

ACCESS NATIONAL CORP  
Form 10-Q  
August 09, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

(Mark One)

**☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2013

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: 000-49929**

**ACCESS NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Virginia**

**82-0545425**

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

**1800 Robert Fulton Drive, Suite 300, Reston, Virginia 20191**

(Address of principal executive offices) (Zip Code)

**(703) 871-2100**

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 x No "

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

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

Large accelerated filer "

Accelerated filer x

Non-accelerated filer " (Do not check if a smaller reporting company)

Smaller reporting company "

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

The number of shares outstanding of Access National Corporation's common stock, par value \$0.835, as of August 6, 2013 was 10,308,483 shares.



**Table of Contents**

**ACCESS NATIONAL CORPORATION**

**FORM 10-Q**

**INDEX**

**PART I FINANCIAL INFORMATION**

|         |                                                                                                     |         |
|---------|-----------------------------------------------------------------------------------------------------|---------|
| Item 1. | Financial Statements (Unaudited)                                                                    |         |
|         | Consolidated Balance Sheets, June 30, 2013 and December 31, 2012                                    | Page 2  |
|         | Consolidated Statements of Income, three and six months ended June 30, 2013 and 2012                | Page 3  |
|         | Consolidated Statements of Comprehensive Income, three and six months ended June 30, 2013 and 2012  | Page 4  |
|         | Consolidated Statements of Changes in Shareholders' Equity, six months ended June 30, 2013 and 2012 | Page 5  |
|         | Consolidated Statements of Cash Flows, six months ended June 30, 2013 and 2012                      | Page 6  |
|         | Notes to Consolidated Financial Statements (Unaudited)                                              | Page 7  |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations               | Page 35 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk                                          | Page 51 |
| Item 4. | Controls and Procedures                                                                             | Page 52 |

**PART II OTHER INFORMATION**

|          |                                                             |         |
|----------|-------------------------------------------------------------|---------|
| Item 1.  | Legal Proceedings                                           | Page 52 |
| Item 1A. | Risk Factors                                                | Page 53 |
| Item 2.  | Unregistered Sales of Equity Securities and Use of Proceeds | Page 54 |
| Item 3.  | Defaults Upon Senior Securities                             | Page 54 |
| Item 4.  | Mine Safety Disclosures                                     | Page 54 |
| Item 5.  | Other Information                                           | Page 54 |
| Item 6.  | Exhibits                                                    | Page 55 |
|          | Signatures                                                  | Page 57 |

## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## ACCESS NATIONAL CORPORATION

**Consolidated Balance Sheets**

(In Thousands, Except for Share and Per Share Data)

|                                                                                      | June 30,<br>2013<br>(Unaudited) | December<br>31,<br>2012 |
|--------------------------------------------------------------------------------------|---------------------------------|-------------------------|
| <b>ASSETS</b>                                                                        |                                 |                         |
| Cash and due from banks                                                              | \$ 11,499                       | \$ 15,735               |
| Interest-bearing deposits in other banks and federal funds sold                      | 35,123                          | 22,206                  |
| Securities:                                                                          |                                 |                         |
| Securities available-for-sale, at fair value                                         | 69,427                          | 35,759                  |
| Securities held-to-maturity, at amortized cost (fair value of \$15,530 and \$45,308) | 15,861                          | 44,952                  |
| Total investment securities                                                          | 85,288                          | 80,711                  |
| Restricted stock                                                                     | 4,284                           | 4,237                   |
| Loans held for sale, at fair value                                                   | 48,887                          | 111,542                 |
| Loans                                                                                | 641,464                         | 616,978                 |
| Allowance for loan losses                                                            | (13,007 )                       | (12,500 )               |
| Net loans                                                                            | 628,457                         | 604,478                 |
| Premises and equipment, net                                                          | 8,434                           | 8,517                   |
| Accrued interest receivable                                                          | 2,480                           | 2,408                   |
| Other assets                                                                         | 17,231                          | 14,080                  |
| Total assets                                                                         | \$ 841,683                      | \$ 863,914              |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                          |                                 |                         |
| Deposits                                                                             |                                 |                         |
| Noninterest-bearing deposits                                                         | \$ 220,474                      | \$ 164,161              |
| Savings and interest-bearing deposits                                                | 190,179                         | 187,997                 |
| Time deposits                                                                        | 249,205                         | 319,338                 |
| Total deposits                                                                       | 659,858                         | 671,496                 |
| Other liabilities                                                                    |                                 |                         |
| Short-term borrowings                                                                | 70,161                          | 83,091                  |
| Subordinated debentures                                                              | 6,186                           | 6,186                   |
| Other liabilities and accrued expenses                                               | 10,898                          | 11,874                  |
| Total liabilities                                                                    | \$ 747,103                      | \$ 772,647              |

SHAREHOLDERS' EQUITY

|                                                                                                                                                                        |            |           |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|-----------|
| Common stock, par value, \$0.835; authorized, 60,000,000 shares; issued and outstanding, 10,285,212 shares at June 30, 2013 and 10,317,767 shares at December 31, 2012 | \$ 8,588   | \$8,615   |
| Additional paid in capital                                                                                                                                             | 16,719     | 17,155    |
| Retained earnings                                                                                                                                                      | 70,653     | 65,404    |
| Accumulated other comprehensive income, net                                                                                                                            | (1,380 )   | 93        |
| Total shareholders' equity                                                                                                                                             | 94,580     | 91,267    |
| Total liabilities and shareholders' equity                                                                                                                             | \$ 841,683 | \$863,914 |

See accompanying notes to consolidated financial statements (Unaudited).

## ACCESS NATIONAL CORPORATION

## Consolidated Statements of Income

(In Thousands, Except for Share and Per Share Data)

(Unaudited)

|                                                     | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|-----------------------------------------------------|-----------------------------|----------|---------------------------|-----------|
|                                                     | 2013                        | 2012     | 2013                      | 2012      |
| Interest and Dividend Income                        |                             |          |                           |           |
| Interest and fees on loans                          | \$ 8,611                    | \$ 8,369 | \$ 17,206                 | \$ 17,040 |
| Interest on deposits in other banks                 | 28                          | 19       | 54                        | 50        |
| Interest and dividends on securities                | 447                         | 614      | 982                       | 1,263     |
| Total interest and dividend income                  | 9,086                       | 9,002    | 18,242                    | 18,353    |
| Interest Expense                                    |                             |          |                           |           |
| Interest on deposits                                | 966                         | 1,150    | 1,967                     | 2,423     |
| Interest on short-term borrowings                   | 15                          | 33       | 28                        | 145       |
| Interest on long-term borrowings                    | -                           | 31       | -                         | 72        |
| Interest on subordinated debentures                 | 53                          | 56       | 106                       | 113       |
| Total interest expense                              | 1,034                       | 1,270    | 2,101                     | 2,753     |
| Net interest income                                 | 8,052                       | 7,732    | 16,141                    | 15,600    |
| Provision for loan losses                           | -                           | 472      | 225                       | 1,190     |
| Net interest income after provision for loan losses | 8,052                       | 7,260    | 15,916                    | 14,410    |
| Noninterest Income                                  |                             |          |                           |           |
| Service fees on deposit accounts                    | 138                         | 160      | 307                       | 337       |
| Gain on sale of loans                               | 7,120                       | 14,738   | 15,001                    | 25,682    |
| Mortgage broker fee income                          | 29                          | 20       | 47                        | 27        |
| Other income                                        | 736                         | (1,186)  | 3,512                     | (213)     |
| Total noninterest income                            | 8,023                       | 13,732   | 18,867                    | 25,833    |
| Noninterest Expense                                 |                             |          |                           |           |
| Salaries and employee benefits                      | 6,799                       | 7,474    | 14,868                    | 15,809    |
| Occupancy and equipment                             | 616                         | 579      | 1,320                     | 1,230     |
| Other operating expenses                            | 3,118                       | 6,358    | 7,000                     | 11,136    |
| Total noninterest expense                           | 10,533                      | 14,411   | 23,188                    | 28,175    |
| Income before income taxes                          | 5,542                       | 6,581    | 11,595                    | 12,068    |
| Income tax expense                                  | 2,018                       | 2,691    | 4,387                     | 4,741     |
| NET INCOME                                          | \$ 3,524                    | \$ 3,890 | \$ 7,208                  | \$ 7,327  |

Earnings per common share:

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|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | \$ 0.34 | \$ 0.38 | \$ 0.70 | \$ 0.72 |
| Diluted | \$ 0.34 | \$ 0.38 | \$ 0.69 | \$ 0.71 |

Average outstanding shares:

|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | 10,306,561 | 10,237,515 | 10,314,592 | 10,219,085 |
| Diluted | 10,379,870 | 10,350,214 | 10,408,735 | 10,331,529 |

See accompanying notes to consolidated financial statements (Unaudited).

- 3 -

ACCESS NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income

(In Thousands)

(Unaudited)

|                                                         | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|---------------------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                                         | 2013                        | 2012     | 2013                      | 2012     |
| Net income                                              | \$ 3,524                    | \$ 3,890 | \$ 7,208                  | \$ 7,327 |
| Other comprehensive income:                             |                             |          |                           |          |
| Unrealized gains (losses) on securities                 |                             |          |                           |          |
| Unrealized holding gains (losses) arising during period | (1,999 )                    | 67       | (2,267 )                  | 6        |
| Tax effect                                              | 700                         | (23 )    | 794                       | (2 )     |
| Net of tax amount                                       | (1,299 )                    | 44       | (1,473 )                  | 4        |
| Comprehensive income                                    | \$ 2,225                    | \$ 3,934 | \$ 5,735                  | \$ 7,331 |

See accompanying notes to consolidated financial statements (Unaudited).

## ACCESS NATIONAL CORPORATION

## Consolidated Statements of Changes in Shareholders' Equity

(In Thousands, Except for Share Data)

(Unaudited)

|                                                            | Common<br>Stock | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Compre-<br>hensive<br>Income<br>(Loss) | Total    |
|------------------------------------------------------------|-----------------|----------------------------------|----------------------|----------------------------------------------------------------|----------|
| Balance, December 31, 2012                                 | \$ 8,615        | \$ 17,155                        | \$ 65,404            | \$ 93                                                          | \$91,267 |
| Net income                                                 | -               | -                                | 7,208                | -                                                              | 7,208    |
| Other comprehensive income                                 | -               | -                                | -                    | (1,473 )                                                       | (1,473 ) |
| Stock option exercises (28,899 shares)                     | 24              | 169                              | -                    | -                                                              | 193      |
| Repurchased under share repurchase program (61,454 shares) | (51 )           | (715 )                           | -                    | -                                                              | (766 )   |
| Excess tax benefits from stock based payment arrangements  | -               | 6                                | -                    | -                                                              | 6        |
| Cash dividend                                              | -               | -                                | (1,959 )             | -                                                              | (1,959 ) |
| Stock-based compensation expense recognized in earnings    | -               | 104                              | -                    | -                                                              | 104      |
| Balance, June 30, 2013                                     | \$ 8,588        | \$ 16,719                        | \$ 70,653            | \$ (1,380 )                                                    | \$94,580 |
| Balance, December 31, 2011                                 | \$ 8,511        | \$ 16,716                        | \$ 57,529            | \$ 59                                                          | \$82,815 |
| Net income                                                 | -               | -                                | 7,327                | -                                                              | 7,327    |
| Other comprehensive income                                 | -               | -                                | -                    | 4                                                              | 4        |
| Stock option exercises (132,453 shares)                    | 110             | 613                              | -                    | -                                                              | 723      |
| Repurchased under share repurchase program (74,300 shares) | (62 )           | (708 )                           | -                    | -                                                              | (770 )   |
| Cash dividend                                              | -               | -                                | (1,183 )             | -                                                              | (1,183 ) |
| Stock-based compensation expense recognized in earnings    | -               | 132                              | -                    | -                                                              | 132      |
| Balance, June 30, 2012                                     | \$ 8,559        | \$ 16,753                        | \$ 63,673            | \$ 63                                                          | \$89,048 |

See accompanying notes to consolidated financial statements (Unaudited).

## ACCESS NATIONAL CORPORATION

## Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

|                                                                                             | Six Months Ended<br>June 30, |          |
|---------------------------------------------------------------------------------------------|------------------------------|----------|
|                                                                                             | 2013                         | 2012     |
| Cash Flows from Operating Activities                                                        |                              |          |
| Net income                                                                                  | \$7,208                      | \$7,327  |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                              |          |
| Provision for loan losses                                                                   | 225                          | 1,190    |
| Provision for losses on mortgage loans sold                                                 | 388                          | 1,600    |
| Provision for off-balance sheet losses                                                      | 65                           | 52       |
| Excess tax benefits                                                                         | 6                            | -        |
| Deferred tax benefit                                                                        | (8 )                         | (183 )   |
| Stock-based compensation                                                                    | 104                          | 132      |
| Valuation allowance on derivatives                                                          | (330 )                       | (898 )   |
| Amortization of premiums and discount accretion on securities, net                          | 195                          | 6        |
| Depreciation and amortization                                                               | 239                          | 209      |
| Changes in assets and liabilities:                                                          |                              |          |
| Decrease (increase) in valuation of loans held for sale carried at fair value               | 4,765                        | (994 )   |
| Decrease (increase) in loans held for sale                                                  | 57,889                       | (4,190 ) |
| Increase in other assets                                                                    | (1,492 )                     | (3,181 ) |
| (Decrease) increase in other liabilities                                                    | (2,036 )                     | 458      |
| Net cash provided by operating activities                                                   | 67,218                       | 1,528    |
| Cash Flows from Investing Activities                                                        |                              |          |
| Proceeds from maturities and calls of securities available-for-sale                         | 21,452                       | 31,248   |
| Proceeds from maturities and calls of securities held-to-maturity                           | 30,000                       | 15,000   |
| Purchases of securities available-for-sale                                                  | (57,650)                     | (20,013) |
| Purchases of securities held-to-maturity                                                    | (889 )                       | (44,947) |
| Net increase in loans                                                                       | (24,204)                     | (14,097) |
| Proceeds from sale of equipment                                                             | 10                           | -        |
| Purchases of premises and equipment                                                         | (156 )                       | (60 )    |
| Net cash used in investing activities                                                       | (31,437)                     | (32,869) |
| Cash Flows from Financing Activities                                                        |                              |          |
| Net increase in demand, interest-bearing demand and savings deposits                        | 58,496                       | 34,878   |
| Net (decrease) increase in time deposits                                                    | (70,134)                     | 1,040    |
| Decrease in securities sold under agreement to repurchase                                   | (17,930)                     | (5,493 ) |
| Net increase (decrease) in other short-term borrowings                                      | 5,000                        | (7,000 ) |
| Net decrease in long-term borrowings                                                        | -                            | (1,107 ) |
| Proceeds from issuance of common stock                                                      | 193                          | 724      |
| Repurchase of common stock                                                                  | (766 )                       | (770 )   |

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|                                                          |            |          |
|----------------------------------------------------------|------------|----------|
| Dividends paid                                           | (1,959 )   | (1,183 ) |
| Net cash (used in) provided by financing activities      | (27,100)   | 21,089   |
|                                                          |            |          |
| Increase (decrease) in cash and cash equivalents         | 8,681      | (10,252) |
| Cash and Cash Equivalents                                |            |          |
| Beginning                                                | 37,941     | 43,909   |
| Ending                                                   | \$46,622   | \$33,657 |
| Supplemental Disclosures of Cash Flow Information        |            |          |
| Cash payments for interest                               | \$1,969    | \$3,069  |
| Cash payments for income taxes                           | \$5,965    | \$4,695  |
| Supplemental Disclosures of Noncash Investing Activities |            |          |
| Unrealized (loss) gain on securities available-for-sale  | \$(2,267 ) | \$6      |

See accompanying notes to consolidated financial statements (Unaudited).

**Notes to Consolidated Financial Statements (Unaudited)**

**NOTE 1 – BASIS OF PRESENTATION**

Access National Corporation (the “Corporation”) is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation has two wholly-owned subsidiaries, Access National Bank (the “Bank”), which is an independent commercial bank chartered under federal laws as a national banking association, and Access National Capital Trust II, which was formed for the purpose of issuing redeemable capital securities. The Bank has three active subsidiaries, Access Real Estate LLC (“Access Real Estate”), ACME Real Estate LLC (“ACME”), and Access Capital Management Holding LLC (“ACM”).

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with rules and regulations of the Securities and Exchange Commission (“SEC”). The statements do not include all of the information and footnotes required by GAAP for complete financial statements. All adjustments have been made which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. Such adjustments are all of a normal and recurring nature. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2013. These consolidated financial statements should be read in conjunction with the Corporation’s audited financial statements and the notes thereto as of December 31, 2012, included in the Corporation’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

**NOTE 2 – STOCK-BASED COMPENSATION PLANS**

During the first six months of 2013, the Corporation granted 141,584 stock options to officers, directors, and employees under the 2009 Stock Option Plan (the “Plan”). Options granted under the Plan have an exercise price equal to the fair market value as of the grant date. Options granted vest over various periods ranging from two and one-half years to four years and expire one year after the full vesting date. Stock-based compensation expense recognized in other operating expense during the first six months of 2013 and 2012 was \$104 thousand and \$132 thousand, respectively. The fair value of options is estimated on the date of grant using a Black Scholes option-pricing model with the assumptions noted below.

The total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan as of June 30, 2013 was \$554,319. The cost is expected to be recognized over a weighted average

period of 1.56 years.

- 7 -

**NOTE 2 – STOCK-BASED COMPENSATION PLANS (continued)**

A summary of stock option activity under the Plan for the six months ended June 30, 2013 and 2012 is presented as follows:

| Six Months Ended<br>June 30, 2013          |                      |                                 |                                                          |                              |
|--------------------------------------------|----------------------|---------------------------------|----------------------------------------------------------|------------------------------|
| Expected life of options granted, in years | 4.61                 |                                 |                                                          |                              |
| Risk-free interest rate                    | 0.36                 |                                 | %                                                        |                              |
| Expected volatility of stock               | 42                   |                                 | %                                                        |                              |
| Annual expected dividend yield             | 3                    |                                 | %                                                        |                              |
| Fair Value of Granted Options              | \$ 435,473           |                                 |                                                          |                              |
| Non-Vested Options                         | 331,477              |                                 |                                                          |                              |
|                                            | Number of<br>Options | Weighted Avg.<br>Exercise Price | Weighted Avg.<br>Remaining Contractual<br>Term, in years | Aggregate Intrinsic<br>Value |
| Outstanding at beginning of year           | 274,800              | \$ 7.72                         | 2.59                                                     | \$ 1,450,016                 |
| Granted                                    | 141,584              | 15.31                           | 4.61                                                     | -                            |
| Exercised                                  | (28,899 )            | 6.67                            | 0.95                                                     | 205,275                      |
| Lapsed or Canceled                         | (5,759 )             | \$ 9.09                         | 2.58                                                     | \$ -                         |
| Outstanding at June 30, 2013               | 381,726              | \$ 10.59                        | 3.11                                                     | \$ 1,237,911                 |
| Exercisable at June 30, 2013               | 50,249               | \$ 7.56                         | 1.84                                                     | \$ 272,275                   |
| Six Months Ended<br>June 30, 2012          |                      |                                 |                                                          |                              |
| Expected life of options granted, in years | 4.60                 |                                 |                                                          |                              |
| Risk-free interest rate                    | 0.39                 |                                 | %                                                        |                              |
| Expected volatility of stock               | 43                   |                                 | %                                                        |                              |
|                                            | 2                    |                                 | %                                                        |                              |

Annual  
expected  
dividend yield

|                                  |    |         |
|----------------------------------|----|---------|
| Fair value of<br>granted options | \$ | 327,368 |
| Non-vested<br>options            |    | 324,650 |

|                                  | Number of<br>Options | Weighted Avg.<br>Exercise Price | Weighted Avg.<br>Remaining Contractual<br>Term, in years | Aggregate Intrinsic<br>Value |
|----------------------------------|----------------------|---------------------------------|----------------------------------------------------------|------------------------------|
| Outstanding at beginning of year | 385,450              | \$ 6.04                         | 1.63                                                     | \$ 1,064,115                 |
| Granted                          | 106,350              | 9.30                            | 4.60                                                     | -                            |
| Exercised                        | (132,453 )           | 5.47                            | 0.03                                                     | 674,588                      |
| Lapsed or canceled               | (8,992 )             | \$ 6.65                         | 2.08                                                     | \$ -                         |
| Outstanding at June 30, 2012     | 350,355              | \$ 7.23                         | 2.64                                                     | \$ 2,055,653                 |
| Exercisable at June 30, 2012     | 25,705               | \$ 3.99                         | 0.07                                                     | \$ 234,173                   |

### **NOTE 3 – SECURITIES**

The following table provides the amortized cost and fair value for the categories of available-for-sale securities and held-to-maturity securities at June 30, 2013 and December 31, 2012. Held-to-maturity securities are carried at amortized cost, which reflects historical cost, adjusted for amortization of premiums and accretion of discounts. Available-for-sale securities are carried at estimated fair value with net unrealized gains or losses reported on an after tax basis as a component of accumulated other comprehensive income in shareholders' equity. The estimated fair value of available-for-sale securities is impacted by interest rates, credit spreads, market volatility, and liquidity.

