OLD SECOND BANCORP INC
Form 10-Q
August 07, 2015
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I

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

OR

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

For transition period from to

Commission File Number 0 -10537

(Exact name of Registrant as specified in its charter)

Delaware	36-3143493
(State or other jurisdiction	(I.R.S. Employer Identification Number)

of incorporation or organization)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Indicate by check mark whether 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 Act). (check one):

Large accelerated filer Accelerated filer Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of August 6, 2015, the Registrant had outstanding 29,478,429 shares of common stock, $1.00 par value per share.

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OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share data)

	(Unaudited) June 30, 2015	December 31, 2014
Assets		
Cash and due from banks	$ 29,164	$ 30,101
Interest bearing deposits with financial institutions	9,352	14,096
Cash and cash equivalents	38,516	44,197
Securities available-for-sale, at fair value	399,836	385,486
Securities held-to-maturity, at amortized cost	253,419	259,670
Federal Home Loan Bank and Federal Reserve Bank stock	8,271	9,058
Loans held-for-sale	6,208	5,072
Loans	1,158,883	1,159,332
Less: allowance for loan losses	18,321	21,637
Net loans	1,140,562	1,137,695
Premises and equipment, net	41,696	42,335
Other real estate owned	31,964	31,982
Mortgage servicing rights, net	5,884	5,462
Bank-owned life insurance (BOLI)	57,444	56,807
Deferred tax assets, net	65,473	70,141
Other assets	15,780	13,882
Total assets	$ 2,065,053	$ 2,061,787
Liabilities		
Deposits:		
Noninterest bearing demand	$ 432,773	$ 400,447
Interest bearing:		
Savings, NOW, and money market	877,587	865,103
Time	403,192	419,505
Total deposits	1,713,552	1,685,055
Securities sold under repurchase agreements	32,415	21,036
Other short-term borrowings	20,000	45,000
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
Other liabilities	9,967	12,655
Total liabilities	1,879,812	1,867,624

Stockholders' Equity		
Preferred stock	31,553	47,331
Common stock	34,423	34,365
Additional paid-in capital	115,651	115,332
Retained earnings	106,791	100,697
Accumulated other comprehensive loss	(7,211)	(7,713)
Treasury stock	(95,966)	(95,849)
Total stockholders' equity	185,241	194,163
Total liabilities and stockholders' equity	$ 2,065,053	$ 2,061,787

	June 30, 2015		December 31, 2014	
	Preferred Stock	Common Stock	Preferred Stock	Common Stock
Par value	$ 1	$ 1	$ 1	$ 1
Liquidation value	1,000	n/a	1,000	n/a
Shares authorized	300,000	60,000,000	300,000	60,000,000
Shares issued	31,553	34,422,234	47,331	34,364,734
Shares outstanding	31,553	29,478,429	47,331	29,442,508
Treasury shares	-	4,943,805	-	4,922,226

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Income

(In thousands, except share data)

	(unaudited) Three Months Ended June 30,		(unaudited) Six Months Ended June 30,	
	2015	2014	2015	2014
Interest and dividend income				
Loans, including fees	$ 13,467	$ 13,046	$ 26,685	$ 25,984
Loans held-for-sale	72	29	115	54
Securities:				
Taxable	3,372	3,352	6,747	6,854
Tax exempt	163	118	304	266
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	77	78	154	154
Interest bearing deposits with financial institutions	19	20	31	35
Total interest and dividend income	17,170	16,643	34,036	33,347
Interest expense				
Savings, NOW, and money market deposits	183	188	362	387
Time deposits	771	1,210	1,578	2,531
Other short-term borrowings	7	3	16	5
Junior subordinated debentures	1,071	1,388	2,143	2,775
Subordinated debt	202	198	399	394
Notes payable and other borrowings	-	4	4	8
Total interest expense	2,234	2,991	4,502	6,100
Net interest and dividend income	14,936	13,652	29,534	27,247
Loan loss reserve release	(2,300)	(1,000)	(2,300)	(2,000)
Net interest and dividend income after provision for loan losses	17,236	14,652	31,834	29,247
Noninterest income				
Trust income	1,596	1,677	3,082	3,136
Service charges on deposits	1,779	1,796	3,320	3,516
Secondary mortgage fees	281	155	525	267
Mortgage servicing gain, net of changes in fair value	500	64	292	17
Net gain on sales of mortgage loans	1,695	1,038	3,318	1,700
Securities (loss) gain, net	(12)	295	(121)	226
Increase in cash surrender value of bank-owned life insurance	283	366	637	724
Debit card interchange income	1,050	930	2,009	1,760
Other income	1,092	1,160	3,175	2,456
Total noninterest income	8,264	7,481	16,237	13,802
Noninterest expense				
Salaries and employee benefits	9,149	9,183	18,404	18,284
Occupancy expense, net	1,094	1,185	2,365	2,666
Furniture and equipment expense	1,065	984	2,066	1,967

