | — |
| Interest rate lock commitments | 389 | — | — | 389 |

| | | December 31, 2013<br>Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| U.S. Government-sponsored enterprises | $56,277 | $— | $56,277 | $— |
| Municipal securities | 46,323 | — | 46,323 | — |
| Mortgage-backed and asset-backed securities - government-sponsored enterprises | 73,941 | — | 73,941 | — |
| Mortgage-backed and asset-backed securities - private labeled | 1,232 | — | 1,232 | — |
| Other securities | 3,636 | 1,963 | — | 1,673 |
| Total available for sale securities | 181,409 | 1,963 | 177,773 | 1,673 |
| Loans held-for-sale (mandatory pricing agreements) | 24,254 | — | 24,254 | — |
| Forward contracts | 227 | 227 | — | — |
| Interest rate lock commitments | 79 | — | — | 79 |

ASC Topic 825, Financial Instruments, permits entities to measure recognized financial assets and financial liabilities using either historical cost or the fair value option at specified election dates. During 2013, the Company began using derivative financial instruments to manage exposure to interest rate risk in its mortgage banking business. These derivative financial instruments are recorded at fair value with changes in fair value reflected in noninterest income on the condensed consolidated statements of income.

To mitigate the volatility reported in earnings caused by measuring related assets and liabilities differently, the Company has elected the fair value option for the hedged item, mortgage loans held-for-sale under mandatory pricing agreements that were originated on or after April 1, 2013. The Company continues to record mortgage loans held-for-sale under best-efforts pricing agreements at the lower of cost or fair value. Prior to April 1, 2013, all mortgage loans held-for-sale were carried at the lower of cost or fair value.

The following table presents the fair value and aggregate principal balance of loans held-for-sale under the fair value option:

| | September 30, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| | Aggregate Value | Gain | Fair Value | Aggregate Value | Loss | Fair Value |
| Loans held-for-sale | $25,278 | $423 | $25,701 | $24,258 | $(4) | $24,254 |

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying condensed consolidated balance sheets using significant unobservable (Level 3) inputs:

| | Three Months Ended | |
|---|---|---|
| | Securities Available-for-Sale | Interest Rate Lock Commitments |
| Balance, July 1, 2014 | $— | $447 |
| Total realized and unrealized gains (losses) | | |
| Included in net income | — | (58) |
| Included in other comprehensive income (loss) | — | — |
| Balance, September 30, 2014 | $— | $389 |
| | | |
| Balance, July 1 , 2013 | $1,531 | $(78) |
| Total realized and unrealized gains (losses) | | |
| Included in net income | — | 934 |
| Included in other comprehensive income (loss) | 88 | — |
| Balance, September 30, 2013 | $1,619 | $856 |

| | Nine Months Ended | |
|---|---|---|
| | Securities Available for Sale | Interest Rate Lock Commitments |
| Balance, January 1, 2014 | $1,673 | $79 |
| Total realized and unrealized gains (losses) | | |
| Included in net income | (259) | 310 |
| Included in other comprehensive income (loss) | (1,414) | — |
| Balance, September 30, 2014 | $— | $389 |
| | | |
| Balance as of January 1, 2013 | $840 | $— |
| Total realized and unrealized gains (losses) | | |
| Included in net income | — | 856 |
| Included in other comprehensive income (loss) | 779 | — |
| Balance, September 30, 2013 | $1,619 | $856 |

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying condensed consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans (Collateral Dependent)

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral, less costs to sell, for collateral dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The following tables present the fair value measurements of impaired loans recognized in the accompanying condensed consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fell at September 30, 2014 and December 31, 2013:

| | | September 30, 2014 Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | $111 | $— | $— | $111 |

| | | December 31, 2013 Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | $137 | $— | $— | $137 |

Unobservable (Level 3) Inputs

The following tables present quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill.

| | Fair Value at September 30, 2014 | Valuation Technique | Unobservable Inputs | Range |
|---|---|---|---|---|
| Collateral dependent impaired loans | $111 | Fair value of collateral | Discount for type of property and current market conditions | 0% - 78% |
| IRLCs | $389 | Discounted cash flow | Loan closing rates | 41% - 95% |

| | Fair Value at December 31, 2013 | Valuation Technique | Unobservable Inputs | Range |
|---|---|---|---|---|
| Other securities | $1,673 | Discounted cash flow | Discount margin<br>Cumulative default %<br>Loss given default %<br>Cumulative prepayment % | 6% - 12.5%<br>2% - 100%<br>85% – 100%<br>0% - 100% |
| Collateral dependent impaired loans | $137 | Fair value of collateral | Discount for type of property and current market conditions | 0% - 54% |
| IRLCs | $79 | Discounted cash flow | Loan closing rates | 53% - 97% |

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying condensed consolidated balance sheets at amounts other than fair value:

Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.

Loans Held-for-Sale

The fair value of these financial instruments approximates carrying value.

Interest-Bearing Time Deposits

The fair value of these financial instruments approximates carrying value.

Loans Receivable

The fair value of loans receivable is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.

Federal Home Loan Bank Stock

The carrying amount approximates fair value.

Deposits

The fair value of noninterest-bearing demand deposits and savings and NOW accounts is the amount payable as of the reporting date. The fair value of fixed maturity certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities.

Advances from Federal Home Loan Bank

The fair value of fixed rate advances is estimated using rates currently available for advances with similar remaining maturities. The carrying value of variable rate advances approximates fair value.

Accrued Interest Payable

The fair value of these financial instruments approximates carrying value.

Subordinated Debt

The fair value of our subordinated debt is estimated using discounted cash flow analysis, based on our current incremental borrowing rates for similar type of borrowing arrangements.

Commitments

The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at each of September 30, 2014 and December 31, 2013.