**NOTE 3 – SECURITIES (continued)**

|                            | June 30, 2013     |                              |                                 |                            |
|----------------------------|-------------------|------------------------------|---------------------------------|----------------------------|
|                            | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Estimated<br>Fair<br>Value |
|                            | (In Thousands)    |                              |                                 |                            |
| Available-for-sale:        |                   |                              |                                 |                            |
| U.S. Government agencies   | \$31,280          | \$ 15                        | \$ (1,144)                      | ) \$ 30,151                |
| Mortgage backed securities | 28,870            | 65                           | (947)                           | ) 27,988                   |
| Corporate bonds            | 6,019             | 93                           | (128)                           | ) 5,984                    |
| Other AFS                  | 3,882             | -                            | (9)                             | ) 3,873                    |
| CRA mutual fund            | 1,500             | -                            | (69)                            | ) 1,431                    |
| Total                      | \$71,551          | \$ 173                       | \$ (2,297)                      | ) \$ 69,427                |

|                          |          |      |          |             |
|--------------------------|----------|------|----------|-------------|
| Held-to-maturity:        |          |      |          |             |
| U.S. Government agencies | \$14,982 | \$ - | \$ (283) | ) \$ 14,699 |
| Municipals - non taxable | 879      | -    | (48)     | ) 831       |
| Total                    | \$15,861 | \$ - | \$ (331) | ) \$ 15,530 |

|                            | December 31, 2012 |                              |                                 |                         |
|----------------------------|-------------------|------------------------------|---------------------------------|-------------------------|
|                            | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Estimated<br>Fair Value |
|                            | (In Thousands)    |                              |                                 |                         |
| Available-for-sale:        |                   |                              |                                 |                         |
| U.S. Government agencies   | \$15,000          | \$ 16                        | \$ -                            | ) \$ 15,016             |
| Mortgage backed securities | 15,103            | 100                          | (26)                            | ) 15,177                |
| Corporate bonds            | 4,012             | 92                           | (25)                            | ) 4,079                 |
| CRA mutual fund            | 1,500             | -                            | (13)                            | ) 1,487                 |
| Total                      | \$35,615          | \$ 208                       | \$ (64)                         | ) \$ 35,759             |

|                          |          |        |      |             |
|--------------------------|----------|--------|------|-------------|
| Held-to-maturity:        |          |        |      |             |
| U.S. Government agencies | \$44,952 | \$ 356 | \$ - | ) \$ 45,308 |
| Total                    | \$44,952 | \$ 356 | \$ - | ) \$ 45,308 |

**NOTE 3 – SECURITIES (continued)**

The amortized cost and estimated fair value of securities available-for-sale and held-to-maturity as of June 30, 2013 and December 31, 2012 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because some of the securities may be called or prepaid without any penalties.

|                                     | June 30, 2013  |                      | December 31, 2012 |                      |
|-------------------------------------|----------------|----------------------|-------------------|----------------------|
|                                     | Amortized Cost | Estimated Fair Value | Amortized Cost    | Estimated Fair Value |
|                                     | (In Thousands) |                      |                   |                      |
| Available-for-sale:                 |                |                      |                   |                      |
| U.S. Government agencies:           |                |                      |                   |                      |
| Due after one through five years    | \$4,367        | \$ 4,335             | \$5,000           | \$ 5,003             |
| Due after five through ten years    | 18,998         | 18,075               | 5,000             | 5,008                |
| Due after ten through fifteen years | 4,391          | 4,406                | 5,000             | 5,005                |
| Due after fifteen years             | 3,524          | 3,335                | -                 | -                    |
| Mortgage backed securities:         |                |                      |                   |                      |
| Due after five through ten years    | 5,989          | 5,848                | 3,696             | 3,745                |
| Due after ten through fifteen years | 19,457         | 18,768               | 10,918            | 10,893               |
| Due after fifteen years             | 3,424          | 3,372                | 489               | 539                  |
| Corporate bonds:                    |                |                      |                   |                      |
| Due after one through five years    | 4,011          | 4,104                | 4,012             | 4,079                |
| Due after five through ten years    | 2,008          | 1,880                | -                 | -                    |
| Other-AFS:                          |                |                      |                   |                      |
| Due after five through ten years    | 1,000          | 1,000                | -                 | -                    |
| Due after fifteen years             | 2,882          | 2,873                | -                 | -                    |
| CRA Mutual Fund                     | 1,500          | 1,431                | 1,500             | 1,487                |
| Total                               | \$71,551       | \$ 69,427            | \$35,615          | \$ 35,759            |
| Held-to-maturity:                   |                |                      |                   |                      |
| U.S. Government agencies:           |                |                      |                   |                      |
| Due after one through five years    | \$4,998        | \$ 4,997             | \$24,981          | \$ 25,085            |
| Due after five through ten years    | 5,000          | 4,961                | 5,000             | 5,175                |
| Due after ten through fifteen years | 4,984          | 4,741                | 14,971            | 15,048               |
| Municipals non-taxable:             |                |                      |                   |                      |
| Due after ten through fifteen years | 879            | 831                  | -                 | -                    |
| Total                               | \$15,861       | \$ 15,530            | \$44,952          | \$ 45,308            |

The estimated fair value of securities pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes amounted to \$47.0 million at June 30, 2013 and \$60.7 million at December 31, 2012.



**NOTE 3 – SECURITIES (continued)**

Securities available-for-sale and held-to-maturity that have an unrealized loss position at June 30, 2013 and December 31, 2012 are as follows:

| June 30, 2013                                            | Securities in a loss<br>Position for less than<br>12 Months |                      | Securities in a loss<br>Position for 12 Months<br>or Longer |                      | Total                      |                      |
|----------------------------------------------------------|-------------------------------------------------------------|----------------------|-------------------------------------------------------------|----------------------|----------------------------|----------------------|
|                                                          | Estimated<br>Fair<br>Value                                  | Unrealized<br>Losses | Estimated<br>Fair<br>Value                                  | Unrealized<br>Losses | Estimated<br>Fair<br>Value | Unrealized<br>Losses |
| Investment securities available-for-sale: (In Thousands) |                                                             |                      |                                                             |                      |                            |                      |
| Mortgage backed securities                               | \$24,443                                                    | \$ (947 )            | \$ -                                                        | \$ -                 | \$24,443                   | \$ (947 )            |
| U.S. Government agencies                                 | 25,746                                                      | (1,144 )             | -                                                           | -                    | 25,746                     | (1,144 )             |
| Other AFS                                                | 2,873                                                       | (9 )                 | -                                                           | -                    | 2,873                      | (9 )                 |
| Corporate bonds                                          | 1,880                                                       | (128 )               | -                                                           | -                    | 1,880                      | (128 )               |
| CRA Mutual fund                                          | 1,431                                                       | (69 )                | -                                                           | -                    | 1,431                      | (69 )                |
| Total                                                    | \$56,373                                                    | \$ (2,297 )          | \$ -                                                        | \$ -                 | \$56,373                   | \$ (2,297 )          |

## Investment securities held-to-maturity:

|                          |          |           |      |      |          |           |
|--------------------------|----------|-----------|------|------|----------|-----------|
| U.S. Government agencies | \$14,699 | \$ (283 ) | \$ - | \$ - | \$14,699 | \$ (283 ) |
| Municipals - non taxable | 831      | (48 )     | -    | -    | 831      | (48 )     |
| Total                    | \$15,530 | \$ (331 ) | \$ - | \$ - | \$15,530 | \$ (331 ) |

| December 31, 2012                                        | Securities in a loss<br>Position for less<br>than<br>12 Months |                      | Securities in a loss<br>Position for 12 Months<br>or Longer |                      | Total                      |                      |
|----------------------------------------------------------|----------------------------------------------------------------|----------------------|-------------------------------------------------------------|----------------------|----------------------------|----------------------|
|                                                          | Estimated<br>Fair<br>Value                                     | Unrealized<br>Losses | Estimated<br>Fair<br>Value                                  | Unrealized<br>Losses | Estimated<br>Fair<br>Value | Unrealized<br>Losses |
| Investment securities available-for-sale: (In Thousands) |                                                                |                      |                                                             |                      |                            |                      |
| Mortgage backed securities                               | \$6,361                                                        | \$ (26 )             | \$ -                                                        | \$ -                 | \$6,361                    | \$ (26 )             |
| Corporate bonds                                          | -                                                              | -                    | 1,967                                                       | (25 )                | 1,967                      | (25 )                |
| CRA Mutual fund                                          | 1,487                                                          | (13 )                | -                                                           | -                    | 1,487                      | (13 )                |
| Total                                                    | \$7,848                                                        | \$ (39 )             | \$ 1,967                                                    | \$ (25 )             | \$9,815                    | \$ (64 )             |

The Corporation evaluates securities for other than temporary impairment (“OTTI”) on a quarterly basis and more frequently when economic or market conditions warrant such evaluation. Consideration is given to various factors in

determining whether the Corporation anticipates a recovery in fair value such as: the length of time and extent to which the fair value has been less than cost, and the financial condition and underlying credit quality of the issuer. When analyzing an issuer's financial condition, the Corporation may consider whether the securities are issued by the federal government or its agencies, the sector or industry trends affecting the issuer, and whether any recent downgrades by bond rating agencies have occurred.

*U.S. Government agencies*

The Corporation's unrealized losses on U.S. Government Agency obligations were caused by interest rate fluctuations. On June 30, 2013, three held-to-maturity securities had unrealized losses of \$283,319 while seven available for sale securities has unrealized losses of \$1,143,620. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. As the securities are obligations of government agencies, it is the Corporation's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Corporation will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these investments other than temporarily impaired.

**NOTE 3 – SECURITIES (continued)**

*Corporate bonds*

The Corporation's unrealized losses on corporate obligations were caused by interest rate fluctuations. At June 30, 2013, one security had an unrealized loss of \$127,924. Based on the credit quality of the issuers, the Corporation's intent to hold this security until a market price recovery or maturity, and the determination that it is more likely than not that the Corporation will not be required to sell the security before its anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.

*Mortgage-backed*

The Corporation's unrealized losses on mortgage backed securities were caused by interest rate fluctuations. At June 30, 2013, seven securities had unrealized losses of \$947,216. As these securities are Ginnie Mae and government sponsored entity securities backed by the United States Government, the Corporation's intent to hold these securities until a market price recovery or maturity, and the determination that it is more likely than not that the Corporation will not be required to sell these securities before their anticipated recoveries, the Corporation does not consider these investments other than temporarily impaired.

*Mutual fund*

The Corporation's unrealized loss on its mutual fund investment was caused by interest rate fluctuations. At June 30, 2013, this one security had an unrealized loss of \$68,881. Based on the credit quality of the issuers, the Corporation's intent to hold this security until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell this security before its anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.

*Other Securities*

The Corporation's unrealized loss on its other investments was caused by interest rate fluctuations. At June 30, 2013, one security had an unrealized loss of \$8,613. Based on the credit quality of the issuers, the Corporation's intent to hold this security until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell the security before its anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.

*Municipal*

The Corporation's unrealized loss on its held to maturity municipal investment was caused by interest rate fluctuations. At June 30, 2013, this one security had an unrealized loss of \$48,106. Based on the credit quality of the issuers, the Corporation's intent to hold this security until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell the security before its anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.

## Restricted Stock

The Corporation's restricted stock consists of Federal Home Loan Bank of Atlanta ("FHLB") stock and Federal Reserve Bank ("FRB") stock. The amortized costs of the restricted stock as of June 30, 2013 and December 31, 2012 are as follows:

|                            | June<br>30,<br>2013 | December 31, 2012 |
|----------------------------|---------------------|-------------------|
| Restricted Stock:          | (In Thousands)      |                   |
| Federal Reserve Bank stock | \$999               | \$ 999            |
| FHLB stock                 | 3,285               | 3,238             |
|                            | \$4,284             | \$ 4,237          |

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES**

The following table presents the composition of the loans held for investment portfolio at June 30, 2013 and December 31, 2012:

|                                             | Composition of Loan Portfolio |                     |   |                   |                     |   |
|---------------------------------------------|-------------------------------|---------------------|---|-------------------|---------------------|---|
|                                             | June 30, 2013                 |                     |   | December 31, 2012 |                     |   |
|                                             | Amount                        | Percentage of Total |   | Amount            | Percentage of Total |   |
|                                             | (Dollars In Thousands)        |                     |   |                   |                     |   |
| Commercial real estate - owner occupied     | \$189,648                     | 29.56               | % | \$182,655         | 29.60               | % |
| Commercial real estate - non-owner occupied | 98,694                        | 15.39               |   | 107,213           | 17.38               |   |
| Residential real estate                     | 157,253                       | 24.51               |   | 144,521           | 23.43               |   |
| Commercial                                  | 156,563                       | 24.41               |   | 149,389           | 24.21               |   |
| Real estate construction                    | 35,396                        | 5.52                |   | 30,038            | 4.87                |   |
| Consumer                                    | 3,910                         | 0.61                |   | 3,162             | 0.51                |   |
| Total loans                                 | \$641,464                     | 100.00              | % | \$616,978         | 100.00              | % |
| Less allowance for loan losses              | 13,007                        |                     |   | 12,500            |                     |   |
| Net loans                                   | \$628,457                     |                     |   | \$604,478         |                     |   |

Unearned income and net deferred loan fees and costs totaled \$1.6 and \$1.7 million at June 30, 2013 and December 31, 2012, respectively. Loans pledged to secure borrowings at the FHLB totaled \$218.9 million and \$215.4 million at June 30, 2013 and December 31, 2012, respectively.

**Allowance for Loan Losses**

The allowance for loan losses totaled \$13.0 million at June 30, 2013 compared to \$12.5 million at year end December 31, 2012. The allowance for loan losses was equivalent to 2.03% of total loans held for investment at June 30, 2013 and December 31, 2012. Adequacy of the allowance is assessed and the allowance is increased by provisions for loan losses charged to expense no less than quarterly. Charge-offs are taken when a loan is identified as uncollectible.

The methodology by which we systematically determine the amount of our allowance is set forth by the Board of Directors in our Loan Policy and implemented by management. The results of the analysis are documented, reviewed, and approved by the Board of Directors no less than quarterly.



**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

The level of the allowance for loan losses is determined by management through an ongoing, detailed analysis of historical loss rates and risk characteristics. During each quarter, management evaluates the collectability of all loans in the portfolio and ensures an accurate risk rating is assigned to each loan. The risk rating scale and definitions commonly adopted by the Federal Banking Agencies is contained within the framework prescribed by the Bank's Loan Policy. Any loan that is deemed to have potential or well defined weaknesses that may jeopardize collection in full is then analyzed to ascertain its level of weakness. If appropriate, the loan may be charged-off or a specific reserve may be assigned if the loan is deemed to be impaired.

During the risk rating verification process, each loan identified as inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged is considered impaired and is placed on non-accrual status. On these loans, management analyzes the potential impairment of the individual loan and may set aside a specific reserve. Any amounts deemed uncollectible during that analysis are charged-off.

For the remaining loans in each segment, the Bank calculates the probability of loss as a group using the risk rating for each of the following loan types: Commercial Real Estate - Owner Occupied, Commercial Real Estate - Non-Owner Occupied, Residential Real Estate, Commercial, Real Estate Construction, and Consumer. Management calculates the historical loss rate in each group by risk rating using a period of at least five years. This historical loss rate may then be adjusted based on management's assessment of internal and external environmental factors. While management may consider other factors, the analysis generally includes factors such as unemployment, office vacancy rates, and any concentrations that exist within the portfolio. This adjustment is meant to account for changes between the historical economic environment and current conditions and for changes in the ongoing management of the portfolio which affects the loans' potential losses.

Once complete, management compares the condition of the portfolio using several different characteristics, as well as its experience, to the experience of other banks in its peer group in order to determine if it is directionally consistent with others' experience in our area and line of business. Based on that analysis, management aggregates the probabilities of loss of the remaining portfolio based on the specific and general allowances and may provide additional amounts to the allowance for loan losses as needed. Since this process involves estimates, the allowance for loan losses may also contain an amount that is non-material which is not allocated to a specific loan or to a group of loans but is deemed necessary to absorb additional losses in the portfolio.

Management and the Board of Directors subject the reserve adequacy and methodology to a review on a regular basis by internal auditors, external auditors and bank regulators, and such reviews have not resulted in any material adjustment to the allowance.



**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

The following tables provide detailed information about the allowance for loan losses as of and for the periods indicated.