FDIC insurance	377	627	650	906
General bank insurance	310	343	667	832
Amortization of core deposit	-	511	-	1,023
Advertising expense	353	459	558	762
Debit card interchange expense	400	412	752	790
Legal fees	420	409	643	666
Other real estate expense, net	2,388	1,650	3,740	2,658
Other expense	3,371	3,289	6,235	6,014
Total noninterest expense	18,927	19,052	36,080	36,568
Income before income taxes	6,573	3,081	11,991	6,481
Provision for income taxes	2,444	1,060	4,363	2,258
Net income	$ 4,129	$ 2,021	$ 7,628	$ 4,223
Preferred stock dividends and accretion of discount	710	1,348	1,534	2,920
Dividends waived upon preferred stock redemption	-	(5,433)	-	(5,433)
Gain on preferred stock redemption	-	(1,348)	-	(1,348)
Net income available to common stockholders	$ 3,419	$ 7,454	$ 6,094	$ 8,084
Basic earnings per share	$ 0.12	$ 0.26	$ 0.21	$ 0.38
Diluted earnings per share	0.12	0.26	0.21	0.38

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(In thousands)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2015	2014	2015	2014
Net Income	$ 4,129	$ 2,021	$ 7,628	$ 4,223
Unrealized holding (losses) gains on available-for-sale securities arising during the period	(575)	3,710	346	2,621
Related tax benefit (expense)	228	(1,527)	(210)	(1,079)
Holding (losses) gains after tax on available-for-sale securities	(347)	2,183	136	1,542
Less: Reclassification adjustment for the net (losses) gains realized during the period				
Net realized (losses) gains	(12)	295	(121)	226
Income tax benefit (expense) on net realized (losses) gains	3	(121)	48	(93)
Net realized (losses) gains after tax	(9)	174	(73)	133
Other comprehensive (loss) income on available-for-sale securities	(338)	2,009	209	1,409
Accretion of net unrealized holding gains on held-to-maturity securities transferred from available-for-sale securities	254	247	497	494
Related tax expense	(104)	(102)	(204)	(204)
Other comprehensive income on held-to-maturity securities	150	145	293	290
Total other comprehensive (loss) income	(188)	2,154	502	1,699
Total comprehensive income	$ 3,941	$ 4,175	$ 8,130	$ 5,922

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	(Unaudited) Six Months Ended June 30, 2015	2014
Cash flows from operating activities		
Net income	$ 7,628	$ 4,223
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of leasehold improvement	1,216	1,272
Change in fair value of mortgage servicing rights	513	630
Loan loss reserve release	(2,300)	(2,000)
Provision for deferred tax expense	4,206	2,335
Originations of loans held-for-sale	(114,718)	(52,057)
Proceeds from sales of loans held-for-sale	115,940	52,784
Net gain on sales of mortgage loans	(3,318)	(1,700)
Change in current income taxes receivable (payable)	27	(78)
Increase in cash surrender value of bank-owned life insurance	(637)	(724)
Change in accrued interest receivable and other assets	(1,899)	(4,399)
Change in accrued interest payable and other liabilities	(2,474)	(21,066)
Net premium amortization/discount (accretion) on securities	154	(950)
Securities losses (gains), net	121	(226)
Amortization of core deposit	-	1,023
Stock based compensation	344	82
Net gain on sale of other real estate owned	(337)	(409)
Provision for other real estate owned losses	2,697	1,261
Net cash provided by (used in) operating activities	7,163	(19,999)
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	28,292	14,606
Proceeds from sales of securities available-for-sale	56,121	163,107
Purchases of securities available-for-sale	(98,806)	(132,073)
Proceeds from maturities and calls including pay down of securities held-to-maturity	6,983	3,902
Purchases of securities held-to-maturity	-	(11,212)
Proceeds from sales of Federal Home Loan Bank stock	787	-
Net change in loans	(7,582)	(42,259)
Improvements in other real estate owned	-	(131)
Proceeds from sales of other real estate owned	4,673	10,927
Net purchases of premises and equipment	(577)	(509)
Net cash (used in) provided by investing activities	(10,109)	6,358
Cash flows from financing activities		
Net change in deposits	28,497	18,696