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at September 30, 2014 and December 31, 2013:

| | September 30, 2014 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | |
| | Carrying Amount | Quoted Prices In Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Cash and cash equivalents | $39,607 | $39,607 | $— | $— |
| Interest-bearing time deposits | 2,000 | 2,000 | — | — |
| Loans held-for-sale (best efforts pricing agreements) | 1,846 | — | 1,846 | — |
| Net loans receivable | 690,465 | — | — | 694,963 |
| Accrued interest receivable | 2,803 | 2,803 | — | — |
| Federal Home Loan Bank of Indianapolis stock | 2,943 | — | 2,943 | — |
| Deposits | 737,970 | 385,524 | — | 355,026 |
| Advances from Federal Home Loan Bank | 86,871 | — | 87,889 | — |
| Subordinated debt | 2,852 | — | 2,985 | — |
| Accrued interest payable | 82 | 82 | — | — |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | |
| | Carrying Amount | Quoted Prices In Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Cash and cash equivalents | $53,690 | $53,690 | $— | $— |
| Interest-bearing time deposits | 2,500 | 2,500 | — | — |
| Loans held-for-sale (best efforts pricing agreements) | 4,356 | — | 4,356 | — |
| Net loans receivable | 495,727 | — | — | 500,447 |
| Accrued interest receivable | 2,904 | 2,904 | — | — |
| Federal Home Loan Bank of Indianapolis stock | 2,943 | — | 2,943 | — |
| Deposits | 673,095 | 362,634 | — | 315,179 |
| Advances from Federal Home Loan Bank | 31,793 | — | 33,415 | — |
| Subordinated debt | 2,789 | — | 2,978 | — |
| Accrued interest payable | 102 | 102 | — | — |

Note 9: Derivative Financial Instruments

The Company uses derivative financial instruments to help manage exposure to interest rate risk and the effects that changes in interest rates may have on net income and the fair value of assets and liabilities. The Company enters into forward contracts for the future delivery of mortgage loans to third party investors and enters into IRLCs with potential borrowers to fund specific mortgage loans that will be sold into the secondary market. The forward contracts are entered into in order to economically hedge the effect of changes in interest rates resulting from the Company's commitment to fund the loans.

Each of these items are considered derivatives, but are not designated as accounting hedges, and are recorded at fair value with changes in fair value reflected in noninterest income on the condensed consolidated statements of income. The fair value of derivative instruments with a positive fair value are reported in accrued income and other assets in the condensed consolidated balance sheets while derivative instruments with a negative fair value are reported in accrued expenses and other liabilities in the condensed consolidated balance sheets.

At September 30, 2014 and December 31, 2013, the notional amount and fair value of IRLCs and forward contracts utilized by the Company were as follows:

| | September 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Asset Derivatives | | | | |
| Derivatives not designated as hedging instruments | | | | |
| IRLCs | $30,518 | $389 | $20,752 | $79 |
| Forward contracts | — | — | 30,628 | 227 |
| Liability Derivatives | | | | |
| Derivatives not designated as hedging instruments | | | | |
| Forward contracts | 42,250 | (21) | — | — |

Fair values of derivative financial instruments were estimated using changes in mortgage interest rates from the date the Company entered into the IRLC and the balance sheet date. Periodic changes in the fair value of the derivative financial instruments on the condensed consolidated statements of income for the three and nine month periods ended September 30, 2014 and 2013 were as follows:

| | Amount of gain / (loss) recognized | | | |
|---|---|---|---|---|
| | September 30, 2014 | | September 30, 2013 | |
| | Three Months Ended | Nine Months Ended | Three Months Ended | Nine Months Ended |
| Asset Derivatives | | | | |
| Derivatives not designated as hedging instruments | | | | |
| IRLCs | $(58) | $310 | $934 | $856 |
| Liability Derivatives | | | | |
| Derivatives not designated as hedging instruments | | | | |
| Forward contracts | 289 | (248) | (2,046) | (837) |

Note 10: Subordinated Debenture

On June 28, 2013, the Company entered into a subordinated debenture purchase agreement with a third party and issued a subordinated debenture in the principal amount of $3,000, which bears interest at a fixed annual rate of 8.00%, and is scheduled to mature on June 28, 2021; however, the Company can repay the debenture without premium or penalty at any time after June 28, 2016. The debenture qualifies for treatment as Tier 2 capital for regulatory capital purposes. The purchase agreement and the debenture contain customary subordination provisions and events of default; however, the right of the investor to accelerate the payment of the debenture is limited to bankruptcy or insolvency.

As partial inducement for the third party to purchase the debenture, the Company issued to the third party a warrant to purchase up to 48,750 shares of common stock at an initial per share exercise price equal to $19.33. The warrant became exercisable on June 28, 2014 and, unless previously exercised, will expire on June 28, 2021. The Company has the right to force an exercise of the warrant after the debenture has been repaid in full if the 20-day volume-weighted average price of a share of its common stock exceeds $30.00.

The Company used the Black-Scholes option pricing model to assign a fair value of $255 to the warrant as of June 28, 2013. The following assumptions were used to value the warrant: a risk-free interest rate of 0.66% per the U.S. Treasury yield curve in effect at the date of issuance, an expected dividend yield of 1.19% calculated using the dividend rate and stock price at the date of the issuance, and an expected volatility of 34% based on the estimated volatility of the Company's stock over the expected term of the warrant, which is estimated to be three years.

Note 11: Shareholders' Equity

In 2013, the Company completed a public offering of 1.587 million shares of its common stock and received net proceeds of approximately $29,101.

Note 12: Accounting Developments

Accounting Standards Update ("ASU" or "Update") 2014-01, Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (January 2014)

This Update permits entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. The ASU modifies the conditions that an entity must meet to be eligible to use a method other than the equity or cost methods to account for qualified affordable housing project investments. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. The amendments in this Update should be applied retrospectively to all periods presented. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (January 2014)

The objective of this Update is to reduce diversity by clarifying when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. The amendments in this Update may be adopted using either a modified retrospective transition method or a prospective transition method. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (April 2014)

This Update seeks to better define the groups of assets which qualify for discontinued operations, in order to ease the burden and cost for preparers and stakeholders. This issue changed "the criteria for reporting discontinued operations" and related reporting requirements, including the provision for disclosures about the "disposal of an individually significant component of an entity that does not qualify for discontinued operations presentation." The amendments in this Update are effective for fiscal years beginning after December 15, 2014. Early adoption is permitted only for disposals or classifications as held for sale. The Company will adopt the methodologies prescribed by this ASU by the date required. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (May 2014)

- Section A - Summary and Amendments That Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs - Contracts with Customers (Subtopic 340-40)
- Section B - Conforming Amendments to Other Topics and Subtopics in the Codification and Status Tables
- Section C - Background Information and Basis for Conclusions