## Allowance for Loan Losses

|                                  | Commercial<br>real<br>estate -<br>owner<br>occupied | Commercial<br>real<br>estate -<br>non-owner<br>occupied | Residential<br>real<br>estate | Commercial | Real<br>estate<br>construction | Consumer | Total     |
|----------------------------------|-----------------------------------------------------|---------------------------------------------------------|-------------------------------|------------|--------------------------------|----------|-----------|
| Three months ended June 30, 2013 |                                                     |                                                         |                               |            |                                |          |           |
| Allowance for credit losses:     |                                                     |                                                         |                               |            |                                |          |           |
| Beginning Balance                | \$3,725                                             | \$ 2,099                                                | \$ 3,020                      | \$ 3,220   | \$ 709                         | \$ 87    | \$12,860  |
| Charge-offs                      | -                                                   | -                                                       | -                             | -          | -                              | -        | -         |
| Recoveries                       | -                                                   | 115                                                     | 15                            | 7          | -                              | 10       | 147       |
| Provisions                       | 349                                                 | (390)                                                   | ) 185                         | (179)      | ) 81                           | (46)     | ) -       |
| Ending Balance                   | \$4,074                                             | \$ 1,824                                                | \$ 3,220                      | \$ 3,048   | \$ 790                         | \$ 51    | \$13,007  |
| Six months ended June 30, 2013   |                                                     |                                                         |                               |            |                                |          |           |
| Allowance for credit losses:     |                                                     |                                                         |                               |            |                                |          |           |
| Beginning Balance                | \$3,701                                             | \$ 2,173                                                | \$ 2,924                      | \$ 3,028   | \$ 610                         | \$ 64    | \$12,500  |
| Charge-offs                      | -                                                   | -                                                       | -                             | -          | -                              | -        | -         |
| Recoveries                       | -                                                   | 171                                                     | 78                            | 21         | -                              | 12       | 282       |
| Provisions                       | 373                                                 | (520)                                                   | ) 218                         | (1)        | ) 180                          | (25)     | ) 225     |
| Ending Balance                   | \$4,074                                             | \$ 1,824                                                | \$ 3,220                      | \$ 3,048   | \$ 790                         | \$ 51    | \$13,007  |
| Three months ended June 30, 2012 |                                                     |                                                         |                               |            |                                |          |           |
| Allowance for credit losses:     |                                                     |                                                         |                               |            |                                |          |           |
| Beginning Balance                | \$3,544                                             | \$ 2,227                                                | \$ 2,652                      | \$ 2,885   | \$ 564                         | \$ 69    | \$11,941  |
| Charge-offs                      | -                                                   | -                                                       | (30)                          | ) (411)    | ) -                            | -        | (441)     |
| Recoveries                       | -                                                   | 23                                                      | 18                            | 17         | -                              | 1        | 59        |
| Provisions                       | 176                                                 | (73)                                                    | ) (24)                        | ) 406      | (9)                            | ) (4)    | ) 472     |
| Ending Balance                   | \$3,720                                             | \$ 2,177                                                | \$ 2,616                      | \$ 2,897   | \$ 555                         | \$ 66    | \$12,031  |
| Six months ended June 30, 2012   |                                                     |                                                         |                               |            |                                |          |           |
| Allowance for credit losses:     |                                                     |                                                         |                               |            |                                |          |           |
| Beginning Balance                | \$3,634                                             | \$ 1,747                                                | \$ 2,874                      | \$ 3,021   | \$ 423                         | \$ 39    | \$11,738  |
| Charge-offs                      | (202)                                               | ) -                                                     | (494)                         | ) (694)    | ) -                            | (35)     | ) (1,425) |

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|                |         |          |          |          |        |       |          |
|----------------|---------|----------|----------|----------|--------|-------|----------|
| Recoveries     | -       | 56       | 229      | 242      | -      | 1     | 528      |
| Provisions     | 288     | 374      | 7        | 328      | 132    | 61    | 1,190    |
| Ending Balance | \$3,720 | \$ 2,177 | \$ 2,616 | \$ 2,897 | \$ 555 | \$ 66 | \$12,031 |

Recorded Investment in Loans

| June 30, 2013                                                   | Commercial real estate - owner occupied (In Thousands) | Commercial real estate - non-owner occupied | Residential real estate | Commercial | Real estate construction | Consumer | Total     |
|-----------------------------------------------------------------|--------------------------------------------------------|---------------------------------------------|-------------------------|------------|--------------------------|----------|-----------|
| Allowance                                                       |                                                        |                                             |                         |            |                          |          |           |
| Ending balance:                                                 | \$4,074                                                | \$ 1,824                                    | \$3,220                 | \$ 3,048   | \$ 790                   | \$ 51    | \$13,007  |
| Ending balance: individually evaluated for impairment           | \$95                                                   | \$ -                                        | \$ 117                  | \$ 252     | \$ -                     | \$ -     | \$464     |
| Ending balance: collectively evaluated for impairment           | \$3,979                                                | \$ 1,824                                    | \$3,103                 | \$ 2,796   | \$ 790                   | \$ 51    | \$12,543  |
| Ending balance: loans acquired with deteriorated credit quality | \$-                                                    | \$ -                                        | \$-                     | \$ -       | \$ -                     | \$ -     | \$-       |
| Loans                                                           |                                                        |                                             |                         |            |                          |          |           |
| Ending balance                                                  | \$189,648                                              | \$ 98,694                                   | \$157,253               | \$ 156,563 | \$ 35,396                | \$ 3,910 | \$641,464 |
| Ending balance: individually evaluated for impairment           | \$-                                                    | \$ -                                        | \$555                   | \$ 1,744   | \$ -                     | \$ -     | \$2,299   |
| Ending balance: collectively evaluated for impairment           | \$189,648                                              | \$ 98,694                                   | \$156,698               | \$ 154,819 | \$ 35,396                | \$ 3,910 | \$639,165 |
| Ending balance: loans acquired with deteriorated credit quality | \$-                                                    | \$ -                                        | \$-                     | \$ -       | \$ -                     | \$ -     | \$-       |

| December 31, 2012                                               | Commercial real estate - owner occupied (In Thousands) | Commercial real estate - non-owner occupied | Residential real estate | Commercial | Real estate construction | Consumer | Total    |
|-----------------------------------------------------------------|--------------------------------------------------------|---------------------------------------------|-------------------------|------------|--------------------------|----------|----------|
| Allowance                                                       |                                                        |                                             |                         |            |                          |          |          |
| Ending balance:                                                 | \$3,701                                                | \$ 2,173                                    | \$2,924                 | \$ 3,028   | \$ 610                   | \$ 64    | \$12,500 |
| Ending balance: individually evaluated for impairment           | \$98                                                   | \$ -                                        | \$230                   | \$ 277     | \$ -                     | \$ -     | \$605    |
| Ending balance: collectively evaluated for impairment           | \$3,603                                                | \$ 2,173                                    | \$2,694                 | \$ 2,751   | \$ 610                   | \$ 64    | \$11,895 |
| Ending balance: loans acquired with deteriorated credit quality | \$-                                                    | \$ -                                        | \$-                     | \$ -       | \$ -                     | \$ -     | \$-      |

Loans

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|                                                                       |           |            |            |            |           |          |           |
|-----------------------------------------------------------------------|-----------|------------|------------|------------|-----------|----------|-----------|
| Ending balance:                                                       | \$182,655 | \$ 107,213 | \$ 144,521 | \$ 149,389 | \$ 30,038 | \$ 3,162 | \$616,978 |
| Ending balance: individually<br>evaluated for impairment              | \$370     | \$ -       | \$922      | \$ 1,937   | \$ -      | \$ -     | \$3,229   |
| Ending balance: collectively<br>evaluated for impairment              | \$182,285 | \$ 107,213 | \$ 143,599 | \$ 147,452 | \$ 30,038 | \$ 3,162 | \$613,749 |
| Ending balance: loans<br>acquired with deteriorated<br>credit quality | \$-       | \$ -       | \$ -       | \$ -       | \$ -      | \$ -     | \$-       |

- 15 -

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

**Identifying and Classifying Portfolio Risks by Risk Rating**

At origination, loans are categorized into risk categories based upon original underwriting. Subsequent to origination, management evaluates the collectability of all loans in the portfolio and assigns a proprietary risk rating. Ratings range from the highest to lowest quality based on factors including measurements of ability to pay, collateral type and value, borrower stability, management experience, and credit enhancements. These ratings are consistent with the bank regulatory rating system.

A loan may have portions of its balance in one rating and other portions in a different rating. The Bank may use these “split ratings” when factors cause loan loss risk to exist for part but not all of the principal balance. Split ratings may also be used where cash collateral or a government agency has provided a guaranty that partially covers a loan.

For clarity of presentation, the Corporation’s loan portfolio is profiled below in accordance with the risk rating framework that has been commonly adopted by the federal banking agencies. The definitions of the various risk rating categories are as follows:

Pass - The condition of the borrower and the performance of the loan is satisfactory or better.

Special mention - A special mention asset has one or more potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution’s credit position at some future date.

Substandard - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful - An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss - Assets classified loss are considered uncollectible and their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, and a partial recovery may be effected in the future.

The Bank did not have any loans classified as loss at June 30, 2013 or December 31, 2012. It is the Bank's policy to charge-off any loan once the risk rating is classified as loss.

The profile of the loan portfolio, as indicated by risk rating, as of June 30, 2013 and December 31, 2012 is shown below.

Credit Quality Indicators  
For the Period Ended, June 30, 2013

Credit Risk Profile by Regulatory Risk Rating

|                 | Commercial<br>real estate -<br>owner occupied |           | Commercial<br>real estate -<br>non-owner<br>occupied |           | Residential real<br>estate |           | Commercial |           | Real estate<br>construction |          |
|-----------------|-----------------------------------------------|-----------|------------------------------------------------------|-----------|----------------------------|-----------|------------|-----------|-----------------------------|----------|
|                 | 6/30/13                                       | 12/31/12  | 6/30/13                                              | 12/31/12  | 6/30/13                    | 12/31/12  | 6/30/13    | 12/31/12  | 6/30/13                     | 12/31/12 |
|                 | (In Thousands)                                |           |                                                      |           |                            |           |            |           |                             |          |
| Pass            | \$171,577                                     | \$159,413 | \$91,266                                             | \$100,443 | \$151,585                  | \$138,388 | \$141,423  | \$130,885 | \$35,573                    | \$30,573 |
| Special mention | 6,689                                         | 11,897    | 2,370                                                | 2,402     | 3,593                      | 3,902     | 9,327      | 12,225    | -                           | -        |
| Substandard     | 11,843                                        | 11,852    | 5,403                                                | 4,725     | 2,289                      | 2,420     | 6,167      | 6,724     | -                           | -        |
| Doubtful        | -                                             | -         | -                                                    | -         | -                          | -         | -          | -         | -                           | -        |
| Loss            | -                                             | -         | -                                                    | -         | -                          | -         | -          | -         | -                           | -        |
| Unearned income | (461 )                                        | (507 )    | (345 )                                               | (357 )    | (214 )                     | (189 )    | (354 )     | (445 )    | (177 )                      | (167 )   |
| Total           | \$189,648                                     | \$182,655 | \$98,694                                             | \$107,213 | \$157,253                  | \$144,521 | \$156,563  | \$149,389 | \$35,396                    | \$30,406 |

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

Loans listed as non-performing are also placed on non-accrual status. The accrual of interest is discontinued at the time a loan is 90 days delinquent or when the credit deteriorates and there is doubt that the credit will be paid as agreed, unless the credit is well-secured and in process of collection. Once the loan is on non-accrual status, all accrued but unpaid interest is also charged-off, and all payments are used to reduce the principal balance. Once the principal balance is repaid in full, additional payments are taken into income. A loan may be returned to accrual status if the borrower shows renewed willingness and ability to repay under the term of the loan agreement. The risk profile based upon payment activity is shown below.

|                | Commercial<br>real estate -<br>owner occupied |           | Commercial<br>real estate -<br>non-owner<br>occupied |           | Residential real<br>estate |           | Commercial |           | Real estate<br>construction |          |
|----------------|-----------------------------------------------|-----------|------------------------------------------------------|-----------|----------------------------|-----------|------------|-----------|-----------------------------|----------|
|                | 6/30/13                                       | 12/31/12  | 6/30/13                                              | 12/31/12  | 6/30/13                    | 12/31/12  | 6/30/13    | 12/31/12  | 6/30/13                     | 12/31/12 |
|                | (In Thousands)                                |           |                                                      |           |                            |           |            |           |                             |          |
| Performing     | \$189,648                                     | \$182,655 | \$98,694                                             | \$107,213 | \$156,698                  | \$143,599 | \$154,819  | \$147,568 | \$35,396                    | \$30,038 |
| Non-performing | -                                             | -         | -                                                    | -         | 555                        | 922       | 1,744      | 1,821     | -                           | -        |
| Total          | \$189,648                                     | \$182,655 | \$98,694                                             | \$107,213 | \$157,253                  | \$144,521 | \$156,563  | \$149,389 | \$35,396                    | \$30,038 |

Loans are considered past due if a contractual payment is not made by the calendar day after the payment is due. However, for reporting purposes loans past due 1 to 29 days are excluded from loans past due and are included in the total for current loans in the table below. The delinquency status of the loans in the portfolio is shown below as of June 30, 2013 and December 31, 2012. Loans that were on non-accrual status are not included in any past due amounts.

**Age Analysis of Past Due Loans**

|                                             | June 30, 2013                |                           |                            |                      |                      |                  |                |
|---------------------------------------------|------------------------------|---------------------------|----------------------------|----------------------|----------------------|------------------|----------------|
|                                             | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | Greater<br>than<br>90 Days | Total<br>Past<br>Due | Non-accrual<br>Loans | Current<br>Loans | Total<br>Loans |
|                                             | (In Thousands)               |                           |                            |                      |                      |                  |                |
| Commercial real estate - owner occupied     | \$-                          | \$ -                      | \$ -                       | \$ -                 | \$ -                 | \$189,648        | \$189,648      |
| Commercial real estate - non-owner occupied | 345                          | -                         | -                          | 345                  | -                    | 98,349           | 98,694         |
| Residential real estate                     | -                            | 725                       | -                          | 725                  | 555                  | 155,973          | 157,253        |
| Commercial                                  | -                            | -                         | -                          | -                    | 1,744                | 154,819          | 156,563        |
| Real estate construction                    | -                            | -                         | -                          | -                    | -                    | 35,396           | 35,396         |

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|          |       |        |      |          |          |           |           |
|----------|-------|--------|------|----------|----------|-----------|-----------|
| Consumer | -     | -      | -    | -        | -        | 3,910     | 3,910     |
| Total    | \$345 | \$ 725 | \$ - | \$ 1,070 | \$ 2,299 | \$638,095 | \$641,464 |

|                                                | December 31, 2012            |                           |                            |                      |                      |                  |                |
|------------------------------------------------|------------------------------|---------------------------|----------------------------|----------------------|----------------------|------------------|----------------|
|                                                | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | Greater<br>than<br>90 Days | Total<br>Past<br>Due | Non-accrual<br>Loans | Current<br>Loans | Total<br>Loans |
|                                                | (In Thousands)               |                           |                            |                      |                      |                  |                |
| Commercial real estate - owner occupied        | \$-                          | \$ -                      | \$ -                       | \$ -                 | \$ -                 | \$182,655        | \$182,655      |
| Commercial real estate - non-owner<br>occupied | -                            | -                         | -                          | -                    | -                    | 107,214          | 107,214        |
| Residential real estate                        | -                            | -                         | -                          | -                    | 922                  | 143,600          | 144,522        |
| Commercial                                     | -                            | -                         | -                          | -                    | 1,821                | 147,568          | 149,389        |
| Real estate construction                       | -                            | -                         | -                          | -                    | -                    | 30,038           | 30,038         |
| Consumer                                       | -                            | -                         | -                          | -                    | -                    | 3,160            | 3,160          |
| Total                                          | \$-                          | \$ -                      | \$ -                       | \$ -                 | \$ 2,743             | \$614,235        | \$616,978      |

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

**Troubled Debt Restructurings**

A troubled debt restructuring ("TDR") is a formal restructure of a loan when the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to a borrower. The Bank classifies these transactions as a TDR if the transaction meets the following conditions: an existing credit agreement must be formally renewed, extended and/or modified; the borrower must be experiencing financial difficulty; and the Bank has granted a concession that it would not otherwise consider. ASU 2011-02 requires public companies to identify and account for TDRs for interim and annual periods beginning on or after June 15, 2011.

Once identified as a TDR, a loan is considered to be impaired, and an impairment analysis is performed for the loan individually, rather than under a general loss allowance based on the loan type and risk rating. Any resulting shortfall is charged-off. This method is used consistently for all segments of the portfolio.

Normally, loans identified as TDRs would be placed on non-accrual status and considered non-performing until sufficient history of timely collection or payment has occurred that allows them to return to performing status, generally 6 months.

One residential real estate loan totaling \$210 thousand was modified in connection with a troubled debt restructuring during the six month period ended June 30, 2013. The modification granted the borrower reduced payments for a period of one year. There were no material financial effects as a direct result of this modification. No loans were modified in connection with a troubled debt restructuring during the three month period ended June 30, 2013.

No loans were modified during the first and second quarter of 2012 in connection with a trouble debt restructuring. There was one commercial loan previously restructured no more than 12 months prior to June 30, 2012 with a recorded balance of \$95,990 that subsequently defaulted in the three month period ended June 30, 2012. No payment defaults occurred during the first quarter of 2012 for loans restructured within the last 12 months.

**Impaired Loans**

A loan is classified as impaired when it is deemed probable by management's analysis that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, or the recorded investment in the impaired loan is greater than the present value of expected future cash flows, discounted at the loan's effective interest rate. In the case of an impaired loan, management conducts an analysis which identifies if a quantifiable potential loss exists, and takes the necessary steps to record that loss when it has been identified as uncollectible.

As the ultimate collectability of the total principal of an impaired loan is in doubt, the loan is placed on nonaccrual status with all payment applied to principal under the cost-recovery method. As such, the Bank did not recognize any interest income on its impaired loans for the three and six month periods ended June 30, 2013 and 2012.

- 18 -

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

The table below shows the results of management's analysis of impaired loans as of June 30, 2013 and December 31, 2012.

|                                              | Impaired Loans      |                          |                   |                     |                          |                   |
|----------------------------------------------|---------------------|--------------------------|-------------------|---------------------|--------------------------|-------------------|
|                                              | June 30, 2013       |                          |                   | December 31, 2012   |                          |                   |
|                                              | Recorded investment | Unpaid principal balance | Related allowance | Recorded investment | Unpaid principal balance | Related allowance |
| With no specific related allowance recorded: | (In Thousands)      |                          |                   |                     |                          |                   |
| Commercial real estate - owner occupied      | \$-                 | \$ -                     | \$ -              | \$-                 | \$ -                     | \$ -              |
| Commercial real estate - non-owner occupied  | -                   | -                        | -                 | -                   | -                        | -                 |
| Residential real estate                      | -                   | -                        | -                 | -                   | -                        | -                 |
| Commercial                                   | 1,083               | 1,230                    | -                 | 154                 | 165                      | -                 |
| Real estate construction                     | -                   | -                        | -                 | -                   | -                        | -                 |
| Consumer                                     | -                   | -                        | -                 | -                   | -                        | -                 |
| With a specific related allowance recorded:  |                     |                          |                   |                     |                          |                   |
| Commercial real estate - owner occupied      | 366                 | 366                      | \$ 95             | \$370               | \$ 370                   | \$ 98             |
| Commercial real estate - non-owner occupied  | -                   | -                        | -                 | -                   | -                        | -                 |
| Residential real estate                      | 555                 | 710                      | 117               | 922                 | 1,068                    | 230               |
| Commercial                                   | 754                 | 982                      | 252               | 1,783               | 2,099                    | 277               |
| Real estate construction                     | -                   | -                        | -                 | -                   | -                        | -                 |
| Consumer                                     | -                   | -                        | -                 | -                   | -                        | -                 |
| Total:                                       |                     |                          |                   |                     |                          |                   |
| Commercial real estate - owner occupied      | \$366               | \$ 366                   | \$ 95             | \$370               | \$ 370                   | \$ 98             |
| Commercial real estate - non-owner occupied  | -                   | -                        | -                 | -                   | -                        | -                 |
| Residential real estate                      | 555                 | 710                      | 117               | 922                 | 1,068                    | 230               |
| Commercial                                   | 1,837               | 2,212                    | 252               | 1,937               | 2,264                    | 277               |
| Real estate construction                     | -                   | -                        | -                 | -                   | -                        | -                 |
| Consumer                                     | -                   | -                        | -                 | -                   | -                        | -                 |
|                                              | \$2,758             | \$ 3,288                 | \$ 464            | \$3,229             | \$ 3,702                 | \$ 605            |

The table below shows the average recorded investment in impaired loans for the periods presented.

| Three Months Ended |               | Six Months Ended |               |
|--------------------|---------------|------------------|---------------|
| June 30, 2013      | June 30, 2012 | June 30, 2013    | June 30, 2012 |

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|                                             | Average<br>Recorded<br>Investment | Average Recorded<br>Investment | Average<br>Recorded<br>Investment | Average Recorded<br>Investment |
|---------------------------------------------|-----------------------------------|--------------------------------|-----------------------------------|--------------------------------|
| Commercial real estate - owner occupied     | \$367                             | \$ 1,691                       | \$ 368                            | \$ 1,677                       |
| Commercial real estate - non-owner occupied | -                                 | 315                            | -                                 | 315                            |
| Residential real estate                     | 560                               | 2,068                          | 563                               | 2,062                          |
| Commercial                                  | 1,861                             | 1,205                          | 1,889                             | 1,303                          |
| Real estate construction                    | -                                 | -                              | -                                 | -                              |
| Consumer                                    | -                                 | -                              | -                                 | -                              |
| Total                                       | \$2,788                           | \$ 5,279                       | \$ 2,820                          | \$ 5,357                       |

**NOTE 5 – SEGMENT REPORTING**

The Corporation has two reportable segments: traditional commercial banking and mortgage banking. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage loans held for sale, gains on sales of loans in the secondary mortgage market, and loan origination fee income.