Net change in securities sold under repurchase agreements	11,379	15,573
Net change in other short-term borrowings	(25,000)	(5,000)
Redemption of preferred stock	(15,778)	(24,321)
Proceeds from the issuance of common stock	-	64,395
Dividends paid on preferred stock	(1,716)	(10,258)
Purchase of treasury stock	(117)	(46)
Net cash (used in) provided by financing activities	(2,735)	59,039
Net change in cash and cash equivalents	(5,681)	45,398
Cash and cash equivalents at beginning of period	44,197	47,660
Cash and cash equivalents at end of period	$ 38,516	$ 93,058

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows - Continued

(In thousands)

	(Unaudited) Six Months Ended June 30,	
Supplemental cash flow information	2015	2014
Income taxes paid	$ 130	$ -
Interest paid for deposits	1,993	3,027
Interest paid for borrowings	2,564	20,150
Non-cash transfer of loans to other real estate owned	7,015	9,343
Change in dividends accrued	(182)	(9,123)
Accretion on preferred stock discount	-	58

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in

Stockholders' Equity

(In thousands)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2013	$ 18,830	$ 72,942	$ 66,212	$ 92,549	$ (7,038)	$ (95,803)	$ 147,692
Net income				4,223			4,223
Other comprehensive gain, net of tax					1,699		1,699
Change in restricted stock	10		(10)				-
Tax effect from vesting of restricted stock			29				29
Stock based compensation			82				82
Purchase of treasury stock						(46)	(46)
Redemption of preferred stock		(25,669)		1,348			(24,321)
Common stock offering	15,525		48,870				64,395
Preferred stock accretion and declared dividends		58		(1,193)			(1,135)
Balance, June 30, 2014	$ 34,365	$ 47,331	$ 115,183	$ 96,927	$ (5,339)	$ (95,849)	$ 192,618
Balance, December 31, 2014	$ 34,365	$ 47,331	$ 115,332	$ 100,697	$ (7,713)	$ (95,849)	$ 194,163
Net income				7,628			7,628
Other comprehensive gain, net of tax					502		502
Change in restricted stock	58		(58)				-
			33				33

Tax effect from vesting of restricted stock							
Stock based compensation			344				344
Purchase of treasury stock						(117)	(117)
Redemption of preferred stock		(15,778)					(15,778)
Preferred stock accretion and declared dividends				(1,534)			(1,534)
Balance, June 30, 2015	$ 34,423	$ 31,553	$ 115,651	$ 106,791	$ (7,211)	$ (95,966)	$ 185,241

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data, unaudited)

Note 1 – Summary of Significant Accounting Policies

The accounting policies followed in the preparation of the interim consolidated financial statements are consistent with those used in the preparation of the annual financial information. The interim consolidated financial statements reflect all normal and recurring adjustments, that are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended June 30, 2015, are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. These interim consolidated financial statements are unaudited and should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the "Company") annual report on Form 10-K for the year ended December 31, 2014. Unless otherwise indicated, amounts in the tables contained in the notes to the consolidated financial statements are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with United States generally accepted accounting principles ("GAAP") and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the consolidated financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. ASU 2014-09 was to be effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. Early application is not permitted. The Company is assessing the impact of ASU 2014-09 on its accounting and disclosures. On April 1, 2015, the FASB voted to propose a delay in the effective date of ASU 2014-09. On April 29, 2015, FASB issued a proposed accounting standards update to defer the effective date of an additional year. The deferral of the effective date was approved on July 9, 2015, and will be effective for annual reporting periods beginning after December 15, 2017.

Note 2 – Securities

Investment Portfolio Management

Our investment portfolio serves the liquidity needs and income objectives of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio will also serve as income producing assets. The size and composition of the portfolio reflects liquidity needs, loan demand and interest income objectives.

Portfolio size and composition will be adjusted from time to time. While a significant portion of the portfolio consists of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. Securities available-for-sale are carried at fair value. Unrealized gains and losses, net of tax, on securities available-for-sale are reported as a separate component of equity. This balance sheet component changes as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

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Securities held-to-maturity are carried at amortized cost and the discount or premium created in the 2013 transfer from available-for-sale securities or at the time of purchase thereafter is accreted or amortized to the maturity or expected payoff date but not an earlier call. In accordance with GAAP, the Company has the positive intent and ability to hold the securities to maturity.

Nonmarketable equity investments include Federal Home Loan Bank of Chicago ("FHLBC") stock and Federal Reserve Bank of Chicago ("Reserve Bank") stock. FHLBC stock was recorded at $3.5 million at June 30, 2015, and $4.3 million at December 31, 2014. Reserve Bank stock was recorded at $4.8 million at June 30, 2015, and December 31, 2014. Our FHLBC stock is necessary to maintain access to FHLBC advances.