The topic of Revenue Recognition had become broad with several other regulatory agencies issuing standards, which lacked cohesion. The new guidance establishes a “comprehensive framework” and “reduces the number of requirements to which an entity must consider in recognizing revenue” and yet provides improved disclosures to assist stakeholders reviewing financial statements. The amendments in this Update are effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company will adopt the methodologies prescribed by this ASU by the date required. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (June 2014)

This Update addresses the concerns of stakeholders' by changing the accounting practices surrounding repurchase agreements. The new guidance changes the "accounting for repurchase-to-maturity transactions and linked repurchase financings to secured borrowing accounting, which is consistent with the accounting for other repurchase agreements." The amendments in this Update are effective for annual reporting periods beginning after December 15, 2014. Early adoption is prohibited. The Company will adopt the methodologies prescribed by this ASU by the date required. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (June 2014)

This Update defines the accounting treatment for share-based payments and "resolves the diverse accounting treatment of those awards in practice." The new requirement mandates that "a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition." Compensation cost will now be recognized in the period in which it becomes likely that the performance target will be met. The amendments in this Update are effective for annual reporting periods beginning after December 15, 2015. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-14, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure (August 2014)

The objective of this Update is to reduce diversity in practice by addressing the classification of foreclosed mortgage loans that are fully or partially guaranteed under government programs. Currently, some creditors reclassify those loans to real estate as with other foreclosed loans that do not have guarantees; others reclassify the loans to other receivables. The amendments affect creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA.

An entity should adopt the amendments in this Update using either a prospective transition method or a modified retrospective transition method.  For prospective transition, an entity should apply the amendments in this Update to foreclosures that occur after the date of adoption.  For the modified retrospective transition, an entity should apply the amendments in the Update by means of a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual period of adoption.  Prior periods should not be adjusted.  However, a reporting entity must apply the same method of transition as elected under ASU 2014-04.  The amendments in this Update are effective for annual reporting periods ending after December 15, 2015 and interim periods beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted if the entity already has adopted Update 2014-04. The Company will adopt the methodologies prescribed by this ASU by the date required. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

ASU 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (August 2014)

The Update provides U.S. GAAP guidance on management's responsibility in evaluating whether there is substantial doubt about a company's ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. The amendments in this Update are effective for annual reporting periods ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated and condensed financial statements and related notes appearing elsewhere in this report. This discussion and analysis includes certain forward-looking statements that involve risks, uncertainties, and assumptions. You should review the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2013 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by such forward-looking statements. See also "Cautionary Note Regarding Forward-Looking Statements" at the beginning of this report.

### Overview

First Internet Bancorp is the parent company of First Internet Bank, which opened for business in 1999 as the nation's first state-chartered, FDIC-insured institution to operate solely via the Internet. With customers in all 50 states, First Internet Bank offers consumers services including checking, savings, money market, certificates of deposit and IRA accounts as well as consumer loans, residential mortgages, residential construction loans, and home equity products. For commercial clients, it provides commercial real estate loans, commercial and industrial loans, asset-based lending, and treasury management services.

The Bank commenced banking operations in 1999 and grew organically in the consumer market in its early years by adding new customers, products, and capabilities through its Internet-based platform. The Company was incorporated under the laws of the State of Indiana on September 15, 2005. On March 21, 2006, we consummated a plan of exchange by which we acquired all of the outstanding shares of the Bank. In 2007, we acquired Indianapolis-based Landmark Financial Corporation. The acquisition merged Landmark Savings Bank, FSB, into the Bank. The Landmark acquisition added a turnkey retail mortgage lending operation that we then expanded on a nationwide basis through our Internet platform. Since then, we have added commercial real estate lending, including a nationwide credit tenant lease financing program, and more recently, commercial and industrial and asset-based lending and business banking/treasury management services to meet the needs of high-quality, under-served commercial borrowers and depositors. Our commercial banking activities are highly dependent on establishing and maintaining strong relationships with our business customers.

### Results of Operations

(dollar amounts in thousands except share and per share data)

Three Months Ended September 30, 2014 versus Three Months Ended September 30, 2013

- Net income in the three months ended September 30, 2014 increased $555, or 76%, to $1,282, or $0.28 per diluted share, compared to $727, or $0.25 per diluted share, for the prior year period. The increase in net income reflects a $1,318, or 30%, increase in net interest income and a $302, or 18%, increase in noninterest income. These increases were partially offset by a $645, or 13%, increase in noninterest expense and a $475, or 255%, increase in income tax provision. Per share net income was also impacted by the 1.61 million share increase in the weighted-average number of basic common shares outstanding following the Company's fourth quarter 2013 public offering of common stock. Return on average assets for the 2014 period was 0.59% compared to 0.41% for the prior year period and return on average equity for the 2014 period was 5.36% compared to 4.80% for the prior year period.

- For the three months ended September 30, 2014, net interest income increased $1,318, or 30%, to $5,673 compared to $4,355 for the prior year period. Compared to the prior year period, total interest income increased $1,505, or 23%, and total interest expense increased $187, or 9%. The increase in total interest income was driven by a $236,152, or

56%, increase in average loan balances, partially offset by a 50 basis point decline in the yield earned on the loan portfolio. Additionally, the impact of the loan growth was offset by a decline of $55,166, or 28%, in the average balance of the investment portfolio. The decline in investment balances was the result of continued efforts to increase the liquidity profile and reduce the interest rate risk and duration of the portfolio. The increase in interest expense during the 2014 period was due primarily to an increase of $133,535, or 23%, in average interest-bearing deposits from the year ago period, partially offset by an 11 basis point decline in the cost of funds related to interest-bearing deposits.

The Company's net interest margin expanded to 2.68% in the three months ended September 30, 2014 from 2.59% in the 2013 period, reflecting a $171,800, or 26%, increase in average interest-earning assets and a lower cost of funds related to interest-bearing liabilities. The Company's cost of funds related to interest-bearing liabilities declined to 1.21% for the three months ended September 30, 2014 from 1.34% in the 2013 period due primarily to higher cost deposits being replaced with those at lower rates.

- Noninterest income for the three months ended September 30, 2014 increased $302, or 18%, to $1,943 compared with $1,641 in the prior year period. The increase was driven by a $339, or 26%, increase in income from mortgage banking activities from the prior year period, primarily due to improved margins on loans sold.