**NOTE 5 – SEGMENT REPORTING (continued)**

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on the prime rate. These transactions are eliminated in the consolidation process.

The “Other” column in the following table includes the operations of the Corporation, Access Real Estate, and ACM. The primary source of income for the Corporation is derived from dividends from the Bank and its primary expense relates to interest on subordinated debentures. The primary source of income for Access Real Estate is derived from rents received from the Bank. ACM’s primary source of income is derived from fees related to its wealth management services.

The following table presents segment information for the three months ended June 30, 2013 and 2012:

| June 30, 2013                     | Commercial<br>Banking | Mortgage<br>Banking | Other   | Eliminations | Consolidated<br>Totals |
|-----------------------------------|-----------------------|---------------------|---------|--------------|------------------------|
|                                   | (In Thousands)        |                     |         |              |                        |
| Revenues:                         |                       |                     |         |              |                        |
| Interest income                   | \$8,915               | \$430               | \$4     | \$ (263      | ) \$ 9,086             |
| Gain on sale of loans             | -                     | 7,356               | -       | (236         | ) 7,120                |
| Other revenues                    | 751                   | (269                | ) 603   | (182         | ) 903                  |
| Total revenues                    | 9,666                 | 7,517               | 607     | (681         | ) 17,109               |
| Expenses:                         |                       |                     |         |              |                        |
| Interest expense                  | 986                   | 159                 | 152     | (263         | ) 1,034                |
| Salaries and employee benefits    | 2,888                 | 3,654               | 257     | -            | 6,799                  |
| Other expenses                    | 1,565                 | 1,817               | 770     | (418         | ) 3,734                |
| Total operating expenses          | 5,439                 | 5,630               | 1,179   | (681         | ) 11,567               |
| Income (loss) before income taxes | \$4,227               | \$ 1,887            | \$(572  | ) \$ -       | \$ 5,542               |
| Total assets                      | \$785,158             | \$ 56,761           | \$9,674 | \$ (9,910    | ) \$ 841,683           |
| June 30, 2012                     | Commercial<br>Banking | Mortgage<br>Banking | Other   | Eliminations | Consolidated<br>Totals |
|                                   | (In Thousands)        |                     |         |              |                        |
| Revenues:                         |                       |                     |         |              |                        |
| Interest income                   | \$8,915               | \$510               | \$3     | \$ (426      | ) \$ 9,002             |
| Gain on sale of loans             | -                     | 14,202              | -       | 536          | 14,738                 |

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|                |       |          |     |        |          |
|----------------|-------|----------|-----|--------|----------|
| Other revenues | 699   | (1,311 ) | 604 | (998 ) | (1,006 ) |
| Total revenues | 9,614 | 13,401   | 607 | (888 ) | 22,734   |

Expenses:

|                                |       |       |       |        |        |
|--------------------------------|-------|-------|-------|--------|--------|
| Interest expense               | 1,231 | 308   | 158   | (427 ) | 1,270  |
| Salaries and employee benefits | 2,810 | 4,342 | 322   | -      | 7,474  |
| Other expenses                 | 2,071 | 5,036 | 763   | (461 ) | 7,409  |
| Total operating expenses       | 6,112 | 9,686 | 1,243 | (888 ) | 16,153 |

|                                   |         |         |          |      |          |
|-----------------------------------|---------|---------|----------|------|----------|
| Income (loss) before income taxes | \$3,502 | \$3,715 | \$(636 ) | \$ - | \$ 6,581 |
|-----------------------------------|---------|---------|----------|------|----------|

|              |           |           |          |              |            |
|--------------|-----------|-----------|----------|--------------|------------|
| Total assets | \$749,588 | \$108,078 | \$10,409 | \$ (26,366 ) | \$ 841,709 |
|--------------|-----------|-----------|----------|--------------|------------|

- 20 -

**NOTE 5 – SEGMENT REPORTING (continued)**

The following table presents segment information for the six months ended June 30, 2013 and 2012:

| June 30, 2013                     | Commercial<br>Banking | Mortgage<br>Banking | Other      | Eliminations | Consolidated<br>Totals |
|-----------------------------------|-----------------------|---------------------|------------|--------------|------------------------|
|                                   | (In Thousands)        |                     |            |              |                        |
| Revenues:                         |                       |                     |            |              |                        |
| Interest income                   | \$ 17,898             | \$ 1,044            | \$ 7       | \$ (707)     | ) \$ 18,242            |
| Gain on sale of loans             | -                     | 15,237              | -          | (236)        | ) 15,001               |
| Other revenues                    | 1,385                 | 1,922               | 1,146      | (587)        | ) 3,866                |
| Total revenues                    | 19,283                | 18,203              | 1,153      | (1,530)      | ) 37,109               |
| Expenses:                         |                       |                     |            |              |                        |
| Interest expense                  | 2,003                 | 502                 | 303        | (707)        | ) 2,101                |
| Salaries and employee benefits    | 5,778                 | 8,598               | 492        | -            | ) 14,868               |
| Other expenses                    | 3,477                 | 4,408               | 1,483      | (823)        | ) 8,545                |
| Total operating expenses          | 11,258                | 13,508              | 2,278      | (1,530)      | ) 25,514               |
| Income (loss) before income taxes | \$ 8,025              | \$ 4,695            | \$ (1,125) | \$ -         | ) \$ 11,595            |
| Total assets                      | \$ 785,158            | \$ 56,761           | \$ 9,674   | \$ (9,910)   | ) \$ 841,683           |

| June 30, 2012                     | Commercial<br>Banking | Mortgage<br>Banking | Other      | Eliminations | Consolidated<br>Totals |
|-----------------------------------|-----------------------|---------------------|------------|--------------|------------------------|
|                                   | (In Thousands)        |                     |            |              |                        |
| Revenues:                         |                       |                     |            |              |                        |
| Interest income                   | \$ 18,004             | \$ 1,360            | \$ 5       | \$ (1,016)   | ) \$ 18,353            |
| Gain on sale of loans             | -                     | 26,561              | -          | (879)        | ) 25,682               |
| Other revenues                    | 1,318                 | (2,250)             | 1,129      | (46)         | ) 151                  |
| Total revenues                    | 19,322                | 25,671              | 1,134      | (1,941)      | ) 44,186               |
| Expenses:                         |                       |                     |            |              |                        |
| Interest expense                  | 2,659                 | 793                 | 318        | (1,017)      | ) 2,753                |
| Salaries and employee benefits    | 5,645                 | 9,546               | 618        | -            | ) 15,809               |
| Other expenses                    | 4,276                 | 8,785               | 1,419      | (924)        | ) 13,556               |
| Total operating expenses          | 12,580                | 19,124              | 2,355      | (1,941)      | ) 32,118               |
| Income (loss) before income taxes | \$ 6,742              | \$ 6,547            | \$ (1,221) | \$ -         | ) \$ 12,068            |
| Total assets                      | \$ 749,588            | \$ 108,078          | \$ 10,409  | \$ (26,366)  | ) \$ 841,709           |

- 21 -

**NOTE 6 – EARNINGS PER SHARE**

The following table shows the calculation of both basic and diluted earnings per share (“EPS”) for the three and six months ended June 30, 2013 and 2012, respectively. The numerator of both the basic and diluted EPS is equivalent to net income. The weighted average number of shares outstanding used as the denominator for diluted EPS is increased over the denominator used for basic EPS by the effect of potentially dilutive common stock options utilizing the treasury stock method.

|                                             | Three<br>Months<br>Ended<br>June 30,<br>2013<br>(In Thousands, Except for<br>Share and Per Share Data) | Three<br>Months<br>Ended<br>June 30,<br>2012<br>(In Thousands, Except for<br>Share and Per Share Data) |
|---------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| <b>BASIC EARNINGS PER SHARE:</b>            |                                                                                                        |                                                                                                        |
| Net income                                  | \$3,524                                                                                                | \$3,890                                                                                                |
| Weighted average shares outstanding         | 10,306,561                                                                                             | 10,237,515                                                                                             |
| Basic earnings per share                    | \$0.34                                                                                                 | \$0.38                                                                                                 |
| <b>DILUTED EARNINGS PER SHARE:</b>          |                                                                                                        |                                                                                                        |
| Net income                                  | \$3,524                                                                                                | \$3,890                                                                                                |
| Weighted average shares outstanding         | 10,306,561                                                                                             | 10,237,515                                                                                             |
| Dilutive stock options                      | 73,309                                                                                                 | 112,699                                                                                                |
| Weighted average diluted shares outstanding | 10,379,870                                                                                             | 10,350,214                                                                                             |
| Diluted earnings per share                  | \$0.34                                                                                                 | \$0.38                                                                                                 |
| <br>                                        |                                                                                                        |                                                                                                        |
|                                             | Six Months<br>Ended<br>June 30,<br>2013<br>(In Thousands, Except for<br>Share and Per Share Data)      | Six Months<br>Ended<br>June 30,<br>2012<br>(In Thousands, Except for<br>Share and Per Share Data)      |
| <b>BASIC EARNINGS PER SHARE:</b>            |                                                                                                        |                                                                                                        |
| Net income                                  | \$7,208                                                                                                | \$7,327                                                                                                |
| Weighted average shares outstanding         | 10,314,592                                                                                             | 10,219,085                                                                                             |
| Basic earnings per share                    | \$0.70                                                                                                 | \$0.72                                                                                                 |

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DILUTED EARNINGS PER SHARE:

|                                             |            |            |
|---------------------------------------------|------------|------------|
| Net income                                  | \$7,208    | \$7,327    |
| Weighted average shares outstanding         | 10,314,592 | 10,219,085 |
| Dilutive stock options                      | 94,143     | 112,444    |
| Weighted average diluted shares outstanding | 10,408,735 | 10,331,529 |
| Diluted earnings per share                  | \$0.69     | \$0.71     |

- 22 -

## **NOTE 7 - DERIVATIVES**

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

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

Since the Bank’s derivative instruments are not designated as hedging instruments, the fair value of the derivatives are recorded as a freestanding asset or liability with the change in value being recognized in current earnings during the period of change. The Bank has not elected to apply hedge accounting to its derivative instruments as provided in Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging.

At June 30, 2013 and December 31, 2012, the Bank had derivative financial instruments with a notional value of \$80.2 million and \$217.4 million, respectively. The fair value of these derivative instruments at June 30, 2013 and December 31, 2012 was \$795 thousand and \$465 thousand, respectively, and was included in other assets and other liabilities.

Included in other noninterest income for the six months ended June 30, 2013 and June 30, 2012 was a net loss of \$1.8 million and a net loss of \$2.3 million, respectively, relating to derivative instruments.

**NOTE 8 – RECENT ACCOUNTING PRONOUNCEMENTS**

In April 2011, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2011-03, “Reconsideration of Effective Control for Repurchase Agreements.” ASU No. 2011-03 modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than as a sale. Currently, an entity that maintains effective control over transferred financial assets must account for the transfer as a secured borrowing rather than as a sale. The provisions of ASU No. 2011-03 removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The FASB believes that contractual rights and obligations determine effective control and that there does not need to be a requirement to assess the ability to exercise those rights. ASU No. 2011-03 does not change the other existing criteria used in the assessment of effective control. The provisions of ASU No. 2011-03 were effective prospectively for transactions, or modifications of existing transactions, that occur on or after January 1, 2012. The adoption of this ASU did not have a material impact on the Corporation’s financial statements.

**NOTE 8 – RECENT ACCOUNTING PRONOUNCEMENTS (continued)**

In April 2011, the FASB issued ASU No. 2011-03, “Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements”. The guidance simplifies the accounting for financial assets transferred under repurchase agreements and similar arrangements and increases the number of transfers to be accounted for as secured borrowings as opposed to sales. The amended guidance is effective prospectively for new transfers and existing transactions modified as of the first interim or annual period beginning on or after December 15, 2011. Repurchase agreements are offered through a commercial banking sweep product as a short-term investment opportunity for customers. All such arrangements are considered typical of the banking industry and are accounted for as borrowings. The Corporation adopted this guidance beginning with first quarter 2012 financial reporting; there was no material impact upon adoption.

In May 2011, the FASB issued ASU No. 2011-04, “Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs”. The Corporation did adopt ASU 2011-04, which generally aligns the principles of fair value measurements with International Financial Reporting Standards (IFRSs), in its consolidated financial statements in the first quarter 2012. The provisions of ASU 2011-04 clarify the application of existing fair value measurement requirements, and expand the disclosure requirements for fair value measurements. While the provisions of ASU 2011-04 did increase the Corporation’s fair value disclosures the adoption of ASU 2011-04 did not have a material effect on the Corporation’s financial condition and results of operations.

In June 2011, the FASB issued ASU No. 2011-5, “Presentation of Comprehensive Income” (Topic 220): This update amended existing guidance relating to presentation of other comprehensive income in a convergence effort with international accounting standards. This guidance eliminates the option to present the components of comprehensive income as a part of the statement of changes in stockholders’ equity and requires a consecutive presentation of net income and other comprehensive income, and a reconciliation of the components of other comprehensive income. Similar to the requirements of existing guidance, entities are required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and other comprehensive income are presented. Although portions of this update related to the reclassification of adjustments out of other comprehensive income were deferred in December 2011, the amendments in this guidance should be applied retrospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted and the amendments do not require any transition disclosures. The adoption of this guidance did not have a material effect on the Corporation’s consolidated financial statements or results of operations.

In December 2011, the FASB issued ASU No. 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities”. This guidance eliminates offsetting of financial instruments disclosure differences between GAAP and IFRS. New disclosures will be required for recognized financial instruments, such as derivatives, repurchase agreements, and reverse repurchase agreements, that are either (1) offset on the balance sheet in accordance with the FASB’s offsetting guidance or (2) subject to an enforceable master netting arrangement or similar

agreement, regardless of whether they are offset in accordance with the FASB's offsetting guidance. The objective of the new disclosure requirements is to enable users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. This amended guidance will be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The adoption of this guidance, which involves disclosure only, did not impact the Corporation's consolidated financial position, results of operations, or cash flows.

In July 2012, the FASB issued ASU 2012-02, "Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" which is related to the impairment of indefinite-lived intangible assets. The guidance simplifies how entities test indefinite-lived intangible assets, other than goodwill, and is similar to the new qualitative impairment test for goodwill. The guidance allows entities to elect to first perform qualitative tests to determine the likelihood that the indefinite-lived intangible asset's fair value is less than its carrying value. If it is determined that it is more likely than not that the fair value of the indefinite-lived intangible asset is less than its carrying amount, the entity would then perform the first step of the goodwill impairment test. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of this guidance has not had a material impact to the consolidated financial statements.

**NOTE 8 – RECENT ACCOUNTING PRONOUNCEMENTS (continued)**

In February 2013, the FASB issued ASU 2013-02, “Comprehensive Income: Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income”. ASU 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in financial statements. The provisions of ASU 2013-02 are effective for periods beginning after December 15, 2012, with prospective application to transactions or modifications of existing transactions that occur on or after the effective date. The adoption of this guidance had no impact to the consolidated financial statements as the Corporation did not have any reclassifications out of accumulated other comprehensive income during the first quarter 2013.

**NOTE 9 - FAIR VALUE**

Fair value pursuant to FASB ASC 820-10, Fair Value Measurements and Disclosures, is the exchange price, in an orderly transaction that is not a forced liquidation or distressed sale, between market participants to sell an asset or transfer a liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or liability. FASB ASC 820-10 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity specific inputs. In addition, FASB ASC 820-10 provides a framework for measuring fair value and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 - Significant other 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.

Level 3 - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods to determine the fair value of each type of financial instrument:

Securities: Fair values for securities available-for-sale are obtained from an independent pricing service. The prices are not adjusted. The independent pricing service uses industry-standard models to price U.S. Government agency obligations and mortgage backed securities that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace (Level 2).

Residential 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).

**NOTE 9 - FAIR VALUE (continued)**

Derivative financial instruments: Derivative instruments are used to hedge residential mortgage loans held for sale and the related interest-rate lock commitments and include forward commitments to sell mortgage loans and mortgage-backed securities as further described in Note 7. The fair values of derivative financial instruments are based on derivative market data inputs as of the valuation date and the underlying value of mortgage loans for interest rate lock commitments (Level 3).

Impaired loans: The fair values of impaired loans are measured on a nonrecurring basis as the fair value of the loan's collateral for collateral-dependent loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The use of discounted cash flow models and management's best judgment are significant inputs in arriving at the fair value measure of the underlying collateral (Level 3).

Other real estate owned: The fair value of other real estate owned, which consists of real estate that has been foreclosed, is recorded at the lower of fair value less selling expenses or the book balance prior to foreclosure. Write downs are provided for subsequent declines in value and are recorded in other operating expenses (Level 2).

Assets and liabilities measured at fair value under FASB ASC 820-10 on a recurring and non-recurring basis, including financial assets and liabilities for which the Corporation has elected the fair value option as of June 30, 2013 and December 31, 2012, are summarized below:

| Description                                    | Fair Value Measurement<br>at June 30, 2013 Using |                                                                         |                                         |                                                 |
|------------------------------------------------|--------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------|-------------------------------------------------|
|                                                | Carrying<br>Value                                | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets (Level 1) | Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |
| Financial Assets-Recurring                     | (In Thousands)                                   |                                                                         |                                         |                                                 |
| Available-for-sale investment securities       |                                                  |                                                                         |                                         |                                                 |
| US Government agency                           | \$30,151                                         | \$ -                                                                    | \$ 30,151                               | \$ -                                            |
| Mortgage backed                                | 27,988                                           | -                                                                       | 27,988                                  | -                                               |
| Corporate bonds                                | 5,984                                            | -                                                                       | 5,984                                   | -                                               |
| Other AFS                                      | 3,873                                            | -                                                                       | 3,873                                   | -                                               |
| CRA Mutual fund                                | 1,431                                            | -                                                                       | 1,431                                   | -                                               |
| Total available-for-sale investment securities | 69,427                                           | -                                                                       | 69,427                                  | -                                               |
| Residential loans held for sale                | 48,887                                           | -                                                                       | 48,887                                  | -                                               |
| Derivative assets                              | 1,273                                            | -                                                                       | -                                       | 1,273                                           |

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|                                       |           |    |   |            |          |
|---------------------------------------|-----------|----|---|------------|----------|
| Total Financial Assets-Recurring      | \$119,587 | \$ | - | \$ 118,314 | \$ 1,273 |
| Financial Liabilities-Recurring       |           |    |   |            |          |
| Derivative liabilities                | \$478     | \$ | - | \$ -       | \$ 478   |
| Total Financial Liabilities-Recurring | \$478     | \$ | - | \$ -       | \$ 478   |
| Financial Assets-Non-Recurring        |           |    |   |            |          |
| Impaired loans <sup>(1)</sup>         | \$2,299   | \$ | - | \$ -       | \$ 2,299 |
| Total Financial Assets-Non-Recurring  | \$2,299   | \$ | - | \$ -       | \$ 2,299 |

(1)Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

- 26 -

**NOTE 9 - FAIR VALUE (continued)**

| Description                                    | Fair Value Measurement<br>at December 31, 2012 Using |                                                                         |                                         |                                                 |
|------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------|-------------------------------------------------|
|                                                | Carrying<br>Value                                    | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets (Level 1) | Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |
| Financial Assets-Recurring                     | (In Thousands)                                       |                                                                         |                                         |                                                 |
| Available-for-sale investment securities       |                                                      |                                                                         |                                         |                                                 |
| US Government agency                           | \$ 15,016                                            | \$ -                                                                    | \$ 15,016                               | \$ -                                            |
| Mortgage backed                                | 15,177                                               | -                                                                       | 15,177                                  | -                                               |
| Corporate bonds                                | 4,079                                                | -                                                                       | 4,079                                   | -                                               |
| CRA Mutual fund                                | 1,487                                                | -                                                                       | 1,487                                   | -                                               |
| Total available-for-sale investment securities | 35,759                                               | -                                                                       | 35,759                                  | -                                               |
| Residential loans held for sale                | 111,542                                              | -                                                                       | 111,542                                 | -                                               |
| Derivative assets                              | 1,091                                                | -                                                                       | -                                       | 1,091                                           |
| Total Financial Assets-Recurring               | \$ 148,392                                           | \$ -                                                                    | \$ 147,301                              | \$ 1,091                                        |
| Financial Liabilities-Recurring                |                                                      |                                                                         |                                         |                                                 |
| Derivative liabilities                         | \$ 626                                               | \$ -                                                                    | \$ -                                    | \$ 626                                          |
| Total Financial Liabilities-Recurring          | \$ 626                                               | \$ -                                                                    | \$ -                                    | \$ 626                                          |
| Financial Assets-Non-Recurring                 |                                                      |                                                                         |                                         |                                                 |
| Impaired loans <sup>(1)</sup>                  | \$ 3,229                                             | \$ -                                                                    | \$ -                                    | \$ 3,229                                        |
| Total Financial Assets-Non-Recurring           | \$ 3,229                                             | \$ -                                                                    | \$ -                                    | \$ 3,229                                        |

(1) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

It is the Corporation's policy to recognize transfers between levels as of the actual date of the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and Level 2 during the six month periods ended June 30, 2013 and 2012.