The following table summarizes the amortized cost and fair value of the securities portfolio at June 30, 2015, and December 31, 2014, and the corresponding amounts of gross unrealized gains and losses (in thousands):

June 30, 2015:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury	$ 1,519	$ 1	$ -	$ 1,520
U.S. government agencies	1,697	-	(102)	1,595
U.S. government agencies mortgage-backed	5,545	-	-	5,545
States and political subdivisions	13,053	368	(172)	13,249
Corporate bonds	31,376	-	(771)	30,605
Collateralized mortgage obligations	76,519	50	(1,575)	74,994
Asset-backed securities	181,625	220	(3,190)	178,655
Collateralized loan obligations	94,243	59	(629)	93,673
Total Securities Available-for-Sale	$ 405,577	$ 698	$ (6,439)	$ 399,836
Securities Held-to-Maturity				
U.S. government agency mortgage-backed	$ 36,995	$ 1,791	$ -	$ 38,786
Collateralized mortgage obligations	216,424	3,391	(634)	219,181
Total Securities Held-to-Maturity	$ 253,419	$ 5,182	$ (634)	$ 257,967

December 31, 2014:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury	$ 1,529	$ -	$ (2)	$ 1,527
U.S. government agencies	1,711	-	(87)	1,624
States and political subdivisions	21,682	432	(96)	22,018
Corporate bonds	31,243	309	(567)	30,985
Collateralized mortgage obligations	65,728	31	(2,132)	63,627

Asset-backed securities	175,565	199	(2,268)	173,496
Collateralized loan obligations	94,236	176	(2,203)	92,209
Total Securities Available-for-Sale	$ 391,694	$ 1,147	$ (7,355)	$ 385,486
Securities Held-to-Maturity				
U.S. government agency mortgage-backed	$ 37,125	$ 2,030	$ -	$ 39,155
Collateralized mortgage obligations	222,545	3,005	(1,439)	224,111
Total Securities Held-to-Maturity	$ 259,670	$ 5,035	$ (1,439)	$ 263,266

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The fair value, amortized cost and weighted average yield of debt securities at June 30, 2015, by contractual maturity, were as follows in the table below. Securities not due at a single maturity date are shown separately.

Securities Available-for-Sale	Amortized Cost	Weighted Average Yield	Fair Value
Due in one year or less	$ 2,141	1.63%	$ 2,159
Due after one year through five years	6,900	2.99%	7,073
Due after five years through ten years	33,501	2.43%	32,811
Due after ten years	5,103	3.28%	4,926
	47,645	2.56%	46,969
Mortgage-backed and collateralized mortgage obligations	82,064	1.44%	80,539
Asset-backed securities	181,625	1.22%	178,655
Collateralized loan obligations	94,243	2.87%	93,673
	$ 405,577	1.81%	$ 399,836
Securities Held-to-Maturity			
Mortgage-backed and collateralized mortgage obligations	$ 253,419	3.02%	$ 257,967

Securities with unrealized losses at June 30, 2015, and December 31, 2014, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (in thousands except for number of securities):

ne 30, 2015	Less than 12 months in an unrealized loss position			Greater than 12 months in an unrealized loss position			Total		
ecurities vailable-for-Sale	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value
.S. government gencies	-	$ -	$ -	1	$ 102	$ 1,595	1	$ 102	$ 1,595
ates and political bdivisions	2	37	1,841	1	135	1,720	3	172	3,561
orporate bonds	6	311	16,064	3	460	14,541	9	771	30,605
ollateralized ortgage bligations	6	335	44,131	4	1,240	19,400	10	1,575	63,531
sset-backed curities	7	2,046	98,917	5	1,144	61,397	12	3,190	160,31
ollateralized loan bligations	8	387	44,231	4	242	24,488	12	629	68,719
	29	$ 3,116	$ 205,184	18	$ 3,323	$ 123,141	47	$ 6,439	$ 328,32
ecurities eld-to-Maturity									

ollateralized ortgage bligations	6	$ 189	$ 31,761	4	$ 445	$ 46,400	10	$ 634	$ 78,161
	6	$ 189	$ 31,761	4	$ 445	$ 46,400	10	$ 634	$ 78,161

ember 31, 2014	Less than 12 months in an unrealized loss position			Greater than 12 months in an unrealized loss position			Total		
urities ilable-for-Sale	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Valu
. Treasury	1	$ 2	$ 1,527	-	$ -	$ -	1	$ 2	$ 1,527
. government ncies	-	-	-	1	87	1,624	1	87	1,624
es and political divisions	4	96	4,896	-	-	-	4	96	4,896
porate bonds	4	486	15,246	1	81	1,921	5	567	17,16
lateralized rtgage gations	5	900	38,284	3	1,232	21,604	8	2,132	59,88
et-backed urities	9	1,077	99,286	3	1,191	43,662	12	2,268	142,9
lateralized loan gations	12	2,203	82,387	-	-	-	12	2,203	82,38
	35	$ 4,764	$ 241,626	8	$ 2,591	$ 68,811	43	$ 7,355	$ 310,4
urities d-to-Maturity lateralized rtgage gations	7	$ 457	$ 49,302	4	$ 982	$ 46,283	11	1,439	95,58
	7	$ 457	$ 49,302	4	$ 982	$ 46,283	11	$ 1,439	$ 95,58