- Noninterest income as a percentage of average assets decreased from 0.93% for the three months ended September 30, 2013 to 0.89% for the three months ended September 30, 2014. Income, which is defined as interest income plus noninterest income, as a percentage of average assets, decreased from 4.58% for the three months ended September 30, 2013 to 4.52% for the three months ended September 30, 2014. The decrease in both of these ratios reflects average assets growing faster than income. Interest income increased 23% and noninterest income increased 18% from the prior year period while average assets increased 24% from the prior year period.

- Total noninterest expense increased $645, or 13%, to $5,785 in the three months ended September 30, 2014 compared to $5,140 in the same period of 2013. The increase was due primarily to an increase of $834, or 33%, in salaries and benefits expense, partially offset by a $159, or 28%, decrease in marketing expense and a $146, or 25%, decrease in professional services expenses. Noninterest expense as a percentage of average assets decreased 27 basis points from 2.91% in the three months ended September 30, 2013 to 2.64% in the three months ended September 30, 2014.

- Income tax expense for the three months ended September 30, 2014 was $661, resulting in an effective tax rate of 34%, compared to $186 and an effective tax rate of 20% for the three months ended September 30, 2013. The increase in the effective tax rate was due primarily to the restructuring of the investment portfolio earlier in 2014 during which the Company liquidated its entire portfolio of odd lot and long duration municipal securities. Municipal securities owned by the Company during the three months ended September 30, 2013 provided interest income that was exempt from federal income tax, resulting in the lower effective tax rate for the 2013 period.

- The Company recorded a credit for loan losses of $112 and $57 for the three months ended September 30, 2014 and 2013, respectively. The negative provision recorded during the 2014 period was driven by a pre-tax recovery of $459 related to the resolution of a nonaccrual commercial real estate credit that experienced significant charge-offs in prior periods. Net charge-offs (recoveries) as a percentage of average loans receivable were (0.27)% for the three months ended September 30, 2014 compared to 0.01% for the prior year period.

Nine Months Ended September 30, 2014 versus Nine Months Ended September 30, 2013

- Net income for the nine months ended September 30, 2014 decreased $1,068, or 27%, to $2,859, or $0.63 per diluted share, compared to $3,927, or $1.36 per diluted share, for the prior year period. The decrease in net income reflects a $3,271, or 39%, decrease in noninterest income and a $1,555, or 10%, increase in noninterest expense. These items were partially offset by a $3,428, or 27%, increase in net interest income and a $191, or 12%, decrease in income tax provision. Per share net income was also impacted by the 1.61 million share increase in the weighted-average number of basic common shares outstanding following the Company's fourth quarter 2013 public offering of common stock. Return on average assets for the 2014 period was 0.45% compared to 0.80% for the prior year period and return on average equity for the 2014 period was 4.11% compared to 8.51% for the prior year period.

- For the nine months ended September 30, 2014, net interest income increased $3,428, or 27%, to $15,912 compared to $12,484 for the prior year period. Compared to the prior year period, total interest income increased $4,162, or 23%, and total interest expense increased $734, or 12%. The increase in total interest income was driven by a $177,391, or 43%, increase in average loan balances, partially offset by a 35 basis point decline in the yield earned on the loan portfolio. Additionally, the impact of the loan growth was offset by a decline of $11,313, or 7%, in the average balance of the investment portfolio. The increase in interest expense during the 2014 period was due primarily to an increase of $157,026, or 29%, in average interest-bearing deposits from the year ago period, partially offset by a 16 basis point decline in the cost of interest-bearing liabilities.

- The Company's net interest margin declined to 2.60% in the nine months ended September 30, 2014 from 2.65% in the 2013 period, reflecting a 23 basis point decline in yield on average earning assets, which was partially offset by a 16 basis point improvement in the cost of funds related to interest-bearing liabilities, due primarily to higher cost deposits being replaced with those at lower rates.

- Noninterest income for the nine months ended September 30, 2014 decreased $3,271, or 39%, to $5,076 compared with $8,347 in the prior year period. The decrease was driven by a $4,000, or 51%, decline in income from mortgage banking activities from the prior year period, reflecting the nationwide slowing in residential mortgage refinancing.

- Noninterest income as a percentage of average assets decreased from 1.69% for the nine months ended September 30, 2013 to 0.80% for the nine months ended September 30, 2014. Income, which is defined as interest income plus noninterest income, as a percentage of average assets, decreased from 5.44% for the nine months ended September 30, 2013 to 4.35% for the nine months ended September 30, 2014. The decrease in both of these ratios reflects the $4,000, or 51%, decline in income from mortgage banking activities and the 29% increase in average assets from the prior year period.

- Total noninterest expense increased $1,555, or 10%, to $16,783 for the nine months ended September 30, 2014 compared to $15,228 for the same period of 2013. The increase was due primarily to an increase of $1,685, or 22%, in salaries and benefits expense and a $348, or 24%, increase in premises and equipment expenses, which were partially offset by a $210, or 15%, decrease in marketing expenses and a $408, or 23%, decrease in professional services expenses. Although total noninterest expense increased, noninterest expense as a percentage of average assets decreased 45 basis points from 3.09% for the nine months ended September 30, 2013 to 2.64% for the nine months ended September 30, 2014 as asset growth outpaced the growth in noninterest expenses.

- Income tax expense for the nine months ended September 30, 2014 was $1,384, resulting in an effective tax rate of 33%, compared to $1,575 and an effective tax rate of 29% for the nine months ended September 30, 2013. The increase in the effective tax rate was due primarily to the restructuring of the investment portfolio earlier in 2014 during which the Company liquidated its entire portfolio of odd lot and long duration municipal securities in the first quarter 2014. Municipal securities owned by the Company during the nine months ended September 30, 2013 provided interest income that was exempt from federal income tax, resulting in the lower effective tax rate for the 2013 period.

- The Company recorded a credit for loan losses of $38 and a provision for loan losses of $101 for the nine months ended September 30, 2014 and 2013, respectively. The negative provision recorded during the 2014 period was driven by a pre-tax recovery of $459 related to the resolution of a nonaccrual commercial real estate credit that experienced significant charge-offs in prior periods. Net charge-offs (recoveries) as a percentage of average loans receivable were (0.02)% for the nine months ended September 30, 2014 compared to 0.17% for the prior year period.