The changes in Level 3 net derivatives measured at fair value on a recurring basis are summarized as follows:

Three  
Months  
Ended June  
30,

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|                                                                  | 2013       | 2012  |
|------------------------------------------------------------------|------------|-------|
|                                                                  | (In        |       |
|                                                                  | Thousands) |       |
| Balance, beginning of period                                     | \$237      | \$481 |
| Realized and unrealized gains (losses) included in earnings      | 558        | 356   |
| Unrealized gains (losses) included in other comprehensive income | -          | -     |
| Purchases, settlements, paydowns, and maturities                 | -          | -     |
| Transfer into Level 3                                            | -          | -     |
| Balance, end of period                                           | \$795      | \$837 |

- 27 -

**NOTE 9 - FAIR VALUE (Continued)**

|                                                                  | Six Months Ended June 30, |          |
|------------------------------------------------------------------|---------------------------|----------|
|                                                                  | 2013                      | 2012     |
|                                                                  | (In Thousands)            |          |
| Balance, beginning of period                                     | \$ 465                    | \$ (61 ) |
| Realized and unrealized gains (losses) included in earnings      | 330                       | 898      |
| Unrealized gains (losses) included in other comprehensive income | -                         | -        |
| Purchases, settlements, paydowns, and maturities                 | -                         | -        |
| Transfer into Level 3                                            | -                         | -        |
| Balance, end of period                                           | \$ 795                    | \$ 837   |

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value at June 30, 2013:

| Description                              | Fair Value Estimate<br>(In Thousands) | Valuation Techniques        | Unobservable Input       | Range (Weighted Average) |
|------------------------------------------|---------------------------------------|-----------------------------|--------------------------|--------------------------|
| Financial Assets - Recurring             |                                       |                             |                          |                          |
| Derivative assets                        | \$1,273                               | Market pricing (3)          | Estimated pullthrough    | 75% - 90%                |
| Derivative liabilities                   | \$478                                 | Market pricing (3)          | Estimated pullthrough    | 75% - 90%                |
| Financial Assets - Non-recurring         |                                       |                             |                          |                          |
| Impaired loans - Real estate secured     | \$555                                 | Appraisal of collateral (1) | Liquidation expenses (2) | 20% - 30%                |
| Impaired loans - Non-real estate secured | \$1,744                               | Cash flow basis             | Liquidation expenses (2) | 10% - 20%                |

(1) Fair value is generally determined through independent appraisals of the underlying collateral on real estate secured loans, which generally include various level 3 inputs which are not identifiable.

Valuations of impaired loans may be adjusted by management for qualitative factors such as liquidation expenses. The range and weighted average of liquidation expense adjustments are presented as a percent of the appraisal.

Market pricing on derivative assets and liabilities is adjusted by management for the anticipated percent of derivative assets and liabilities that will create a realized gain or loss. The range and weighted average of estimated pull-through is presented as a percent of the volume.

Financial instruments recorded using FASB ASC 825-10

Under FASB ASC 825-10, Financial Instruments, the Corporation may elect to report most financial instruments and certain other items at fair value on an instrument-by-instrument basis with changes in fair value reported in net income. After the initial adoption the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election, with respect to an item, may not be revoked once an election is made.

- 28 -

**NOTE 9 - FAIR VALUE (Continued)**

The following table reflects the differences between the fair value carrying amount of residential mortgage loans held for sale at June 30, 2013, measured at fair value under FASB ASC 825-10, and the aggregate unpaid principal amount the Corporation is contractually entitled to receive at maturity.

| (In Thousands)                           | Aggregate<br>Fair Value | Difference | Contractual<br>Principal |
|------------------------------------------|-------------------------|------------|--------------------------|
| Residential mortgage loans held for sale | \$ 48,887               | \$ 85      | \$ 48,802                |

The Corporation has elected to account for residential loans held for sale at fair value to eliminate the mismatch that would occur by recording changes in market value on derivative instruments used to hedge loans held for sale while carrying the loans at the lower of cost or market.

The following methods and assumptions not previously presented were used in estimating the fair value of financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis:

**Cash and Short-Term Investments**

For those short-term instruments, the carrying amount is a reasonable estimate of fair value. As such they are classified as Level 1 for noninterest-bearing deposits and Level 2 for interest-bearing deposits due from banks or federal funds sold.

**Restricted Stock**

It is not practical to determine the fair value of restricted stock due to the restrictions placed on its transferability.

**Loans, Net of Allowance**

For certain homogeneous categories of loans, such as some residential mortgages, and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics resulting in a Level 3 classification. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities resulting in a Level 3 classification.

### **Accrued Interest**

The carrying amounts of accrued interest approximate fair value resulting in a Level 2 or Level 3 classification depending upon the level of the asset or liability, with which, the accrual is associated.

### **Deposits and Borrowings**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date resulting in a Level 1 classification. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities also resulting in a Level 1 classification. The fair value of all other deposits and borrowings is determined using the discounted cash flow method thereby resulting in a Level 2 classification. The discount rate was equal to the rate currently offered on similar products.

### **Subordinated debentures**

Due to the pooled nature of these instruments, which are not actively traded, estimated fair value is based on broker prices from recent similar sales resulting in a Level 2 classification.

**NOTE 9 - FAIR VALUE (Continued)****Off-Balance-Sheet Financial Instruments**

The fair value of commitments to extend credit is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed interest rates. The fair value of stand-by letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

At June 30, 2013 and December 31, 2012, the majority of off-balance-sheet items are variable rate instruments or convert to variable rate instruments if drawn upon. Therefore, the fair value of these items is largely based on fees, which are nominal and immaterial.

The carrying amounts and estimated fair values of financial instruments at June 30, 2013 and December 31, 2012 were as follows:

|                                 | June 30, 2013   |                      | December 31, 2012 |                      |
|---------------------------------|-----------------|----------------------|-------------------|----------------------|
|                                 | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| Financial assets:               | (In Thousands)  |                      |                   |                      |
| Cash and short-term investments | \$46,622        | \$46,622             | \$37,941          | \$37,941             |
| Securities available-for-sale   | 69,427          | 69,427               | 35,759            | 35,759               |
| Securities held-to-maturity     | 15,861          | 15,530               | 45,308            | 45,308               |
| Restricted stock                | 4,284           | 4,284                | 4,237             | 4,237                |
| Loans, net of allowance         | 677,344         | 675,586              | 716,020           | 742,255              |
| Derivatives                     | 1,273           | 1,273                | 1,091             | 1,091                |
| Total financial assets          | \$814,811       | \$812,722            | \$840,356         | \$866,591            |
| Financial liabilities:          |                 |                      |                   |                      |
| Deposits                        | \$659,858       | \$612,652            | \$671,496         | \$650,619            |
| Short-term borrowings           | 70,161          | 70,137               | 83,091            | 83,515               |
| Subordinated debentures         | 6,186           | 6,240                | 6,186             | 6,187                |
| Derivatives                     | 478             | 478                  | 626               | 626                  |
| Total financial liabilities     | \$736,683       | \$689,507            | \$761,399         | \$740,947            |



**NOTE 10 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK**

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, deemed necessary by the Corporation upon extension of credit is based on management's credit evaluation of the counterparty. Collateral normally consists of real property, liquid assets or business assets. The Corporation had \$30.2 million and \$9.7 million in outstanding commitments at June 30, 2013 and December 31, 2012, respectively.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The Corporation had \$173.9 million and \$174.8 million in unfunded lines of credit whose contract amounts represent credit risk at June 30, 2013 and December 31, 2012, respectively.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary. The Corporation had standby letters of credit outstanding in the amount of \$4.4 million and \$6.4 million at June 30, 2013 and December 31, 2012, respectively.

The Bank maintains a reserve for potential off-balance sheet credit losses that is included in other liabilities on the balance sheet. At June 30, 2013 and December 31, 2012 the balance in this account totaled \$548 thousand and \$483 thousand, respectively.

The mortgage division of the Bank makes representations and warranties that loans sold to investors meet its program's guidelines and that the information provided by the borrowers is accurate and complete. In the event of a default on a loan sold, the investor may make a claim for losses due to document deficiencies, program compliance, early payment default, and fraud or borrower misrepresentations. The mortgage division maintains a reserve in other liabilities for potential losses on mortgage loans sold. At June 30, 2013, December 31, 2012, and June 30, 2012, the balance in this reserve totaled \$4.6 million, \$4.4 million, and \$4.2 million, respectively.

**NOTE 10 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK**

The following table shows the changes to the Allowance for Losses on Mortgage Loans Sold.

|                                                                   | Six Months ended June 30,<br>2013 | 2012     | Year ended<br><b>December 31, 2012</b> |
|-------------------------------------------------------------------|-----------------------------------|----------|----------------------------------------|
|                                                                   | (In Thousands)                    |          |                                        |
| Allowance for losses on mortgage loans sold - beginning of period | \$ 4,376                          | \$ 2,616 | \$ 2,616                               |
| Provision charged to operating expense                            | 388                               | 1,600    | 2,510                                  |
| Recoveries                                                        | -                                 | -        | -                                      |
| Charge-offs                                                       | (119 )                            | -        | (750 )                                 |
| Allowance for losses on mortgage loans sold - end of period       | \$ 4,645                          | \$ 4,216 | \$ 4,376                               |

**NOTE 11 – CLOSING OF MORTGAGE PRODUCTION BRANCH**

In April 2013 management made the decision to close its Mortgage Production Branch (Branch) located in Denver, Colorado. The Branch ceased taking loan applications during April 2013 with all obligations and activities terminated as of April 30, 2013. The closure was expected to and has reduced mortgage banking revenue beginning with the second quarter of 2013. Management did not incur any operating losses associated with the closure process.

**NOTE 11 – CLOSING OF MORTGAGE PRODUCTION BRANCH (Continued)**

In order to evaluate the impact of this change on the overall Corporation's financial performance, condensed consolidated pro forma financial statements are presented below. The pro forma information is presenting results as if the Branch, which closed in the second quarter of 2013, had not been in existence during the three month periods ending June 30, 2013 and 2012. The adjustment for Branch closure does not reflect indirect overhead reductions management plans to make on a go-forward basis.

Access National Corporation  
Condensed Consolidated Statement of Income  
Three Months Ended June 30, 2013  
(In Thousands, Except for Share Data)

|                                                     | As Reported | Adjustment for<br>Mortgage<br>Production Branch<br>Closure | Pro Forma Totals |
|-----------------------------------------------------|-------------|------------------------------------------------------------|------------------|
| Interest and dividend income                        | \$9,086     | \$ (55 )                                                   | \$ 9,031         |
| Interest expense                                    | 1,034       | -                                                          | 1,034            |
| Net interest income                                 | 8,052       | (55 )                                                      | 7,997            |
| Provision for loan losses                           | -           | -                                                          | -                |
| Net interest income after provision for loan losses | 8,052       | (55 )                                                      | 7,997            |
| Noninterest income                                  | 8,023       | (1,075 )                                                   | 6,948            |
| Noninterest expense                                 | 10,533      | (636 )                                                     | 9,897            |
| Income before income taxes                          | 5,542       | (494 )                                                     | 5,048            |
| Provision for income taxes                          | 2,018       | (193 )                                                     | 1,825            |
| Net income                                          | \$3,524     | \$ (302 )                                                  | \$ 3,222         |
| Earnings per common share:                          |             |                                                            |                  |
| Basic                                               | \$0.34      | \$ (0.03 )                                                 | \$ 0.31          |
| Diluted                                             | \$0.34      | \$ (0.03 )                                                 | \$ 0.31          |
| Average outstanding shares:                         |             |                                                            |                  |
| Basic                                               | 10,306,561  | -                                                          | 10,306,561       |
| Diluted                                             | 10,379,870  | -                                                          | 10,379,870       |

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|                                                     |           |    |         |    |            |   |
|-----------------------------------------------------|-----------|----|---------|----|------------|---|
| Average total assets (in thousands)                 | \$850,200 | \$ | (302    | )  | \$ 849,898 |   |
| Average shareholders' equity (in thousands)         | \$94,735  | \$ | (100    | )  | \$ 94,635  |   |
| Return on average assets (annualized)               | 1.66      | %  | (0.14   | )% | 1.52       | % |
| Return on average shareholders' equity (annualized) | 14.88     | %  | (1.26   | )% | 13.62      | % |
| Total loan volume (in thousands)                    | \$171,427 | \$ | (35,407 | )  | \$ 136,020 |   |
| Purchase loan units as a percentage of business     | 44.82     | %  | 7.55    | %  | 52.37      | % |

- 33 -

**NOTE 11 – CLOSING OF MORTGAGE PRODUCTION BRANCH (Continued)**

Access National Corporation  
Condensed Consolidated Statement of Income  
Three Months Ended June 30, 2012  
(In Thousands, Except for Share Data)

|                                                     | As Reported | Adjustment for<br>Mortgage<br>Production Branch<br>Closure |    | Pro Forma Totals |   |
|-----------------------------------------------------|-------------|------------------------------------------------------------|----|------------------|---|
| Interest and dividend income                        | \$9,002     | \$ (197                                                    | )  | \$ 9,199         |   |
| Interest expense                                    | 1,270       | -                                                          |    | 1,270            |   |
| Net interest income                                 | 7,732       | (197                                                       | )  | 7,929            |   |
| Provision for loan losses                           | 472         | -                                                          |    | 472              |   |
| Net interest income after provision for loan losses | 7,260       | -                                                          |    | 7,457            |   |
| Noninterest income                                  | 13,732      | (5,519                                                     | )  | 8,213            |   |
| Noninterest expense                                 | 14,411      | (3,601                                                     | )  | 10,810           |   |
| Income before income taxes                          | 6,581       | (1,918                                                     | )  | 4,860            |   |
| Provision for income taxes                          | 2,691       | (748                                                       | )  | 1,943            |   |
| Net income                                          | \$3,890     | \$ (1,170                                                  | )  | \$ 2,917         |   |
| Earnings per common share:                          |             |                                                            |    |                  |   |
| Basic                                               | \$0.38      | \$ (0.11                                                   | )  | \$ 0.27          |   |
| Diluted                                             | \$0.38      | \$ (0.11                                                   | )  | \$ 0.27          |   |
| Average outstanding shares:                         |             |                                                            |    |                  |   |
| Basic                                               | 10,237,515  | -                                                          |    | 10,237,515       |   |
| Diluted                                             | 10,349,704  | -                                                          |    | 10,349,704       |   |
| Average total assets (in thousands)                 | \$798,272   | \$ (1,085                                                  | )  | \$ 797,187       |   |
| Average shareholders' equity (in thousands)         | \$88,648    | \$ (398                                                    | )  | \$ 88,250        |   |
| Return on average assets (annualized)               | 1.95        | % (0.49                                                    | )% | 1.46             | % |
| Return on average shareholders' equity (annualized) | 17.55       | % (4.33                                                    | )% | 13.22            | % |
| Total loan volume (in thousands)                    | \$266,850   | \$ (102,715                                                | )  | \$ 164,135       |   |
| Purchase loan units as a percentage of business     | 28.77       | % \$ 22.87                                                 | %  | 51.64            | % |

**NOTE 12 – SUBSEQUENT EVENT**

On July 8, 2013, the Corporation redeemed its Floating Rate Capital Securities (Preferred) and its Floating Rate Common Securities (Common) with shareholders in the amount of \$6.1 million and \$187.6 thousand, respectively. Included in the redemption values were interest payments in the amounts of \$52,736 and \$1,635 for the Preferred and Common shareholders, respectively.

- 34 -

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with Access National Corporation's ("Corporation", "we", "us") consolidated financial statements, and notes thereto, included in the Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Operating results for the three months ended June 30, 2013 are not necessarily indicative of the results for the year ending December 31, 2013 or any future period.

### **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements. For this purpose, any statements contained herein, including documents incorporated by reference, that are not statements of historical fact may be deemed to be forward-looking statements. Examples of forward-looking statements include discussions as to our expectations, beliefs, plans, goals, objectives and future financial or other performance or assumptions concerning matters discussed in this document. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" or other similar meaning. Forward-looking statements in this Quarterly Report on Form 10-Q include, without limitation, statements regarding the Corporation's beliefs regarding the future strength of the economy and labor markets and anticipated interest rates and the effect of such rates on the Corporation's performance and net interest margin and the volume of future mortgage refinancing, as well as the Corporation's expectations concerning operating losses and the profitability of its mortgage segment after the closure of the Mortgage Production Branch.. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in: collateral values, especially in the real estate market; continued challenging economic conditions or deterioration in general business and economic conditions and in the financial markets; the impact of any laws, regulations, policies or programs implemented pursuant to the Dodd-Frank Act, the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009; branch expansion plans; interest rates; monetary and fiscal policies of the U.S. Government, including policies of the Office of the Comptroller of the Currency ("Comptroller"), the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Richmond; the economy of Northern Virginia, including governmental spending and commercial and residential real estate markets; the quality or composition of the loan or investment portfolios; demand for loan products; deposit flows; competition; the liquidity of the Corporation; the impact that the closure of the Mortgage Production Branch has on the Corporation's operating losses and profitability; and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made.

For additional discussion of risk factors that may cause our actual future results to differ materially from the results indicated within forward looking statements, please see “Item 1A – Risk Factors” of the Corporation’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

### **CRITICAL ACCOUNTING POLICIES**

The Corporation’s consolidated financial statements have been prepared in accordance with GAAP. In preparing the Corporation’s financial statements management makes estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. Management believes that the most significant subjective judgments that it makes include the following:

- 35 -

### **Allowance for Loan Losses**

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) FASB ASC 450-10, which requires that losses be accrued when they are probable of occurring and can be estimated, and (ii) FASB ASC 310-10, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance. An allowance for loan losses is established through a provision for loan losses based upon industry standards, known risk characteristics, management's evaluation of the risk inherent in the loan portfolio, and changes in the nature and volume of loan activity. Such evaluation considers, among other factors, the estimated market value of the underlying collateral and current economic conditions. For further information about our practices with respect to allowance for loan losses, please see Note 4 to the consolidated financial statements.