Recognition of other-than-temporary impairment was not necessary in the three and six months ending June 30, 2015, or the year ended December 31, 2014. The changes in fair value related primarily to interest rate fluctuations. Our review of other-than-temporary impairment determined that there was no credit quality deterioration.

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Note 3 – Loans

Major classifications of loans were as follows:

	June 30, 2015	December 31, 2014
Commercial	$ 123,372	$ 119,158
Real estate - commercial	612,379	600,629
Real estate - construction	32,157	44,795
Real estate - residential	365,989	370,191
Consumer	3,854	3,504
Overdraft	408	649
Lease financing receivables	8,571	8,038
Other	11,391	11,630
	1,158,121	1,158,594
Net deferred loan fees	762	738
	$ 1,158,883	$ 1,159,332

It is the policy of the Company to review each prospective credit in order to determine if an adequate level of security or collateral was obtained prior to making a loan. The type of collateral, when required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to lending laws, the Company's lending standards and credit monitoring procedures. The Bank generally makes loans solely within its market area. There are no significant concentrations of loans where the customers' ability to honor loan terms is dependent upon a single economic sector, although the real estate related categories listed above represent 87.2% and 87.6% of the portfolio at June 30, 2015, and December 31, 2014, respectively.

Aged analysis of past due loans by class of loans were as follows:

.

June 30, 2015	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing
Commercial	$ -	$ -	$ -	$ -	$ 131,343	$ 600	$ 131,943	$ -
Real estate - commercial								

Owner occupied general purpose	-	-	-	-	127,516	1,915	129,431	-
Owner occupied special purpose	-	-	-	-	173,200	790	173,990	-
Non-owner occupied general purpose	270	-	-	270	156,771	730	157,771	-
Non-owner occupied special purpose	4,021	-	-	4,021	92,865	-	96,886	-
Retail properties	-	-	-	-	41,016	-	41,016	-
Farm	-	-	-	-	12,013	1,272	13,285	-
Real estate - construction								
Homebuilder	-	41	-	41	2,654	-	2,695	-
Land	-	-	-	-	2,573	-	2,573	-
Commercial speculative	-	-	-	-	2,286	3,472	5,758	-
All other	-	-	-	-	20,651	480	21,131	-
Real estate - residential								
Investor	168	-	-	168	138,474	792	139,434	-
Owner occupied	31	297	-	328	110,140	6,273	116,741	-
Revolving and junior liens	418	-	-	418	106,744	2,652	109,814	-
Consumer	50	-	-	50	3,804	-	3,854	-
All other1	-	-	-	-	12,561	-	12,561	-
	$ 4,958	$ 338	$ -	$ 5,296	$ 1,134,611	$ 18,976	$ 1,158,883	$ -

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December 31, 2014	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing
Commercial	$ 38	$ -	$ -	$ 38	$ 125,658	$ 1,500	$ 127,196	$ -
Real estate - commercial								
Owner occupied general purpose	699	-	-	699	126,029	5,937	132,665	-
Owner occupied special purpose	-	-	-	-	167,874	1,441	169,315	-
Non-owner occupied general purpose	-	-	-	-	153,328	4,907	158,235	-
Non-owner occupied special purpose	-	-	-	-	87,054	1,423	88,477	-
Retail properties	-	-	-	-	37,780	-	37,780	-
Farm	-	-	-	-	14,157	-	14,157	-
Real estate - construction								
Homebuilder	-	-	-	-	3,204	-	3,204	-
Land	-	-	-	-	1,658	-	1,658	-
Commercial speculative	-	-	-	-	13,431	-	13,431	-
All other	71	29	-	100	25,841	561	26,502	-
Real estate - residential								
Investor	-	-	-	-	135,273	1,942	137,215	-
Owner occupied	1,076	914	-	1,990	107,727	6,711	116,428	-
Revolving and junior liens	94	44	-	138	113,906	2,504	116,548	-
Consumer	-	-	-	-	3,504	-	3,504	-
All other1	-	-	-	-	13,017	-	13,017	-
	$ 1,978	$ 987	$ -	$ 2,965	$ 1,129,441	$ 26,926	$ 1,159,332	$ -

1. The “All other” class includes overdrafts and net deferred costs.

Credit Quality Indicators:

The Company categorizes loans into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, historical payment experience, and current economic trends. This analysis includes loans with outstanding balances or commitments greater than $50,000 and excludes homogeneous loans such as home equity lines of credit and residential mortgages. Loans with a classified risk rating are reviewed quarterly regardless of size or loan type. The Company uses the following definitions for classified risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

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

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as 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.