Average Balance Sheets and Net Interest Income Analysis

For the periods presented, the following tables provide the total dollar amount of interest income from average interest-earning assets and the resulting yields. They also highlight the interest expense on average interest-bearing liabilities, expressed both in dollars and cost of funds, and the net interest margin. The tables do not reflect any effect of income taxes. Balances are based on the average of daily balances. Nonaccrual loans are included in average loan balances.

| Average Balance Sheets (dollars in thousands) | Three Months Ended September 30, 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest and Dividends | Yield/Cost | Average Balance | Interest and Dividends | Yield/Cost |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, including loans held for sale | $660,650 | $7,218 | 4.33 % | $424,498 | $5,170 | 4.83 % |
| Securities – taxable | 139,569 | 684 | 1.94 % | 149,287 | 771 | 2.05 % |
| Securities – non-taxable | — | — | — % | 45,448 | 447 | 3.90 % |
| Other earning assets | 38,964 | 45 | 0.46 % | 48,150 | 54 | 0.44 % |
| Total interest-earning assets | 839,183 | 7,947 | 3.76 % | 667,383 | 6,442 | 3.83 % |
| Allowance for loan losses | (5,248) | | | (5,444) | | |
| Noninterest-earning assets | 34,426 | | | 38,136 | | |
| Total assets | $868,361 | | | $700,075 | | |
| Liabilities and equity: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Regular savings accounts | $16,932 | $25 | 0.59 % | $13,548 | $20 | 0.59 % |
| Interest-bearing demand deposits | 69,635 | 96 | 0.55 % | 67,605 | 94 | 0.55 % |
| Money market accounts | 272,697 | 501 | 0.73 % | 229,588 | 428 | 0.74 % |
| Certificates and brokered deposits | 358,836 | 1,336 | 1.48 % | 273,824 | 1,216 | 1.76 % |
| Total interest-bearing deposits | 718,100 | 1,958 | 1.08 % | 584,565 | 1,758 | 1.19 % |
| Other borrowed funds | 29,748 | 316 | 4.21 % | 34,078 | 329 | 3.83 % |
| Total interest-bearing liabilities | 747,848 | 2,274 | 1.21 % | 618,643 | 2,087 | 1.34 % |
| Noninterest-bearing deposits | 21,960 | | | 13,594 | | |
| Other non-interest bearing liabilities | 3,713 | | | 7,729 | | |
| Total liabilities | 773,521 | | | 639,966 | | |
| Shareholders’ equity | 94,840 | | | 60,109 | | |
| Total liabilities and shareholders' equity | $868,361 | | | $700,075 | | |
| Net interest income | | $5,673 | | | $4,355 | |
| Interest rate spread[1] | | | 2.55 % | | | 2.49 % |
| Net interest margin[2] | | | 2.68 % | | | 2.59 % |
| | | | 112.21 % | | | 107.88 % |

Average interest-earning assets to
average interest-bearing liabilities

(1) Yield on total interest-earning assets minus cost of total interest-bearing liabilities

(2) Net interest income divided by total interest-earning assets

| (dollars in thousands) | Nine Months Ended September 30, 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest and Dividends | Yield/Cost | Average Balance | Interest and Dividends | Yield/Cost |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, including loans held for sale | $593,387 | $19,918 | 4.49 % | $415,996 | $15,073 | 4.84 % |
| Securities – taxable | 159,474 | 2,421 | 2.03 % | 130,807 | 2,063 | 2.11 % |
| Securities – non-taxable | 2,387 | 58 | 3.25 % | 42,367 | 1,146 | 3.62 % |
| Other earning assets | 63,403 | 195 | 0.41 % | 40,041 | 148 | 0.49 % |
| Total interest-earning assets | 818,651 | 22,592 | 3.69 % | 629,211 | 18,430 | 3.92 % |
| Allowance for loan losses | (5,373 ) | | | (5,607 ) | | |
| Noninterest-earning assets | 36,654 | | | 34,825 | | |
| Total assets | $849,932 | | | $658,429 | | |
| Liabilities and equity: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Regular savings accounts | $18,160 | $81 | 0.60 % | $13,729 | $60 | 0.58 % |
| Interest-bearing demand deposits | 70,831 | 290 | 0.55 % | 69,065 | 284 | 0.55 % |
| Money market accounts | 267,672 | 1,462 | 0.73 % | 216,108 | 1,205 | 0.75 % |
| Certificates and brokered deposits | 345,720 | 3,907 | 1.51 % | 246,455 | 3,493 | 1.89 % |
| Total interest-bearing deposits | 702,383 | 5,740 | 1.09 % | 545,357 | 5,042 | 1.24 % |
| Other borrowed funds | 29,831 | 940 | 4.21 % | 30,433 | 904 | 3.97 % |
| Total interest-bearing liabilities | 732,214 | 6,680 | 1.22 % | 575,790 | 5,946 | 1.38 % |
| Noninterest-bearing deposits | 19,661 | | | 13,085 | | |
| Other non-interest bearing liabilities | 4,947 | | | 7,873 | | |
| Total liabilities | 756,822 | | | 596,748 | | |
| Shareholders’ equity | 93,110 | | | 61,681 | | |
| Total liabilities and shareholders' equity | $849,932 | | | $658,429 | | |
| Net interest income | | $15,912 | | | $12,484 | |
| Interest rate spread[1] | | | 2.47 % | | | 2.54 % |
| Net interest margin[2] | | | 2.60 % | | | 2.65 % |
| Average interest-earning assets to average interest-bearing liabilities | | | 111.80 % | | | 109.28 % |

[1] Yield on total interest-earning assets minus cost of total interest-bearing liabilities
[2] Net interest income divided by total interest-earning assets

Rate/Volume Analysis

The following tables illustrate the impact of changes in the volume of interest-earning assets and interest-bearing liabilities and interest rates on net interest income for the periods indicated. The change in interest not due solely to volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each.