### **Other Than Temporary Impairment of Securities**

Securities in the Corporation's securities portfolio are classified as either available-for-sale or held-to-maturity. At June 30, 2013, there were no non-agency mortgage backed securities or trust preferred securities in the portfolio. The estimated fair value of the portfolio fluctuates due to changes in market interest rates and other factors. Changes in estimated fair value are recorded in shareholders' equity as a component of other comprehensive income. Securities are monitored to determine whether a decline in their value is other than temporary. Management evaluates the securities portfolio on a quarterly basis to determine the collectability of amounts due per the contractual terms of each security. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to net income is recognized. At June 30, 2013, there were no securities with other than temporary impairment.

### **Income Taxes**

The Corporation uses the liability method of accounting for income taxes. This method results in the recognition of deferred tax assets and liabilities that are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable results in the income tax expense for the current year. The Corporation's evaluation of the deductibility or taxability of items included in the Corporation's tax returns has not resulted in the identification of any material, uncertain tax positions.

**Fair Value**

Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments. For additional information about our financial assets carried at fair value, please see Note 9 to the consolidated financial statements.

- 36 -

**FINANCIAL CONDITION****Executive Summary**

At June 30, 2013, the Corporation's assets totaled \$841.7 million, compared to \$863.9 million at December 31, 2012, a decrease of \$22.2 million. Lower activity in the mortgage segment fueled by an increase in interest rates as well as the closing of our Denver Mortgage Production Branch caused loans held for sale to decrease \$62.7 million. This decrease in loans held for sale was positively offset by an increase in interest-bearing balances of \$12.9 million as well as growth in the commercial banking segment of \$24.5. The increase in loans held for investment at June 30, 2013 in comparison with December 31, 2012 is primarily attributable to a \$7.2 million or 4.8% growth in commercial loans, a \$12.7 million or 8.8% increase in residential real estate loans, and a \$5.4 million or 17.8% increase in real estate construction loans. At June 30, 2013, loans secured by real estate collateral comprised 75.0% of our total loan portfolio, with loans secured by commercial real estate contributing 45.0% of our total loan portfolio, loans secured by residential real estate contributing 24.5% and real estate construction loans contributing 5.5%. Loans held for sale totaled \$48.9 million at June 30, 2013, compared to \$111.5 million at December 31, 2012. Loans held for sale fluctuates with the volume of loans originated during any given month and the length of time the loans are held prior to selling them in the secondary market. Deposits totaled \$659.9 million at June 30, 2013, compared to \$671.5 million at December 31, 2012, down \$11.6 million. Management has utilized CDARS reciprocal balances and brokered deposits as a cost effective way to fund certain asset portfolio classes, namely the loans held for sale and the investment portfolio. With the overall reduction in mortgage banking activity during the first half of 2013, management's utilization of CDARS reciprocal balances and brokered deposits was reduced as noted by a \$59.3 million decrease in those balances. Noninterest-bearing deposits increased \$56.3 million from \$164.2 million at December 31, 2012 to \$220.5 million at June 30, 2013, and when coupled with the decrease in time deposits of \$11.0 million from December 31, 2012 to June 30, 2013 as well as the CDARS balance reduction, accounts for the overall decrease in deposits.

Net income for the second quarter of 2013 totaled \$3.5 million compared to \$3.9 million for the same period in 2012. Earnings per diluted share were \$0.34 for the second quarter of 2013, compared to \$0.38 per diluted share in the same period of 2012. Net income continued to remain stable even with a \$95.4 million decrease in loan origination volume for the three month period ended June 30, 2013 in comparison with the same period in 2012. This decreased volume as well as the rise in current interest rates led to the \$7.6 million decrease in gain on sale of loans when comparing the three month period ending June 2013 to the same period ending June 2012. The decreased income on loans held for sale was favorably offset by a \$1.5 million reduction in salaries and management fees related to the production of loans when comparing the three month period ended June 2013 to the same period in 2012. Also mitigating the impact of the reduced loan volume was the gain on hedging activity of \$2.8 million in the second quarter of 2013 compared to the \$2.0 million loss for the same period in 2012. The growth in our loans held for investment portfolio as well as favorable changes in our deposit mix attributed to the increase in net interest income for the three month period ended June 30, 2013 of \$320 thousand when compared to the same period in 2012. The reduction in the provision for loan loss as well as the income tax expense of \$472 thousand and \$673 thousand, respectively, further mitigated the impact of the reduced loan volume on net income.

Net income for the six months ended June 30, 2013 totaled \$7.2 million compared to \$7.3 million for the same period in 2012. Earnings per diluted share were \$0.69 for the first six months of 2013, compared to \$0.71 per diluted share in the same period of 2012. Even with a \$135.0 million decrease in loan origination volume for the six month period ended June 30, 2013 in comparison with the same period in 2012, net income remained stable. This decreased volume as well as the rise in current interest rates led to the \$10.7 million decrease in gain on sale of loans when comparing the six month period ending June 2013 to the same period ending June 2012. The decreased income on loans held for sale was favorably offset by a \$2.5 million reduction in salaries and management fees related to the production of loans when comparing the six month period ended June 2013 to the same period in 2012. Also mitigating the impact of the reduced loan volume was the gain on hedging activity of \$3.9 million for the six month period ended June 30, 2013 compared to the \$3.1 million loss for the same period in 2012. The growth in our loans held for investment portfolio as well as favorable changes in our deposit mix attributed to the increase in net interest income for the six month period ended June 30, 2013 of \$541 thousand when compared to the same period in 2012. The reduction in the provision for loan loss as well as the income tax expense of \$965 thousand and \$354 thousand, respectively, further mitigated the impact of the reduced loan volume on net income.

Non-performing assets (“NPA”) totaled \$2.3 million, or 0.27%, of total assets at June 30, 2013, down from \$2.7 million, or 0.32%, of total assets at December 31, 2012. NPA are comprised solely of non-accrual loans at June 30, 2013.

As noted in Note 11 of the consolidated financial statements, management closed its Mortgage Production Branch (Branch) located in Denver, Colorado. The Branch ceased taking loan applications during April 2013 with all obligations and activities terminated as of April 30, 2013. The closure has reduced mortgage banking revenue beginning in the second quarter of 2013 and will continue to impact future periods. Management did not incur any operating losses associated with the closure process and expects the continuing mortgage segment to be a profitable and meaningful contributor to consolidated earnings.

In order to evaluate the impact of this change on the overall Corporation’s financial performance, condensed consolidated pro forma financial statements have been presented in Note 11 of the consolidated financial statements. The pro forma information is presenting results as if the Branch, which closed in the second quarter of 2013, had not been in existence during the second quarter of 2013 and 2012. The adjustment for the Branch closure does not reflect indirect overhead reductions management has made or will continue to make on a go-forward basis.

We believe the economic recovery is continuing to strengthen and the labor market is improving. The U.S. Bureau of Labor Statistics reported an increase in labor productivity in the nonfarm business sector for the first quarter of 2013. The unemployment rate for Fairfax County, Virginia at the end of June 2013 was 4.5% compared to 6.0% for the state of Virginia and 7.8% for the nation. Information reviewed at the Federal Open Market Committee’s June 2013 meeting suggested economic activity was expanding at a modest pace during the first half of 2013. The historically low interest rate environment continues to negatively impact yields of variable loans and the securities portfolio. Recent upward movement in interest rates during the second quarter 2013 has slowed the loan origination volume for refinances and caused the investment portfolio to incur negative market adjustments on its available-for-sale securities. The Corporation’s net interest margin for the three months ended June 30, 2013 decreased to 3.64% from the June 30, 2012 percentage of 3.74% as a result of the decrease in yields across the majority of interest earning asset segments. While there is no certainty to the magnitude of any impact, the continued extended period of low interest rates, as presently forecasted by the Federal Reserve, will continue to have an adverse effect on the net interest margin.

While the economy continues to show signs of improvement with unemployment rates declining, and we are beginning to see price appreciation in the local residential real estate market, there is no guarantee that these positive trends will continue. As such, we remain cautious as to the macro-economic risks, many openly identified by the Federal Open Market Committee, including persistently high rates of unemployment and underemployment, adverse impact of the higher Federal Tax Rates, and automatic reductions of Federal Expenditures that became effective beginning in the first quarter of 2013. As a consequence, we have generally retained more cautious loan underwriting criteria established during the financial crisis period of 2007 – 2009. In spite of these challenges, we are proactive in seeking new client relationships driven by our target market profile: business-to-business and business-to-government companies with annual revenue of \$1 million to \$100 million and the various banking services needed by the business and the professionals associated with the businesses. With the aforementioned macro-economic uncertainty, we are finding most desirable clients and prospects carrying higher cash reserves and weary of increasing debt loads. These

behaviors in our target market have elevated the levels of our short-term deposit balances while loan balance growth is muted by tepid utilization of loan commitments.

- 38 -

## **Securities**

The Corporation's securities portfolio is comprised of U.S. government agency securities, mortgage backed securities, corporate bonds, a CRA mutual fund, and other available-for-sale securities as well as a non-taxable municipal bond. The portfolio does not have any non-agency mortgage backed securities or trust preferred securities.

At June 30, 2013 the fair value of the securities portfolio totaled \$85.0 million, compared to \$81.1 million at December 31, 2012. Included in the fair value totals are held-to-maturity securities with an amortized cost of \$15.9 million (fair value of \$15.5 million) and \$45.0 million (fair value of \$45.3 million) at June 30, 2013 and December 31, 2012, respectively. Securities classified as available-for-sale are accounted for at fair market value with unrealized gains and losses recorded directly to a separate component of shareholders' equity, net of associated tax effect while held-to-maturity securities are carried at amortized cost. Investment securities are used to provide liquidity, to generate income, and to temporarily supplement loan growth as needed.

## **Restricted Stock**

Restricted stock consists of FHLB stock and FRB stock. These stocks are classified as restricted stocks because their ownership is restricted to certain types of entities and they lack a market. Restricted stock is carried at cost on the Corporation's financial statements. Dividends are paid semiannually on FRB stock and quarterly on FHLB stock.

## **Loans**

The loan portfolio constitutes the largest component of earning assets and is comprised of commercial real estate – owner occupied, commercial real estate – non-owner occupied, residential real estate, commercial, real estate construction, and consumer loans. All lending activities of the Bank and its subsidiaries are subject to the regulations and supervision of the Comptroller. The loan portfolio does not have any pay option adjustable rate mortgages, loans with teaser rates or subprime loans or any other loans considered “high risk loans”. Loans totaled \$641.5 million at June 30, 2013 compared to \$617.0 million at December 31, 2012, an increase of \$24.5 million. Comprising the majority of the growth, commercial loans increased \$7.2 million, residential real estate loans increased \$12.7 million and real estate construction loans increased \$5.4 million. The overall increase in loans reflects a continued improvement in loan demand by local businesses, as seen through the increase in commercial segments of the loan portfolio, and is principally due to improvement in economic conditions in Northern Virginia. Please see Note 4 to the consolidated financial statements for a table that summarizes the composition of the Corporation's loan portfolio. The following is a summary of the loan portfolio at June 30, 2013.

Commercial Real Estate Loans – Owner Occupied: This category of loans represented the largest segment of the loan portfolio and was comprised of owner occupied loans secured by the commercial property, totaling \$189.6 million, representing 29.56% of the loan portfolio at June 30, 2013. Commercial real estate loans are secured by the subject property and underwritten to policy standards. Policy standards approved by the Board of Directors from time to time set forth, among other considerations, loan-to-value limits, cash flow coverage ratios, and the general creditworthiness of the obligors.

Commercial Real Estate Loans – Non-Owner Occupied: This category of loans represented the fourth largest segment of the loan portfolio and was comprised of loans secured by income producing commercial property, totaling \$98.7 million and representing 15.39% of the loan portfolio at June 30, 2013. Commercial real estate loans are secured by the subject property and underwritten to policy standards as listed above.

Residential Real Estate Loans: This category represented the second largest segment of the loan portfolio and included loans secured by first or second mortgages on one to four family residential properties. This segment totaled \$157.3 million and comprised 24.51% of the loan portfolio as of June 30, 2013. Of this amount, the following sub-categories existed as a percentage of the whole residential real estate loan portfolio as of June 30, 2013: home equity lines of credit, 18.7%; first trust mortgage loans, 71.0%; and junior trust loans, 10.3%.

Home equity lines of credit are extended to borrowers in our target market. Real estate equity is often the largest component of consumer wealth in our marketplace. Once approved, this consumer finance tool allows the borrowers to access the equity in their homes or investment properties and use the proceeds for virtually any purpose. Home equity lines of credit are most frequently secured by a second lien on residential property. The proceeds of first trust mortgage loans are used to acquire or refinance the primary financing on owner occupied and residential investment properties. Junior trust loans are loans to consumers wherein the proceeds have been used for a stated consumer purpose. Examples of consumer purposes are education, refinancing debt, or purchasing consumer goods. The loans are generally extended in a single disbursement and repaid over a specified period of time. Loans in the residential real estate portfolio are underwritten to standards within a traditional consumer framework that is periodically reviewed and updated by management and the Board of Directors and takes into consideration repayment source and capacity, value of the underlying property, credit history, savings pattern, and stability.

Commercial Loans: Commercial Loans represented the third largest segment of the loan portfolio, totaling \$156.6 million and representing 24.41% of the loan portfolio as of June 30, 2013. These loans are made to businesses or individuals within our target market for business purposes. Typically the loan proceeds are used to support working capital and the acquisition of fixed assets of an operating business. We underwrite these loans based upon our assessment of the obligor(s)' ability to generate operating cash flows in the future necessary to repay the loan. To address the risks associated with the uncertainties of future cash flows, these loans are generally well secured by assets owned by the business or its principal shareholders/owners and the principal shareholders/owners are typically required to guarantee the loan.

Real Estate Construction Loans: Real estate construction loans, also known as construction and land development loans represented the fifth largest segment of the loan portfolio and totaled \$35.4 million and represented 5.52% of the loan portfolio as of June 30, 2013. These loans generally fall into one of three categories: first, loans to individuals that are ultimately used to acquire property and construct an owner occupied residence; second, loans to builders for the purpose of acquiring property and constructing homes for sale to consumers; and third, loans to developers for the purpose of acquiring land that is developed into finished lots for the ultimate construction of residential or commercial buildings. Loans of these types are generally secured by the subject property within limits established by the Board of Directors based upon an assessment of market conditions and updated from time to time. The loans typically carry recourse to principal owners. In addition to the repayment risk associated with loans to individuals and businesses, loans in this category carry construction completion risk. To address this additional risk, loans of this type are subject to additional administration procedures designed to verify and ensure progress of the project in accordance with allocated funding, project specifications and time frames.

Consumer Loans: Consumer loans, which was the smallest segment of the loan portfolio, totaled \$3.9 million and represented 0.61% of the loan portfolio as of June 30, 2013. Most loans in this category are well secured with assets other than real estate, such as marketable securities or automobiles. Very few consumer loans are unsecured. As a matter of operation, management discourages unsecured lending. Loans in this category are underwritten to standards within a traditional consumer framework that is periodically reviewed and updated by management and the Board of Directors and takes into consideration repayment capacity, collateral value, savings pattern, credit history, and stability.

- 40 -

### **Loans Held for Sale (“LHFS”)**

LHFS are residential mortgage loans originated by the mortgage division of the Bank to consumers and underwritten in accordance with standards set forth by an institutional investor to whom we expect to sell the loans for a profit. Loan proceeds are used for the purchase or refinance of the property securing the loan. Loans are sold with the servicing released to the investor. At June 30, 2013, LHFS at fair value totaled \$48.9 million compared to \$111.5 million at December 31, 2012.

The LHFS loans are closed by the Bank and held on average fifteen to thirty days pending their sale primarily to mortgage banking subsidiaries of large financial institutions. The Bank is also approved to sell loans directly to Fannie Mae and Freddie Mac and is able to securitize loans that are insured by the Federal Housing Administration. During the second quarter of 2013 we originated \$170.3 million of loans processed in this manner, compared to \$217.7 million in the first quarter of 2013 and \$265.3 million for the second quarter of 2012. Loans are sold without recourse and subject to industry standard representations and warranties that may require the repurchase by the Bank of loans previously sold. The repurchase risks associated with this activity center around early payment defaults and borrower fraud.

### **Brokered Loans**

Brokered loans are underwritten and closed by a third party lender. The Bank is paid a fee for procuring and packaging brokered loans. We have historically brokered loans that do not conform to the products offered by the Bank. As of April 1, 2011 we began a phase out of brokering loans as a result of new disclosure and compensation regulations. This phase out is evidenced when comparing the first six months of 2013 to the same period for 2012. Brokered loans accounted for 0.29%, or \$1.1 million, of the total loan volume for the first six months of 2013 compared to 0.38%, or \$2.0 million, for the same period of 2012. The change pertaining to brokered loans has not had a material impact on our business.

### **Allowance for Loan Losses**

The allowance for loan losses totaled \$13.0 million at June 30, 2013 compared to \$12.5 million at December 31, 2012. The allowance for loan losses was equivalent to 2.03% of total loans held for investment at June 30, 2013 and December 31, 2012. Adequacy of the allowance is assessed and increased by provisions for loan losses charged to expense no less than quarterly. Charge-offs are taken when a loan is identified as uncollectible. For additional information about the allowance for loan losses, please see Note 4 to the consolidated financial statements.

**Non-performing Assets**

At June 30, 2013 and December 31, 2012, the Bank had non-performing assets totaling \$2.3 million and \$2.7 million, respectively. Non-performing assets consist of non-accrual and restructured loans. All non-performing loans are carried at the expected liquidation value of the underlying collateral.

- 41 -

The following table is a summary of our non-performing assets at June 30, 2013 and December 31, 2012.

|                                                        | June<br>30,<br>2013    | December 31, 2012 |  |
|--------------------------------------------------------|------------------------|-------------------|--|
| Non-accrual loans :                                    | (Dollars In Thousands) |                   |  |
| Commercial real estate - owner occupied                | \$-                    | \$ -              |  |
| Commercial real estate - non-owner occupied            | -                      | -                 |  |
| Residential real estate                                | 555                    | 922               |  |
| Commercial                                             | 1,744                  | 1,821             |  |
| Real estate construction                               | -                      | -                 |  |
| Consumer                                               | -                      | -                 |  |
| Total non-accrual loans                                | \$2,299                | \$ 2,743          |  |
| Other real estate owned ("OREO")                       | -                      | -                 |  |
| Total non-performing assets                            | \$2,299                | \$ 2,743          |  |
| Restructured loans included above in non-accrual loans | \$210                  | \$ 759            |  |
| Ratio of non-performing assets to:                     |                        |                   |  |
| Total loans plus OREO                                  | 0.36 %                 | 0.44 %            |  |
| Total Assets                                           | 0.27 %                 | 0.32 %            |  |
| Accruing Past due loans:                               |                        |                   |  |
| 90 or more days past due                               | \$-                    | \$ -              |  |

At June 30, 2013 and December 31, 2012, the Bank had no loans past due 90 days or more and still accruing interest.

### **Deposits**

Deposits are the primary sources of funding loan growth. At June 30, 2013, deposits totaled \$659.9 million compared to \$671.5 million on December 31, 2012, a decrease of \$11.6 million. Management has utilized CDARS reciprocal balances and brokered deposits as a cost effective way to fund certain asset portfolio classes, namely the loans held for sale and the investment portfolio. With the overall reduction in mortgage banking activity during the first half of 2013, management's utilization of CDARS reciprocal balances and brokered deposits was reduced as noted by a \$59.3 million decrease in those balances. Noninterest-bearing deposits increased \$56.3 million from \$164.2 million at December 31, 2012 to \$220.5 million at June 30, 2013, and when coupled with the decrease in time deposits of \$11.0 million from December 31, 2012 to June 30, 2013 as well as the CDARS balance reduction, accounts for the overall decrease in deposits. The growth in noninterest-bearing accounts is attributable to new accounts opened during the

first six months of 2013 as a result of our outreach to operating businesses and positive balance fluctuations of existing commercial accounts. The overall increase in deposits allowed the Corporation to decrease its borrowings in the first half of 2013.