Credits that are not covered by the definitions above are pass credits, which are not considered to be adversely rated.

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Credit Quality Indicators by class of loans were as follows:

June 30, 2015	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	$ 124,831	$ 6,414	$ 698	$ -	$ 131,943
Real estate - commercial					
Owner occupied general purpose	124,737	2,779	1,915	-	129,431
Owner occupied special purpose	171,862	1,338	790	-	173,990
Non-owner occupied general purpose	150,971	5,800	1,000	-	157,771
Non-owner occupied special purpose	92,865	4,021	-	-	96,886
Retail Properties	39,506	1,510	-	-	41,016
Farm	11,484	529	1,272	-	13,285
Real estate - construction					
Homebuilder	2,695	-	-	-	2,695
Land	2,573	-	-	-	2,573
Commercial speculative	2,286	-	3,472	-	5,758
All other	20,651	-	480	-	21,131
Real estate - residential					
Investor	138,459	-	975	-	139,434
Owner occupied	109,690	-	7,051	-	116,741
Revolving and junior liens	106,334	188	3,292	-	109,814
Consumer	3,853	-	1	-	3,854
All other	12,561	-	-	-	12,561
Total	$ 1,115,358	$ 22,579	$ 20,946	$ -	$ 1,158,883

December 31, 2014	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	$ 118,845	$ 3,948	$ 4,403	$ -	$ 127,196
Real estate - commercial					
Owner occupied general purpose	124,936	253	7,476	-	132,665
Owner occupied special purpose	154,225	11,607	3,483	-	169,315
Non-owner occupied general purpose	148,212	3,235	6,788	-	158,235
Non-owner occupied special purpose	78,957	8,097	1,423	-	88,477
Retail Properties	36,779	1,001	-	-	37,780
Farm	14,157	-	-	-	14,157
Real estate - construction					
Homebuilder	3,204	-	-	-	3,204
Land	1,658	-	-	-	1,658
Commercial speculative	9,947	-	3,484	-	13,431
All other	25,941	-	561	-	26,502
Real estate - residential					
Investor	134,952	-	2,263	-	137,215
Owner occupied	109,085	-	7,343	-	116,428
Revolving and junior liens	112,647	188	3,713	-	116,548

Consumer	3,503	-	1	-	3,504
All other	13,017	-	-	-	13,017
Total	$ 1,090,065	$ 28,329	$ 40,938	$ -	$ 1,159,332

1 The substandard credit quality indicator includes both potential problem loans that are currently performing and nonperforming loans

The Company did not have any repossessed assets reported in other assets as of June 30, 2015, and December 31, 2014. The Company had $3.2 million and $3.5 million residential assets in the process of foreclosure as of June 30, 2015, and December 31, 2014, respectively.

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Impaired loans by class of loans were as follows:

	As of June 30, 2015			Six Months Ended June 30, 2015	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ 600	$ 776	$ -	$ 1,050	$ -
Commercial real estate					
Owner occupied general purpose	3,079	3,769	-	5,102	39
Owner occupied special purpose	1,141	1,236	-	1,470	12
Non-owner occupied general purpose	729	1,162	-	2,780	-
Non-owner occupied special purpose	-	-	-	711	-
Retail properties	-	-	-	-	-
Farm	1,272	1,338	-	636	-
Construction					
Homebuilder	-	-	-	896	-
Land	-	-	-	-	-
Commercial speculative	3,472	3,472	-	1,736	-
All other	229	287	-	260	-
Residential					
Investor	1,519	1,864	-	2,057	19
Owner occupied	11,435	12,894	-	11,427	90
Revolving and junior liens	2,437	3,671	-	2,337	2
Consumer	-	-	-	-	-
Total impaired loans with no recorded allowance	25,913	30,469	-	30,462	162
With an allowance recorded					
Commercial	-	-	-	-	-
Commercial real estate					
Owner occupied general purpose	-	-	-	-	-
Owner occupied special purpose	-	-	-	-	-
Non-owner occupied general purpose	-	-	-	38	-
Non-owner occupied special purpose	177	293	-	89	9
Retail properties	-	-	-	-	-
Farm	-	-	-	-	-
Construction					
Homebuilder	-	-	-	-	-
Land	-	-	-	-	-
Commercial speculative	-	-	-	-	-
All other	251	294	27	260	-
Residential					
Investor	-	-	-	68	-
Owner occupied	13	56	22	18	-
Revolving and junior liens	462	505	89	416	2