| (dollars in thousands) | Rate/Volume Analysis of Net Interest Income Three Months Ended September 30, 2014 vs. 2013 Due to Changes in | | |
|---|---|---|---|
| | Volume | Rate | Net |
| Interest income | | | |
| Loans, including loans held for sale | $5,305 | $(3,257) | $2,048 |
| Securities – taxable | (48) | (39) | (87) |
| Securities – non-taxable | (447) | — | (447) |
| Other earning assets | (23) | 14 | (9) |
| Total | 4,787 | (3,282) | 1,505 |
| Interest expense | | | |
| Interest-bearing deposits | 1,211 | (1,011) | 200 |
| Other borrowed funds | (152) | 139 | (13) |
| Total | 1,059 | (872) | 187 |
| Increase (decrease) in net interest income | $3,728 | $(2,410) | $1,318 |

| (dollars in thousands) | Rate/Volume Analysis of Net Interest Income Nine Months Ended September 30, 2014 vs. 2013 Due to Changes in | | |
|---|---|---|---|
| | Volume | Rate | Net |
| Interest income | | | |
| Loans, including loans held for sale | $6,632 | $(1,787) | $4,845 |
| Securities – taxable | 484 | (126) | 358 |
| Securities – non-taxable | (982) | (106) | (1,088) |
| Other earning assets | 87 | (40) | 47 |
| Total | 6,221 | (2,059) | 4,162 |
| Interest expense | | | |
| Interest-bearing deposits | 1,860 | (1,162) | 698 |
| Other borrowed funds | (27) | 63 | 36 |
| Total | 1,833 | (1,099) | 734 |
| Increase (decrease) in net interest income | $4,388 | $(960) | $3,428 |

Financial Condition
(dollar amounts in thousands except share and per share data)

Comparison of September 30, 2014 to December 31, 2013

- Total assets were $926,883 at September 30, 2014 compared to $802,342 at December 31, 2013, an increase of $124,541, or 16%. The increase was primarily due to a $194,776, or 39%, increase in loans receivable, partially offset by a $53,206, or 29%, decrease in securities available-for-sale.

- Loans receivable increased 39% from $501,153 at December 31, 2013 to $695,929 at September 30, 2014. Total commercial and industrial loan balances increased $16,931, or 31%, at September 30, 2014 versus December 31, 2013. Commercial real estate loans, which include owner-occupied loans, increased $93,449, or 66%, at September 30, 2014 compared to December 31, 2013. Credit tenant lease financing experienced the largest growth within the commercial real estate portfolio, increasing $81,565, or 97%, since December 31, 2013. In connection with the repositioning of the investment portfolio to provide increased liquidity, the Company deployed excess balance sheet capacity to acquire $106,480 of high quality adjustable rate mortgage assets during the period to complement its organic loan growth.

- Credit quality continues to remain strong as nonperforming loans to total loans receivable declined to 0.06% from 0.37% at December 31, 2013. Additionally, nonperforming assets to total assets declined to 0.55% from 0.90% at December 31, 2013. Compared to December 31, 2013, total nonperforming loans decreased $1,452, or 78%, due primarily to the resolution of a nonaccrual commercial real estate credit with a recorded value of $955. The Company recovered 100% of the unpaid principal balance, resulting in a recovery of $459.

- The allowance for loan losses was $5,464 as of September 30, 2014 compared to $5,426 as of December 31, 2013. The allowance as a percentage of total nonperforming loans increased to 1,366% at September 30, 2014 from 293% at December 31, 2013. Due to the improvement in credit quality, the allowance for loan losses to total loans receivable decreased to 0.79% at September 30, 2014 compared to 1.09% at December 31, 2013.

- Total deposits increased $64,875, or 10%, to $737,970 at September 30, 2014, compared to $673,095 at December 31, 2013. Certificates of deposit and money market accounts exhibited the strongest growth, increasing $41,951, or 14%, and $20,732, or 8%, respectively, from December 31, 2013.

- Tangible common equity increased $3,866 from $86,221 at December 31, 2013 to $90,087 at September 30, 2014. Tangible book value per common share increased 5% from $19.38 at December 31, 2013 to $20.29 at September 30, 2014. A reconciliation of tangible common equity and tangible book value per common share to the most directly comparable measure under U.S. GAAP appears later in this discussion under “Reconciliation of Non-GAAP Financial Measures.”

Loan Portfolio Analysis

The table below provides a detailed listing of the Company's loan portfolio:

| (dollars in thousands) | September 30, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| Real estate loans: | | | | | | |
| Residential mortgage | $220,499 | 31.94 | % | $153,101 | 30.86 | % |
| Home equity loans and lines of credit | 61,799 | 8.95 | % | 37,906 | 7.64 | % |
| Commercial – credit tenant lease financing | 165,738 | 24.01 | % | 84,173 | 16.96 | % |
| Commercial – other | 70,140 | 10.16 | % | 58,256 | 11.74 | % |
| Total real estate loans | 518,176 | 75.06 | % | 333,436 | 67.20 | % |
| Commercial loans | 72,099 | 10.44 | % | 55,168 | 11.12 | % |
| Consumer loans – trailers | 65,085 | 9.43 | % | 68,991 | 13.90 | % |
| Consumer loans – recreational vehicle | 31,591 | 4.58 | % | 34,738 | 7.00 | % |
| Consumer loans – other | 3,398 | 0.49 | % | 3,833 | 0.78 | % |
| Total loans | 690,349 | 100.00 | % | 496,166 | 100.00 | % |
| Net deferred loan fees, premiums and discounts | 5,580 | | | 4,987 | | |
| Loans receivable | 695,929 | | | 501,153 | | |
| Allowance for losses | (5,464) | | | (5,426) | | |
| Net loans receivable | $690,465 | | | $495,727 | | |

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Asset Quality and Allowance for Loan Losses

| (dollars in thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Nonaccrual loans: | | |
| Real estate loans: | | |
| Residential | $57 | $630 |
| Commercial | 89 | 1,054 |
| Total real estate loans | 146 | 1,684 |
| Commercial loans | — | — |
| Consumer loans | 153 | 150 |
| Total nonaccrual loans | 299 | 1,834 |
| Accruing loans past due 90 days or more: | | |
| Real estate loans: | | |
| Residential | 96 | — |
| Commercial | — | — |
| Total real estate loans | 96 | — |
| Commercial loans | — | — |
| Consumer loans | 5 | 18 |
| Total accruing loans past due 90 days or more | 101 | 18 |
| Total nonperforming loans | 400 | 1,852 |
| Other real estate owned: | | |
| Residential | 57 | 368 |
| Commercial | 4,488 | 4,013 |
| Total other real estate owned | 4,545 | 4,381 |
| Other nonperforming assets | 122 | 956 |
| Total nonperforming assets | $5,067 | $7,189 |
| Total nonperforming loans to total loans | 0.06 % | 0.37 % |
| Total nonperforming assets to total assets | 0.55 % | 0.90 % |