### **Shareholders' Equity**

Shareholders' equity totaled \$94.6 million at June 30, 2013 compared to \$91.3 million at December 31, 2012. The increase in shareholders' equity is due mainly to retained earnings net of dividends paid. Banking regulators have defined minimum regulatory capital ratios that the Corporation and the Bank are required to maintain. These risk based capital guidelines take into consideration risk factors, as defined by the banking regulators, associated with various categories of assets, both on and off the balance sheet. Both the Corporation and Bank are classified as well capitalized, which is the highest rating.

- 42 -

The following table outlines the regulatory components of the Corporation's capital and risk based capital ratios.

|                                                | June 30,<br>2013<br>(In Thousands) | December 31,<br>2012 |
|------------------------------------------------|------------------------------------|----------------------|
| Tier 1 Capital:                                |                                    |                      |
| Common stock                                   | \$8,588                            | \$ 8,615             |
| Capital surplus                                | 16,719                             | 17,155               |
| Retained earnings                              | 70,653                             | 65,404               |
| Less: Net unrealized loss on equity securities | (45 )                              | -                    |
| Subordinated debentures                        | 6,000                              | 6,000                |
| Less: Dissallowed servicing assets             | (55 )                              | (80 )                |
| Total Tier 1 capital                           | 101,860                            | 97,094               |
| Subordinated debentures not included in Tier 1 | -                                  | -                    |
| Allowance for loan losses                      | 9,212                              | 8,664                |
|                                                | 9,212                              | 8,664                |
| Total risk based capital                       | \$111,072                          | \$ 105,758           |
| Risk weighted assets                           | \$732,592                          | \$ 688,782           |
| Quarterly average assets                       | \$849,363                          | \$ 844,256           |

|                                 |        |        | Regulatory<br>Minimum |
|---------------------------------|--------|--------|-----------------------|
| Capital Ratios:                 |        |        |                       |
| Tier 1 risk based capital ratio | 13.90% | 14.10% | 4.00%                 |
| Total risk based capital ratio  | 15.16% | 15.35% | 8.00%                 |
| Leverage ratio                  | 11.99% | 11.50% | 4.00%                 |

## RESULTS OF OPERATIONS

### Summary

Net income for the second quarter of 2013 totaled \$3.5 million or \$0.34 diluted earnings per share. This compares with \$3.9 million or \$0.38 diluted earnings per share for the same quarter in 2012. The decrease in net income for the three months ended June 30, 2013 as compared to the same period in 2012 is attributable to the decreased earnings from the mortgage banking segment and was mitigated by favorable increases in net interest income and a decrease in provision for loan loss.

Net income for the six months ended June 30, 2013 totaled \$7.2 million or \$0.69 diluted earnings per share compared to \$7.3 million or \$0.71 diluted earnings per share for the same period in 2012. The decrease in earnings for the six months ended June 30, 2013 is attributable to the decreased earnings from the mortgage banking segment. The decrease in mortgage activity was mitigated by favorable increases in net interest income as well as a decrease in provision for loan loss.

- 43 -

**Net Interest Income**

Net interest income, the principal source of earnings, is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities (primarily deposits) used to fund earning assets. Net interest income before the provision for loan losses totaled \$8.1 million for the three months ended June 30, 2013 compared to \$7.7 million for the same period in 2012. The increase in net interest income is primarily due to lower funding costs and changes in the composition of earning assets. The annualized yield on earning assets was 4.31% for the quarter ended June 30, 2013 when compared to 4.64% for the quarter ended June 30, 2012. The decrease in the second quarter income on earning assets of \$84 thousand is attributable to decreased yields in all interest earning asset categories. A \$66.1 million increase in average loans held for investment mitigated the overall reduction in yields from June 2013 to June 2012. The cost of interest-bearing deposits and borrowings decreased from 0.90% for the quarter ended June 30, 2012 to 0.74% for the quarter ended June 30, 2013. Net interest margin was 3.89% for the quarter ended June 30, 2013 compared to 3.98% for the same period in 2012.

Net interest income before the provision for loan losses totaled \$16.1 million for the first six months of 2013 compared to \$15.6 million for the same period in 2012. The annualized yield on earning assets for the first six months of 2013 was 4.31% compared to 4.64% for the same period in 2012. The cost of interest-bearing deposits and borrowings for the first six months of 2013 was 0.72% compared to 0.94% for the same period in 2012 as all of the segments of deposits and borrowings bore a lower rate of interest in 2013 than in 2012. Net interest margin was 3.81% for the first six months of 2013 compared to 3.95% for the same period in 2012.

**Volume and Rate Analysis**

The following tables present the dollar amount of changes in interest income and interest expense for each category of interest earning assets and interest-bearing liabilities.

|                           | Three Months Ended June 30,<br>2013 compared to 2012<br>Change Due To:<br>Increase<br>/<br>(Decrease) Volume    Rate<br>(In Thousands) |          |          |
|---------------------------|----------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| Interest Earning Assets:  |                                                                                                                                        |          |          |
| Investments               | \$ (167 )                                                                                                                              | \$ (87 ) | \$ (80 ) |
| Loans held for sale       | (81 )                                                                                                                                  | (69 )    | (12 )    |
| Loans                     | 323                                                                                                                                    | 859      | (536 )   |
| Interest-bearing deposits | 9                                                                                                                                      | 8        | 1        |

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|                                                |        |        |           |
|------------------------------------------------|--------|--------|-----------|
| Total increase (decrease) in interest income   | 84     | 711    | (627 )    |
| Interest-Bearing Liabilities:                  |        |        |           |
| Interest-bearing demand deposits               | (15 )  | (1 )   | (14 )     |
| Money market deposit accounts                  | (51 )  | 3      | (54 )     |
| Savings accounts                               | 0      | (0 )   | 0         |
| Time deposits                                  | (118 ) | (10 )  | (108 )    |
| Total interest-bearing deposits                | (184 ) | (8 )   | (176 )    |
| FHLB Advances                                  | (13 )  | (0 )   | (13 )     |
| Securities sold under agreements to repurchase | (5 )   | (1 )   | (4 )      |
| Other short-term borrowings                    | -      | -      | -         |
| Long-term borrowings                           | (31 )  | (16 )  | (15 )     |
| FDIC term note                                 | -      | -      | -         |
| Subordinated debentures                        | (3 )   | -      | (3 )      |
| Total increase (decrease) in interest expense  | (236 ) | (25 )  | (211 )    |
| Increase (decrease) in net interest income     | \$ 320 | \$ 736 | \$ (416 ) |

|                                                | Six Months Ended June 30,<br>2013 compared to 2012 |          |           |
|------------------------------------------------|----------------------------------------------------|----------|-----------|
|                                                | Change Due To:                                     |          |           |
|                                                | Increase                                           |          |           |
|                                                | /                                                  |          |           |
|                                                | (Decrease)                                         | Volume   | Rate      |
| (In Thousands)                                 |                                                    |          |           |
| Interest Earning Assets:                       |                                                    |          |           |
| Investments                                    | \$ (281 )                                          | \$ (92 ) | \$ (189 ) |
| Loans held for sale                            | (317 )                                             | (120 )   | (197 )    |
| Loans                                          | 483                                                | 1,626    | (1,143 )  |
| Interest-bearing deposits                      | 4                                                  | 11       | (7 )      |
| Total increase (decrease) in interest income   | (111 )                                             | 1,425    | (1,536 )  |
| Interest-Bearing Liabilities:                  |                                                    |          |           |
| Interest-bearing demand deposits               | (24 )                                              | 13       | (37 )     |
| Money market deposit accounts                  | (108 )                                             | (8 )     | (100 )    |
| Savings accounts                               | -                                                  | (0 )     | 0         |
| Time deposits                                  | (324 )                                             | 9        | (333 )    |
| Total interest-bearing deposits                | (456 )                                             | 13       | (469 )    |
| FHLB Advances                                  | (13 )                                              | 5        | (18 )     |
| Securities sold under agreements to repurchase | (6 )                                               | 0        | (6 )      |
| Other short-term borrowings                    | -                                                  | -        | -         |
| Long-term borrowings                           | (72 )                                              | (36 )    | (36 )     |
| FDIC term note                                 | (98 )                                              | (49 )    | (49 )     |
| Subordinated debentures                        | (7 )                                               | -        | (7 )      |
| Total increase (decrease) in interest expense  | (652 )                                             | (67 )    | (585 )    |
| Increase (decrease) in net interest income     | \$ 541                                             | \$ 1,492 | \$ (951 ) |

**Average Balances, Net Interest Income, Yields Earned and Rates Paid**

The following tables present for the periods indicated the total dollar amount of interest income from average interest earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in dollars and rates.

Yield on Average Earning Assets and Rates on Average Interest-Bearing  
Liabilities  
Three Months Ended

|                                                                            | June 30, 2013          |                     |                 | June 30, 2012      |                     |                 |
|----------------------------------------------------------------------------|------------------------|---------------------|-----------------|--------------------|---------------------|-----------------|
|                                                                            | Average<br>Balance     | Income /<br>Expense | Yield /<br>Rate | Average<br>Balance | Income /<br>Expense | Yield /<br>Rate |
|                                                                            | (Dollars In Thousands) |                     |                 |                    |                     |                 |
| Assets:                                                                    |                        |                     |                 |                    |                     |                 |
| Interest earning assets:                                                   |                        |                     |                 |                    |                     |                 |
| Securities                                                                 | \$ 94,358              | \$ 447              | 1.90 %          | \$ 111,277         | \$ 614              | 2.21 %          |
| Loans held for sale                                                        | 49,814                 | 430                 | 3.45 %          | 57,721             | 511                 | 3.54 %          |
| Loans <sup>(1)</sup>                                                       | 645,654                | 8,181               | 5.07 %          | 579,541            | 7,858               | 5.42 %          |
| Interest-bearing balances and federal funds sold                           | 38,310                 | 28                  | 0.29 %          | 27,613             | 19                  | 0.28 %          |
| Total interest earning assets                                              | 828,136                | 9,086               | 4.39 %          | 776,152            | 9,002               | 4.64 %          |
| Noninterest earning assets:                                                |                        |                     |                 |                    |                     |                 |
| Cash and due from banks                                                    | 11,922                 |                     |                 | 9,381              |                     |                 |
| Premises, land and equipment                                               | 8,501                  |                     |                 | 8,561              |                     |                 |
| Other assets                                                               | 14,576                 |                     |                 | 16,123             |                     |                 |
| Less: allowance for loan losses                                            | (12,936 )              |                     |                 | (11,945 )          |                     |                 |
| Total noninterest earning assets                                           | 22,063                 |                     |                 | 22,120             |                     |                 |
| Total Assets                                                               | \$ 850,200             |                     |                 | \$ 798,272         |                     |                 |
| Liabilities and Shareholders' Equity:                                      |                        |                     |                 |                    |                     |                 |
| Interest-bearing deposits:                                                 |                        |                     |                 |                    |                     |                 |
| Interest-bearing demand deposits                                           | \$ 62,215              | \$ 25               | 0.16 %          | \$ 64,481          | \$ 40               | 0.25 %          |
| Money market deposit accounts                                              | 122,468                | 73                  | 0.24 %          | 118,984            | 124                 | 0.42 %          |
| Savings accounts                                                           | 2,499                  | 1                   | 0.18 %          | 2,678              | 1                   | 0.15 %          |
| Time deposits                                                              | 321,558                | 867                 | 1.08 %          | 324,856            | 985                 | 1.21 %          |
| Total interest-bearing deposits                                            | 508,740                | 966                 | 0.76 %          | 510,999            | 1,150               | 0.90 %          |
| Borrowings:                                                                |                        |                     |                 |                    |                     |                 |
| FHLB Advances                                                              | 17,011                 | 11                  | 0.26 %          | 17,335             | 24                  | 0.55 %          |
| Securities sold under agreements to repurchase and federal funds purchased | 23,265                 | 4                   | 0.08 %          | 24,777             | 9                   | 0.15 %          |
| Other short-term borrowings                                                | -                      | -                   | 0.00 %          | -                  | -                   | 0.00 %          |
| FHLB Long-term borrowings                                                  | -                      | -                   | 0.00 %          | 3,256              | 31                  | 3.81 %          |
| FDIC Term Note                                                             | -                      | -                   | 0.00 %          | -                  | -                   | 0.00 %          |

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|                                                |         |          |        |         |          |        |
|------------------------------------------------|---------|----------|--------|---------|----------|--------|
| Subordinated Debentures                        | 6,186   | 53       | 3.43 % | 6,186   | 56       | 3.62 % |
| Total borrowings                               | 46,462  | 68       | 0.59 % | 51,554  | 120      | 0.93 % |
| Total interest-bearing deposits and borrowings | 555,202 | 1,034    | 0.74 % | 562,553 | 1,270    | 0.90 % |
| Noninterest-bearing liabilities:               |         |          |        |         |          |        |
| Demand deposits                                | 191,009 |          |        | 136,492 |          |        |
| Other liabilities                              | 9,254   |          |        | 10,579  |          |        |
| Total liabilities                              | 755,465 |          |        | 709,624 |          |        |
| Shareholders' Equity                           | 94,735  |          |        | 88,648  |          |        |
| Total Liabilities and Shareholders' Equity: \$ | 850,200 |          |        | 798,272 |          |        |
| Interest Spread <sup>(2)</sup>                 |         |          | 3.64 % |         |          | 3.74 % |
| Net Interest Margin <sup>(3)</sup>             |         | \$ 8,052 | 3.89 % |         | \$ 7,732 | 3.98 % |

(1) Loans placed on nonaccrual status are included in loan balances

(2) Interest spread is the average yield earned on earning assets, less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is net interest income, expressed as a percentage of average earning assets.

Yield on Average Earning Assets and Rates on Average Interest-Bearing Liabilities  
Six Months Ended

|                                                                            | June 30, 2013                                |                     |                 | June 30, 2012      |                     |                 |
|----------------------------------------------------------------------------|----------------------------------------------|---------------------|-----------------|--------------------|---------------------|-----------------|
|                                                                            | Average<br>Balance<br>(Dollars In Thousands) | Income /<br>Expense | Yield /<br>Rate | Average<br>Balance | Income /<br>Expense | Yield /<br>Rate |
| Assets:                                                                    |                                              |                     |                 |                    |                     |                 |
| Interest earning assets:                                                   |                                              |                     |                 |                    |                     |                 |
| Securities                                                                 | \$ 100,493                                   | \$ 982              | 1.95 %          | \$ 108,882         | \$ 1,263            | 2.32 %          |
| Loans held for sale                                                        | 62,222                                       | 1,044               | 3.36 %          | 68,648             | 1,361               | 3.97 %          |
| Loans <sup>(1)</sup>                                                       | 636,129                                      | 16,162              | 5.08 %          | 573,946            | 15,679              | 5.46 %          |
| Interest-bearing balances and federal funds sold                           | 48,567                                       | 54                  | 0.22 %          | 39,043             | 50                  | 0.26 %          |
| Total interest earning assets                                              | 847,411                                      | 18,242              | 4.31 %          | 790,519            | 18,353              | 4.64 %          |
| Noninterest earning assets:                                                |                                              |                     |                 |                    |                     |                 |
| Cash and due from banks                                                    | 11,659                                       |                     |                 | 9,173              |                     |                 |
| Premises, land and equipment                                               | 8,521                                        |                     |                 | 8,601              |                     |                 |
| Other assets                                                               | 14,466                                       |                     |                 | 16,438             |                     |                 |
| Less: allowance for loan losses                                            | (12,773 )                                    |                     |                 | (11,876 )          |                     |                 |
| Total noninterest earning assets                                           | 21,873                                       |                     |                 | 22,336             |                     |                 |
| Total Assets                                                               | \$ 869,285                                   |                     |                 | \$ 812,855         |                     |                 |
| Liabilities and Shareholders' Equity:                                      |                                              |                     |                 |                    |                     |                 |
| Interest-bearing deposits:                                                 |                                              |                     |                 |                    |                     |                 |
| Interest-bearing demand deposits                                           | \$ 73,571                                    | \$ 67               | 0.18 %          | \$ 63,362          | \$ 91               | 0.29 %          |
| Money market deposit accounts                                              | 120,707                                      | 162                 | 0.27 %          | 124,673            | 270                 | 0.43 %          |
| Savings accounts                                                           | 2,472                                        | 2                   | 0.16 %          | 2,618              | 2                   | 0.15 %          |
| Time deposits                                                              | 345,328                                      | 1,736               | 1.01 %          | 343,861            | 2,060               | 1.20 %          |
| Total interest-bearing deposits                                            | 542,078                                      | 1,967               | 0.73 %          | 534,514            | 2,423               | 0.91 %          |
| Borrowings:                                                                |                                              |                     |                 |                    |                     |                 |
| FHLB Advances                                                              | 11,066                                       | 15                  | 0.27 %          | 9,269              | 28                  | 0.60 %          |
| Securities sold under agreements to repurchase and federal funds purchased | 26,807                                       | 13                  | 0.10 %          | 26,601             | 19                  | 0.14 %          |
| Other short-term borrowings                                                | -                                            | -                   | 0.00 %          | -                  | -                   | 0.00 %          |
| FHLB Long-term borrowings                                                  | -                                            | -                   | 0.00 %          | 4,003              | 72                  | 3.60 %          |
| FDIC Term Note                                                             | -                                            | -                   | 0.00 %          | 7,253              | 98                  | 2.70 %          |
| Subordinated Debentures                                                    | 6,186                                        | 106                 | 3.43 %          | 6,186              | 113                 | 3.65 %          |
| Total borrowings                                                           | 44,059                                       | 134                 | 0.61 %          | 53,312             | 330                 | 1.24 %          |
| Total interest-bearing deposits and borrowings                             | 586,137                                      | 2,101               | 0.72 %          | 587,826            | 2,753               | 0.94 %          |
| Noninterest-bearing liabilities:                                           |                                              |                     |                 |                    |                     |                 |
| Demand deposits                                                            | 180,045                                      |                     |                 | 124,395            |                     |                 |
| Other liabilities                                                          | 9,562                                        |                     |                 | 13,409             |                     |                 |
| Total liabilities                                                          | 775,744                                      |                     |                 | 725,630            |                     |                 |
| Shareholders' Equity                                                       | 93,541                                       |                     |                 | 87,225             |                     |                 |
|                                                                            | \$ 869,285                                   |                     |                 | \$ 812,855         |                     |                 |

Total Liabilities and Shareholders'  
Equity:

|                                    |           |        |           |        |
|------------------------------------|-----------|--------|-----------|--------|
| Interest Spread <sup>(2)</sup>     |           | 3.59 % |           | 3.71 % |
| Net Interest Margin <sup>(3)</sup> | \$ 16,141 | 3.81 % | \$ 15,600 | 3.95 % |

(1) Loans placed on nonaccrual status are included in loan balances

(2) Interest spread is the average yield earned on earning assets, less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is net interest income, expressed as a percentage of average earning assets.

### **Noninterest Income**

Noninterest income consists of revenue generated from financial services and activities other than lending and investing. The mortgage segment provides the most significant contributions to noninterest income. Total noninterest income was \$8.0 million for the second quarter of 2013 compared to \$13.7 million for the same period in 2012. Gains on the sale of loans originated by the Banks's mortgage segment are the largest component of noninterest income. Gains on the sale of loans totaled \$7.1 million for the three month period ended June 30, 2013, compared to \$14.7 million for the same period of 2012. Gains on the sale of loans fluctuate with the volume of mortgage loans originated. During the three months ended June 30, 2013, the Bank's mortgage segment originated \$171.4 million in mortgage and brokered loans, down from \$266.9 million for the same period in 2012. For the three months ended June 30, 2013, other income reflected a gain of \$736 thousand, as compared to a \$1.2 million loss for the three months ended June 30, 2012, due mainly to a \$2.8 million gain relating to hedging activities associated with loans held for sale. Our hedging activities are designed to insulate the net gain on sale margins from movements of interest rates during the mortgage loan origination and delivery process. When losses are recognized on instruments used to hedge interest rate risk, the value of the loans being hedged increase proportionately resulting in higher realized gains on sale income.