Consumer	-	-	-	-	-
Total impaired loans with a recorded allowance	903	1,148	138	889	11
Total impaired loans	$ 26,816	$ 31,617	$ 138	$ 31,351	$ 173

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Impaired loans by class of loans were as follows:

	As of December 31, 2014			Six Months Ended June 30, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ 1,500	$ 2,114	$ -	$ 24	$ -
Commercial real estate					
Owner occupied general purpose	7,125	7,870	-	2,527	2
Owner occupied special purpose	1,798	1,941	-	3,151	-
Non-owner occupied general purpose	4,831	5,653	-	5,964	30
Non-owner occupied special purpose	1,423	1,930	-	600	-
Retail properties	-	-	-	3,078	-
Farm	-	-	-	-	-
Construction					
Homebuilder	1,791	1,791	-	1,904	47
Land	-	-	-	209	-
Commercial speculative	-	-	-	369	-
All other	291	323	-	156	-
Residential					
Investor	2,595	3,024	-	4,294	1
Owner occupied	11,419	12,816	-	9,483	88
Revolving and junior liens	2,238	3,541	-	1,851	3
Consumer	-	-	-	-	-
Total impaired loans with no recorded allowance	35,011	41,003	-	33,610	171
With an allowance recorded					
Commercial	-	-	-	-	-
Commercial real estate					
Owner occupied general purpose	-	-	-	609	-
Owner occupied special purpose	-	-	-	2,450	-
Non-owner occupied general purpose	76	76	21	745	-
Non-owner occupied special purpose	-	-	-	-	-
Retail properties	-	-	-	-	-
Farm	-	-	-	-	-
Construction					
Homebuilder	-	-	-	84	-
Land	-	-	-	-	-
Commercial speculative	-	-	-	587	-
All other	270	306	98	363	-
Residential					
Investor	135	145	24	960	-
Owner occupied	23	65	38	1,028	7
Revolving and junior liens	371	405	97	914	-

Consumer	-	-	-	-	-
Total impaired loans with a recorded allowance	875	997	278	7,740	7
Total impaired loans	$ 35,886	$ 42,000	$ 278	$ 41,350	$ 178

Troubled debt restructurings ("TDRs") are loans for which the contractual terms have been modified and both of these conditions exist: (1) there is a concession to the borrower and (2) the borrower is experiencing financial difficulties. Loans are restructured on a case-by-case basis during the loan collection process with modifications generally initiated at the request of the borrower. These modifications may include reduction in interest rates, extension of term, deferrals of principal, and other modifications. The Bank participates in the U.S. Department of the Treasury's (the "Treasury") Home Affordable Modification Program ("HAMP") which gives qualifying homeowners an opportunity to refinance into more affordable monthly payments.

The specific allocation of the allowance for loan losses on a TDR is determined by either discounting the modified cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance (i.e. specific reserve) as a component of the allowance for loan losses or charges off the impaired balance if it determines

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that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. The allowance for loan losses also includes an allowance based on a loss migration analysis for each loan category on loans that are not individually evaluated for specific impairment. All loans charged-off, including TDRs charged-off, are factored into this calculation by portfolio segment.

TDRs that were modified during the period are as follows:

	TDR Modifications Three Months Ended June 30, 2015			TDR Modifications Six Months Ended June 30, 2015		
	# of contracts	Pre-modification recorded investment	Post-modification recorded investment	# of contracts	Pre-modification recorded investment	Post-modification recorded investment
Troubled debt restructurings						
Real estate - commercial						
Bifurcate1	-	$ -	$ -	1	$ 300	$ 177
Real estate - residential						
Owner occupied						
Other2	1	46	45	3	404	414
Revolving and junior liens						
HAMP3	4	233	233	4	233	233
	5	$ 279	$ 278	8	$ 937	$ 824

	TDR Modifications Three Months Ended June 30, 2014			TDR Modifications Six Months Ended June 30, 2014		
	# of contracts	Pre-modification recorded investment	Post-modification recorded investment	# of contracts	Pre-modification recorded investment	Post-modification recorded investment
Troubled debt restructurings						
Real estate - commercial						
Other2	-	$ -	$ -	2	$ 1,320	$ 1,159
Real estate - residential						
Owner occupied						
HAMP3	-	-	-	1	102	75

Deferral4	1	107	107	2	344	231
	1	$ 107	$ 107	5	$ 1,766	$ 1,465

1 Bifurcate: Refers to an "A/B" restructure separated into two notes, charging off the entire B portion of the note.

2 Other: Change of terms from bankruptcy court

3 HAMP: Home Affordable Modification Program

4 Deferral: Refers to the deferral of principal

TDRs are classified as being in default on a case-by-case basis when they fail to be in compliance with the modified terms. There was no TDR default activity for the three and six months ended June 30, 2015, and June 30, 2014, that was restructured within the 12 month period prior to default.