Troubled Debt Restructurings

| (dollars in thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Troubled debt restructurings – nonaccrual | $25 | $27 |
| Troubled debt restructurings – performing | 1,154 | 1,243 |
| Total troubled debt restructurings | $1,179 | $1,270 |

Total nonperforming assets decreased $2,122, or 30%, to $5,067 at September 30, 2014 from $7,189 at December 31, 2013. Total nonperforming loans decreased by $1,452, or 78%, from December 31, 2013 to September 30, 2014 primarily due to the resolution of a nonaccrual commercial real estate credit with a recorded value of $955. Other nonperforming assets decreased $834, or 87%, from $956 at December 31, 2013 to $122 at September 30, 2014. The Company sold all of its nonaccrual securities during the nine months ended September 30, 2014, resulting in the decrease in other nonperforming assets. The Company has one commercial property in other real estate owned at September 30, 2014. This property consists of two buildings

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which are residential units adjacent to a college campus. Improvements have been made in collaboration with the university and the property continues to be occupied.

Nonperforming assets and troubled debt restructurings to total assets decreased from 1.05% at December 31, 2013 to 0.67% at September 30, 2014. The allowance for loan losses as a percentage of loans receivable decreased from 1.09% at December 31, 2013 to 0.79% at September 30, 2014.

Nonperforming loans are comprised of loans past due 90 days or more and other nonaccrual loans. Nonperforming assets include nonperforming loans, impaired investment securities, other real estate owned, and other assets which are primarily repossessed vehicles.

Deposits

| (dollars in thousands) | September 30, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| Regular savings accounts | $17,503 | 2.37 | % | $14,330 | 2.13 | % |
| Noninterest-bearing deposits | 20,359 | 2.76 | % | 19,386 | 2.88 | % |
| Interest-bearing demand deposits | 71,762 | 9.72 | % | 73,748 | 10.96 | % |
| Money market accounts | 275,901 | 37.39 | % | 255,169 | 37.91 | % |
| Certificates of deposit | 334,636 | 45.35 | % | 292,685 | 43.48 | % |
| Brokered deposits | 17,809 | 2.41 | % | 17,777 | 2.64 | % |
| Total | $737,970 | 100.00 | % | $673,095 | 100.00 | % |

Our independence from a traditional branch delivery system permits us to offer competitive rates for interest-bearing accounts, as needed, in order to fund loan growth. As noted in the table above, total deposits increased $64,875, or 10%, to $737,970 at September 30, 2014 from $673,095 at December 31, 2013.

Investment Securities

The following table summarizes the book value and approximate fair value and distribution of our investment securities as of the dates indicated:

| (dollars in thousands) | September 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Amortized Cost | Approximate Fair Value | Amortized Cost | Approximate Fair Value |
| Securities available-for-sale | | | | |
| U.S. Government-sponsored enterprises | $16,049 | $15,725 | $57,569 | $56,277 |
| Municipal securities | — | — | 46,126 | 46,323 |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 111,524 | 110,489 | 75,058 | 73,941 |
| Mortgage-backed and asset-backed securities – private labeled | — | — | 1,313 | 1,232 |
| Other securities | 2,000 | 1,989 | 5,025 | 3,636 |
| Total securities available-for-sale | $129,573 | $128,203 | $185,091 | $181,409 |

In 2014, the Company repositioned its securities portfolio to provide increased liquidity and to reduce the interest rate risk and duration of the portfolio. These actions included selling a portion of the portfolio, including the ALESCO IV and I-PreTSL I collateralized debt obligations. The Company also sold all of the municipal securities that were held in the securities portfolio at December 31, 2013.

Premises and Equipment

The Bank does not serve its retail or commercial customer base through a branch network. During 2013, the Company acquired an office building with approximately 52,000 square feet of office space and related real estate in Fishers, Indiana for $4,083. The Bank uses the Fishers property for its mortgage operations and some of its administrative operations but not as a branch. The Company's headquarters, located in Indianapolis, Indiana, is leased. The Bank also operates loan production offices from leased spaces in Tempe, Arizona and Portland, Oregon.

Shareholders’ Equity

Shareholders’ equity increased to $94,774 at September 30, 2014 compared to $90,908 at December 31, 2013. This was the result of net income for the nine months ended September 30, 2014 of $2,859, other comprehensive income of $1,490, and the recognition of $443 of the fair value of share based compensation. These increases were offset by $810 of dividends declared on common stock, $71 of common stock redeemed for the net settlement of share-based awards, and other changes of $45. Tangible common equity to tangible assets decreased from 10.81% at December 31, 2013 to 9.77% at September 30, 2014 due to strong asset growth.

At September 30, 2014, the Company and the Bank exceeded all applicable regulatory capital minimum requirements, and the Bank was considered “well-capitalized” under applicable regulations.

| (dollars in thousands) | Actual | | | Minimum Capital Requirement | | | Minimum to be Well Capitalized Under Prompt Corrective Actions | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amount | Ratio | | Amount | Ratio | | Amount | Ratio | |
| As of September 30, 2014: | | | | | | | | | |
| Total capital to risk-weighted assets | | | | | | | | | |
| Consolidated | $99,434 | 14.45 | % | $55,064 | 8.0 | % | N/A | N/A | |
| Bank | 81,972 | 11.94 | % | 54,900 | 8.0 | % | 68,626 | 10.0 | % |
| Tier 1 capital to risk-weighted assets | | | | | | | | | |
| Consolidated | 90,970 | 13.22 | % | 27,532 | 4.0 | % | N/A | N/A | |
| Bank | 76,508 | 11.15 | % | 27,450 | 4.0 | % | 41,175 | 6.0 | % |
| Tier 1 capital to average assets | | | | | | | | | |
| Consolidated | 90,970 | 10.52 | % | 34,574 | 4.0 | % | N/A | N/A | |
| Bank | 76,508 | 8.87 | % | 34,500 | 4.0 | % | 43,125 | 5.0 | % |

Liquidity and Capital Resources

The Company’s primary source of funds is dividends from the Bank, the declaration of which is subject to regulatory limits. Most recently, the Bank's Board of Directors declared a cash dividend of $250 in June 2013. There have been no subsequent declarations of dividends by the Bank.