Noninterest income was \$18.9 million for the first six months of 2013 compared to \$25.8 million for the same period in 2012. Gains on the sale of loans totaled \$15.0 million for the six month period ended June 30, 2013, compared to \$25.7 million for the same period of 2012. During the six months ended June 30, 2013, the Bank's mortgage segment originated \$389.1 million in mortgage and brokered loans, down from \$524.1 million for the same period in 2012. For the six months ended June 30, 2013, other income reflected a gain of \$3.5 million, as compared to a \$213 thousand loss for the six months ended June 30, 2012, due mainly to a \$3.9 million gain relating to hedging activities associated with loans held for sale which was partially offset by a \$2.0 million loss on derivative activities associated with loans held for sale.

### **Noninterest Expense**

Noninterest expense totaled \$10.5 million for the three months ended June 30, 2013, compared to \$14.4 million for the same period in 2012, a decrease of \$3.9 million. Salaries and employee benefits totaled \$6.8 million for the three months ended June 30, 2013, compared to \$7.5 million for the same period last year. The decrease in salary and employee benefits is attributable in part to the reduction in the mortgage loan production. Other operating expenses totaled \$3.1 million for the three months ended June 30, 2013, compared to \$6.4 million for the same period in 2012.

Noninterest expense totaled \$23.2 million for the six months ended June 30, 2013, compared to \$28.2 million for the same period in 2012, a decrease of \$5.0 million. Salaries and employee benefits totaled \$14.9 million for the six

months ended June 30, 2013, compared to \$15.8 million for the same period last year. The decrease in salary and employee benefits is attributable to the decrease in volume related compensation in the mortgage banking segment. Other operating expenses totaled \$7.0 million for the six months ended June 30, 2013, compared to \$11.1 million for the same period in 2012. This decrease is also primarily due to volume related expenses associated with a decrease in mortgage loan production.

Management fee expense for the Bank's mortgage division decreased \$1.7 million in the first half of 2013 from the first half of 2012 due to the decrease in mortgage division production. Advertising and promotional expense decreased \$738 thousand for the six months ended June 30, 2013, compared to the same period in 2012. Provision for losses on mortgage loans sold decreased \$1.2 million for the six months ended June 30, 2013 compared to the same period in 2012 due to the decrease in mortgage loan volume.

The table below provides the composition of other operating expenses.

|                                             | Six Months Ended June 30, |           |
|---------------------------------------------|---------------------------|-----------|
|                                             | 2013                      | 2012      |
|                                             | (In Thousands)            |           |
| Management fees                             | \$ 1,167                  | \$ 2,820  |
| Advertising and promotional                 | 915                       | 1,653     |
| Investor fees                               | 530                       | 612       |
| Business and franchise tax                  | 416                       | 361       |
| Provision for losses on mortgage loans sold | 388                       | 1,600     |
| Data processing                             | 360                       | 319       |
| Consulting fees                             | 323                       | 242       |
| Accounting and auditing                     | 306                       | 306       |
| FDIC insurance                              | 225                       | 168       |
| Credit report                               | 186                       | 199       |
| Director fees                               | 180                       | 130       |
| Publication and subscription                | 162                       | 129       |
| Telephone                                   | 147                       | 106       |
| Office supplies-stationary print            | 138                       | 134       |
| Legal fees                                  | 124                       | 114       |
| SBA guarantee fee                           | 111                       | 92        |
| Early payoff expense                        | 105                       | 3         |
| Stock option expense                        | 104                       | 132       |
| Regulatory examinations                     | 103                       | 92        |
| Disaster recovery expense                   | 88                        | 85        |
| Verification fees                           | 87                        | 102       |
| Education and training                      | 64                        | 99        |
| Freight and express                         | 54                        | 7         |
| Appraisal fees                              | 34                        | 84        |
| Other settlement fees                       | 27                        | 69        |
| Postage                                     | 24                        | 74        |
| Other                                       | 632                       | 1,404     |
|                                             | \$ 7,000                  | \$ 11,136 |

## Liquidity Management

Liquidity is the ability of the Corporation to meet current and future cash flow requirements. The liquidity of a financial institution reflects its ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining the Corporation's ability to meet the daily cash flow requirements of both depositors and borrowers. Management monitors liquidity through a regular review of asset and liability maturities, funding sources, and loan and deposit forecasts.

Asset and liability management functions not only serve to assure adequate liquidity in order to meet the needs of the Corporation's customers, but also to maintain an appropriate balance between interest sensitive assets and interest sensitive liabilities so that the Corporation can earn an appropriate return for its shareholders.

- 49 -

The asset portion of the balance sheet provides liquidity primarily through loan principal repayments and maturities of investment securities. Other short-term investments such as federal funds sold and interest-bearing deposits with other banks provide an additional source of liquidity funding. At June 30, 2013, overnight interest-bearing balances totaled \$35.1 million and unpledged available-for-sale investment securities totaling approximately \$33.5 million.

The Bank proactively manages a portfolio of short-term time deposits issued to local municipalities and wholesale depositors in order to fund loans held for sale and short-term investments. As of June 30, 2013, the portfolio of CDARS and wholesale time deposits totaled \$140.8 million compared to \$200.1 million and \$233.5 million at December 31, 2012 and June 30, 2012, respectively.

The liability portion of the balance sheet provides liquidity through various interest-bearing and noninterest-bearing deposit accounts, federal funds purchased, securities sold under agreement to repurchase and other short-term borrowings. At June 30, 2013, the Bank had a line of credit with the FHLB totaling \$262.5 million and had outstanding \$50 million in a short term loan at a fixed rate of 0.19% leaving \$212.5 million available on the line. In addition to the line of credit at the FHLB, the Bank issues repurchase agreements. In the first quarter of 2012, the Bank paid off the senior unsecured term note guaranteed by the FDIC under the Temporary Liquidity Guarantee program of \$30.0 million issued in February 2009. As of June 30, 2013, outstanding repurchase agreements totaled \$20.2 million. The interest rates on these instruments are variable and subject to change daily. The Bank also maintains federal funds lines of credit with its correspondent banks and, at June 30, 2013, these lines totaled \$60.5 million and were available as an additional funding source.

The following table presents the composition of borrowings at June 30, 2013 and December 31, 2012 and for the periods indicated.

#### Borrowed Funds Distribution

|                                                                            | June 30,<br>2013       | December 31, 2012 |
|----------------------------------------------------------------------------|------------------------|-------------------|
|                                                                            | (Dollars In Thousands) |                   |
| Borrowings:                                                                |                        |                   |
| FHLB advances                                                              | \$50,000               | \$ 45,000         |
| Securities sold under agreements to repurchase and federal funds purchased | 20,161                 | 38,091            |
| Subordinated debentures                                                    | 6,186                  | 6,186             |
| Total at period end                                                        | \$76,347               | \$ 89,277         |

December 31, 2012

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June 30,  
2013

Borrowings:

(Dollars In Thousands)

Average Balances

|                                                                            |          |    |        |
|----------------------------------------------------------------------------|----------|----|--------|
| FHLB advances                                                              | \$11,066 | \$ | 11,141 |
| FHLB long-term borrowings                                                  | -        |    | 3,015  |
| Securities sold under agreements to repurchase and federal funds purchased | 26,807   |    | 26,744 |
| Subordinated debentures                                                    | 6,186    |    | 6,186  |
| FDIC term note                                                             | -        |    | 3,607  |
| Total average balance                                                      | \$44,059 | \$ | 50,693 |

|                                         |      |   |      |   |
|-----------------------------------------|------|---|------|---|
| Average rate paid on all borrowed funds | 0.61 | % | 1.25 | % |
|-----------------------------------------|------|---|------|---|

- 50 -

Management believes the Corporation is well positioned with liquid assets, the ability to generate liquidity through liability funding and the availability of borrowed funds, to meet the liquidity needs of depositors and customers' borrowing needs. The Corporation's ability to maintain sufficient liquidity may be affected by numerous factors, including economic conditions nationally and in our markets. Depending on the Corporation's liquidity levels, its capital position, conditions in the capital markets and other factors, the Corporation may from time to time consider the issuance of debt, equity or other securities, or other possible capital markets transactions, the proceeds of which could provide additional liquidity for its operations.

### **Contractual Obligations**

There have been no material changes outside the ordinary course of business to the contractual obligations disclosed in the

Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Corporation's market risk is composed primarily of interest rate risk. The Funds Management Committee is responsible for reviewing the interest rate sensitivity position and establishes policies to monitor and coordinate the Corporation's sources, uses and pricing of funds.

### **Interest Rate Sensitivity Management**

The Corporation uses a simulation model to analyze, manage and formulate operating strategies that address net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on various interest rate scenarios over a twelve month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and liabilities. The model incorporates certain assumptions which management believes to be reasonable regarding the impact of changing interest rates and the prepayment assumption of certain assets and liabilities. The table below reflects the outcome of these analyses at June 30, 2013 and December 31, 2012, assuming budgeted growth in the balance sheet. According to the model run for the six month period ended June 30, 2013, and projecting forward over a twelve month period, an immediate 100 basis point increase in interest rates would result in an increase in net interest income of 4.37%. Modeling for an immediate 100 basis point decrease in interest rates has been suspended due to the current rate environment. While management carefully monitors the exposure to changes in interest rates and takes actions as warranted to mitigate any adverse impact, there can be no assurance about the actual effect of interest rate changes on net interest income.

The following table reflects the Corporation's earnings sensitivity profile.

| Increase in Federal<br>Funds Target Rate | Hypothetical Percentage             | Hypothetical Percentage                 |
|------------------------------------------|-------------------------------------|-----------------------------------------|
|                                          | Change in Earnings<br>June 30, 2013 | Change in Earnings<br>December 31, 2012 |
| 3.00%                                    | 15.34%                              | 15.35%                                  |
| 2.00%                                    | 9.94%                               | 10.03%                                  |
| 1.00%                                    | 4.37%                               | 4.46%                                   |

The Corporation's net interest income and the fair value of its financial instruments are influenced by changes in the level of interest rates. The Corporation manages its exposure to fluctuations in interest rates through policies established by its Funds Management Committee. The Funds Management Committee meets periodically and has responsibility for formulating and implementing strategies to improve balance sheet positioning and earnings and reviewing interest rate sensitivity.

The Bank is party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed to, and locked by both the Bank and the borrower for specified periods of time. When the borrower locks its interest rate, the Bank effectively extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Bank must honor the interest rate for the specified time period. The Bank is exposed to interest rate risk during the accumulation of interest rate lock commitments and loans prior to sale. The Bank utilizes either a best efforts forward sale commitment or a mandatory forward sale commitment to economically hedge the changes in fair value of the loan due to changes in market interest rates. Failure to effectively monitor, manage and hedge the interest rate risk associated with the mandatory commitments subjects the Bank to potentially significant market risk.

Throughout the lock period, the changes in the market value of interest rate lock commitments, best efforts, and mandatory forward sale commitments are recorded as unrealized gains and losses and are included in the statement of operations in other income. The Bank's management has made complex judgments in the recognition of gains and losses in connection with this activity. The Bank utilizes a third party and its proprietary simulation model to assist in identifying and managing the risk associated with this activity.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

The Corporation's management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed in the reports that the Corporation files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation to disclose material information required to be set forth in the Corporation's periodic and current reports.

##### **Changes in Internal Control over Financial Reporting**

The Corporation's management is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). No changes in the Corporation's internal control over financial reporting occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The Corporation, and the Bank are from time to time parties to legal proceedings arising in the ordinary course of business. Management is of the opinion that these legal proceedings will not have a material adverse effect on the Corporation's financial condition or results of operations. From time to time the Bank and the Corporation may initiate legal actions against borrowers in connection with collecting defaulted loans. Such actions are not considered material by management unless otherwise disclosed.

Prior to discontinuing the operations of the Mortgage Corporation, a subpoena dated May 3, 2011 was received from the United States Attorney's Office (the "U.S. Attorney's Office") for the Southern District of New York. Correspondence accompanying the subpoena indicated that the U.S. Attorney's Office is investigating potential violations by the Mortgage Corporation of the statutes, regulations, and rules governing the Federal Housing Administration's direct endorsement lender program and potential violations of sections 215, 656, 657, 1005, 1006, 1007, 1014, or 1344 of Title 18 or section 287, 1001, 1032, 1341, or 1343 of Title 18 affecting a federally insured financial institution in contemplation of a possible civil proceeding under 12 U.S.C. Section 1833a.

The subpoena requires the Mortgage Corporation, through the Bank since the activities of the Mortgage Corporation have been transitioned into an operating division of the Bank, to produce certain documents and designate a knowledgeable witness to testify with respect to the matters set forth above. The Corporation and its subsidiaries have cooperated fully with this investigation.

The Corporation cannot determine the outcome of this investigation or any related civil proceeding. In addition, the Corporation cannot predict how long the investigation will take or whether it or any of its subsidiaries will be required to take any additional actions.

#### **Item 1A. Risk Factors**

Except as noted below, there have been no material changes in the risk factors faced by the Corporation from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012.

**The Basel III capital framework will require higher levels of capital and liquid assets, which could adversely affect the Corporation's net income and return on equity.**

In July 2013, the federal bank regulatory agencies adopted rules to implement the Basel III capital framework and for calculating risk-weighted assets, as modified by the U.S. federal bank regulators (or the Basel III Capital Rules).

The Basel III Capital Rules, when implemented by the U.S. banking agencies and fully phased-in, represent the most comprehensive overhaul of the U.S. banking capital framework in over two decades. These rules will require bank holding companies and their subsidiaries, such as the Corporation and the Bank, to dedicate more resources to capital planning and regulatory compliance, and maintain substantially more capital as a result of higher required capital levels and more demanding regulatory capital risk-weightings and calculations. The rules will also require all banks to substantially change the manner in which they collect and report information to calculate risk-weighted assets, and

will likely increase risk-weighted assets at many banking organizations as a result of applying higher risk-weightings to certain types of loans and securities. As a result, we may be forced to limit originations of certain types of commercial and mortgage loans, thereby reducing the amount of credit available to borrowers and limiting opportunities to earn interest income from the loan portfolio, or change the way we manage past-due exposures.

Due to the changes to bank capital levels and the calculation of risk-weighted assets, many banks could be required to access the capital markets on short notice and in relatively weak economic conditions, which could result in banks raising capital that significantly dilutes existing shareholders. Additionally, many community banks could be forced to limit banking operations and activities, and growth of loan portfolios and interest income, in order to focus on retention of earnings to improve capital levels. If the Basel III Capital Rules require the Corporation to access the capital markets in this manner, or similarly limit the Bank's operations and activities, the Basel III Capital Rules would have a detrimental effect on our net income and return on equity and limit the products and services we provide to our customers.

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table details the Corporation's purchases of its common stock during the second quarter of 2013 pursuant to a Share Repurchase Program announced on March 20, 2007. On June 22, 2010 the number of shares authorized for repurchase under the share repurchase program was increased from 2,500,000 to 3,500,000. The Share Repurchase Program does not have an expiration date.

| Period                   | Issuer Purchases of Equity Securities               |                                     |                                            |                                          |
|--------------------------|-----------------------------------------------------|-------------------------------------|--------------------------------------------|------------------------------------------|
|                          | (a)<br>Total<br>Number<br>of<br>Shares<br>Purchased | (b) Average Price<br>Paid Per Share | (c) Total Number of<br>Shares Purchased as | (d) Maximum Number<br>of Shares that may |
|                          |                                                     |                                     | Part of Publicly                           | yet be Purchased                         |
|                          |                                                     |                                     | Announced Plan                             | Under the Plan                           |
| April 1 - April 30, 2013 | 28,919                                              | \$ 12.26                            | 28,919                                     | 801,316                                  |
| May 1 - May 31, 2013     | 25,177                                              | 12.50                               | 25,177                                     | 776,139                                  |
| June 1 - June 30, 2013   | 7,358                                               | 12.50                               | 7,358                                      | 768,781                                  |
|                          | 61,454                                              | \$ 12.39                            | 61,454                                     | 768,781                                  |

## **Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

- 53 -

**Item 6. Exhibits**

| <u>Exhibit No.</u> | <u>Description</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                | Amended and Restated Articles of Incorporation of Access National Corporation (incorporated by reference to Exhibit 3.1 to Form 8-K filed July 18, 2006 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                                      |
| 3.1.1              | Articles of Amendment to Amended and Restated Articles of Incorporation of Access National Corporation (incorporated by reference to Exhibit 3.1.1 to Form 10-Q filed August 15, 2011 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                        |
| 3.2                | Amended and Restated Bylaws of Access National Corporation (incorporated by reference to Exhibit 3.2 to Form 8-K filed October 24, 2007 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 4.0                | Certain instruments relating to long-term debt as to which the total amount of securities authorized thereunder does not exceed 10% of Access National Corporation's total assets have been omitted in accordance with Item 601(b)(4)(iii) of Regulation S-K. The registrant will furnish a copy of any such instrument to the Securities and Exchange Commission upon its request.                                                                                                                                                                                                   |
| 10.11+             | Termination Agreement between Access National Bank and Charles Wimer, dated as of June 4, 2012 (incorporated by reference to Exhibit 10.11 to Form 10-Q filed August 14, 2012 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                |
| 10.12+             | Termination Agreement between Access National Bank and Dean Hackemer, dated as of March 14, 2013 (incorporated by reference to Exhibit 10.12 to Form 10-K filed March 18, 2013 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                               |
| 10.13+             | Employment Agreement between Access National Bank and Michael W. Clarke (incorporated by reference to Exhibit 10.13 to Form 10-K filed March 18, 2013 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                                        |
| 10.14+             | Employment Agreement between Access National Bank and Robert C. Shoemaker (incorporated by reference to Exhibit 10.14 to Form 10-K filed March 18, 2013 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                                      |
| 10.15+             | Employment Agreement between Access National Bank and Dean Hackemer (incorporated by reference to Exhibit 10.15 to Form 10-K filed March 18, 2013 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                                            |
| 10.16+             | Employment Agreement between Access National Bank and Margaret M. Taylor (incorporated by reference to Exhibit 10.16 to Form 10-Q filed May 10, 2013 (file number 000-49929))                                                                                                                                                                                                                                                                                                                                                                                                         |
| 31.1*              | CEO Certification Pursuant to Rule 13a-14(a)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 31.2*              | CFO Certification Pursuant to Rule 13a-14(a)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 32*                | CEO/CFO Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 101*               | The following materials from Access National Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013 formatted in XBRL (Extensible Business Reporting Language), furnished herewith: (i) Consolidated Balance Sheets (unaudited), (ii) Consolidated Statements of Income (unaudited), (iii) Consolidated Statements of Comprehensive Income (unaudited), (iv) Consolidated Statements of Changes in Shareholders' Equity (unaudited), (v) Consolidated Statements of Cash Flows (unaudited), and (vi) Notes to Consolidated Financial Statements (unaudited). |

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

\* filed herewith

+ indicates a management contract or compensatory plan or arrangement

\*\* In accordance with Rule 406T of Regulation S-T, the information in this exhibit shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

- 55 -

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Access National Corporation  
(Registrant)

Date: August 9, 2013 By: /s/ Michael W. Clarke  
Michael W. Clarke  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 9, 2013 By: /s/ Margaret M. Taylor  
Margaret M. Taylor  
Senior Vice President and Chief Financial Officer  
(Principal Financial & Accounting Officer)

- 56 -