The Company’s Board of Directors declared a cash dividend for the third quarter of 2014 of $0.06 per share of common stock payable October 15, 2014 to shareholders of record on September 30, 2014. Subsequent to September 30, 2014, the Company's Board of Directors also declared a cash dividend for the fourth quarter of 2014 of $0.06 per share of common stock payable January 15, 2015 to shareholders of record on December 31, 2014. The Company expects to continue to pay dividends on a quarterly basis; however, the declaration and amount of any future dividends will be determined by the Board of Directors on the basis of financial condition, earnings, regulatory constraints, and other factors.

At September 30, 2014, the Company had $169,810 in cash, interest-bearing time deposits, and investment securities available for sale and $27,547 in loans held-for-sale that were generally available for our cash needs compared to $237,599 and $28,610 at December 31, 2013, respectively. At September 30, 2014, the Company had the ability to borrow an additional $231,000 in advances from Federal Home Loan Bank and correspondent bank fed funds line of credit draws. At September 30, 2014, the Company, on an unconsolidated basis, had $15,797 in cash generally available for its cash needs.

We believe our capital resources are sufficient to meet our current and expected needs, including any cash dividends we may pay. However, we may require additional capital resources to accommodate continued growth.

At September 30, 2014, approved outstanding loan commitments, including unused lines of credit, amounted to $83,492 compared to $49,100 at December 31, 2013, an increase of $34,392. Commercial unfunded loan commitments accounted for $28,351 of the increase as the Company continued to expand its commercial lending business. Certificates of deposit scheduled to mature in one year or less at September 30, 2014, totaled $199,600. Generally, we believe that a majority of maturing deposits will remain with the Bank due to our competitive rates.

Reconciliation of Non-GAAP Financial Measures

Tangible common equity, tangible assets, and tangible book value per common share are financial performance measures not recognized in U.S. GAAP. Our management, banking regulators, many financial analysts, and other investors use these non-GAAP financial measures to compare the capital adequacy of banking organizations with significant amounts of preferred equity and/or goodwill or other intangible assets, which typically stem from the use of the purchase accounting method of accounting for mergers and acquisitions. Tangible common equity, tangible assets, tangible book value per share, or related measures should not be considered as a substitute for total shareholders' equity, total assets, book value per share, or any other measure calculated in accordance with GAAP. Moreover, the manner in which we calculate these measures may differ from those of other companies reporting measures with similar names. The following table reconciles these non-GAAP performance measures and a capital ratio using such measures to the most directly comparable GAAP measure or ratio.

| (dollars in thousands, except share data) | September 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| Total equity - GAAP | $94,774 | | $90,908 | |
| Adjustments | | | | |
| Goodwill | (4,687 | ) | (4,687 | ) |
| Tangible common equity | $90,087 | | $86,221 | |
| | | | | |
| Total assets - GAAP | $926,883 | | $802,342 | |
| Adjustments | | | | |
| Goodwill | (4,687 | ) | (4,687 | ) |
| Tangible assets | $922,196 | | $797,655 | |
| | | | | |
| Total common shares outstanding | 4,439,575 | | 4,448,326 | |
| | | | | |
| Book value per common share | $21.35 | | $20.44 | |
| Effect of adjustment | (1.06 | ) | (1.06 | ) |
| Tangible book value per common share | $20.29 | | $19.38 | |
| | | | | |
| Total shareholders' equity to assets ratio | 10.23 | % | 11.33 | % |
| Effect of adjustment | (0.46 | ) | (0.52 | ) |
| Tangible common equity to tangible assets ratio | 9.77 | % | 10.81 | % |

Critical Accounting Policies and Estimates

There have been no material changes in our critical accounting policies from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013.

Future Accounting Pronouncements

Refer to Note 12 of the condensed consolidated financial statements.

Off-Balance Sheet Arrangements

In the ordinary course of business, the Company enters into financial transactions to extend credit and forms of commitments that may be considered off-balance sheet arrangements. We enter into forward contracts relating to our mortgage banking business to hedge the exposures we have from commitments to extend new residential mortgage loans to our customers and from our mortgage loans held-for-sale. At September 30, 2014 and December 31, 2013, we had commitments to sell residential real estate loans of $42,250 and $30,628, respectively. These contracts mature in less than one year. We do not believe that off-balance sheet arrangements will have a material impact on our liquidity or capital resources.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is recorded, processed, summarized, and reported within the time period specified in SEC rules and forms. These controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including our principal executive and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, we have recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Management is required to apply judgment in evaluating its controls and procedures.

We performed an evaluation under the supervision and with the participation of our management, including our principal executive and principal financial officers, to assess the effectiveness of the design and operation of our disclosure controls and procedures under the Exchange Act. Based on that evaluation, our management, including our principal executive and principal financial officer, concluded that our disclosure controls and procedures were effective as of September 30, 2014.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended September 30, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

We are not party to any material legal proceedings. From time to time, the Bank is a party to legal actions arising from its normal business activities.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2013.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Unless otherwise indicated, all documents incorporated into this quarterly report on Form 10-Q by reference to a document filed with the SEC pursuant to the Exchange Act are located under SEC file number 1-35750.

| Exhibit No. | Description |
|---|---|
| 3.1 | Articles of Incorporation of First Internet Bancorp (incorporated by reference to Exhibit 3.1 to registration statement on Form 10 filed November 30, 2012) |
| 3.2 | Amended and Restated Bylaws of First Internet Bancorp, as amended March 18, 2013 (incorporated by reference to Exhibit 3.2 to annual report on Form 10-K for the year ended December 31, 2012) |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32.1 | Section 1350 Certifications |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | | |
|---|---|---|
| | | FIRST INTERNET BANCORP |
| Date: 11/12/2014 | By | /s/ David B. Becker<br>David B. Becker,<br>Chairman, President and Chief Executive Officer |
| Date: 11/12/2014 | By | /s/ Kenneth J. Lovik<br>Kenneth J. Lovik,<br>Senior Vice President & Chief Financial Officer<br>(Principal Financial Officer) |

EXHIBIT INDEX

| Exhibit No. | Description | Method of Filing |
|---|---|---|
| 3.1 | Articles of Incorporation of First Internet Bancorp | Incorporated by Reference |
| 3.2 | Amended and Restated Bylaws of First Internet Bancorp, as amended March 18, 2013 | Incorporated by Reference |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer | Filed Electronically |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer | Filed Electronically |
| 32.1 | Section 1350 Certifications | Filed Electronically |
| 101.INS | XBRL Instance Document | Filed Electronically |
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