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Note 4 – Allowance for Loan Losses

Changes in the allowance for loan losses by segment of loans based on method of impairment for three and six months ending June 30, 2015, were as follows:

Allowance for loan losses:	Commercial	Real Estate Commercial	Real Estate Construction	Real Estate Residential	Consumer	Unallocated	Total
Three months ended June 30, 2015							
Beginning balance	$ 1,512	$ 14,033	$ 1,272	$ 1,917	$ 1,417	$ 1,030	$ 21,181
Charge-offs	858	1,031	1	159	93	-	2,142
Recoveries	83	965	61	403	70	-	1,582
(Release) provision	895	(3,766)	(670)	(301)	(145)	1,687	(2,300)
Ending balance	$ 1,632	$ 10,201	$ 662	$ 1,860	$ 1,249	$ 2,717	$ 18,321
Six months ended June 30, 2015							
Beginning balance	$ 1,644	$ 12,577	$ 1,475	$ 1,981	$ 1,454	$ 2,506	$ 21,637
Charge-offs	890	1,526	2	777	211	-	3,406
Recoveries	224	1,295	66	627	178	-	2,390
(Release) provision	654	(2,145)	(877)	29	(172)	211	(2,300)
Ending balance	$ 1,632	$ 10,201	$ 662	$ 1,860	$ 1,249	$ 2,717	$ 18,321
Ending balance: Individually evaluated for impairment	$ -	$ -	$ 27	$ 111	$ -	$ -	$ 138
Ending balance: Collectively evaluated for impairment	$ 1,632	$ 10,201	$ 635	$ 1,749	$ 1,249	$ 2,717	$ 18,183
Loans:							
Ending balance	$ 131,943	$ 612,379	$ 32,157	$ 365,989	$ 3,854	$ 12,561	$ 1,158,883
Ending balance: Individually evaluated for impairment	$ 600	$ 6,398	$ 3,952	$ 15,866	$ -	$ -	$ 26,816
Ending balance: Collectively	$ 131,343	$ 605,981	$ 28,205	$ 350,123	$ 3,854	$ 12,561	$ 1,132,067

evaluated for impairment

Changes in the allowance for loan losses by segment of loans based on method of impairment for three and six months ending June 30, 2014, were as follows:

Allowance for loan losses:	Commercial	Real Estate Commercial	Real Estate Construction	Real Estate Residential	Consumer	Unallocated	Total
Three months ended June 30, 2014							
Beginning balance	$ 2,326	$ 14,066	$ 1,998	$ 2,268	$ 1,495	$ 3,323	$ 25,476
Charge-offs	3	760	105	978	139	-	1,985
Recoveries	35	87	467	689	87	-	1,365
(Release) provision	(367)	(165)	(606)	394	21	(277)	(1,000)
Ending balance	$ 1,991	$ 13,228	$ 1,754	$ 2,373	$ 1,464	$ 3,046	$ 23,856
Six months ended June 30, 2014							
Beginning balance	$ 2,250	$ 16,763	$ 1,980	$ 2,837	$ 1,439	$ 2,012	$ 27,281
Charge-offs	7	1,089	173	1,827	249	-	3,345
Recoveries	50	228	504	939	199	-	1,920
(Release) provision	(302)	(2,674)	(557)	424	75	1,034	(2,000)
Ending balance	$ 1,991	$ 13,228	$ 1,754	$ 2,373	$ 1,464	$ 3,046	$ 23,856
Ending balance: Individually evaluated for impairment	$ -	$ 803	$ 135	$ 502	$ -	$ -	$ 1,440
Ending balance: Collectively evaluated for impairment	$ 1,991	$ 12,425	$ 1,619	$ 1,871	$ 1,464	$ 3,046	$ 22,416
Loans:							
Ending balance	$ 115,474	$ 599,796	$ 32,265	$ 368,592	$ 3,064	$ 13,556	$ 1,132,747
Ending balance: Individually evaluated for impairment	$ 21	$ 17,131	$ 2,598	$ 16,379	$ -	$ -	$ 36,129
Ending balance: Collectively	$ 115,453	$ 582,665	$ 29,667	$ 352,213	$ 3,064	$ 13,556	$ 1,096,618

evaluated for
impairment

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Note 5 – Other Real Estate Owned

Details related to the activity in the other real estate owned (“OREO”) portfolio, net of valuation reserve, for the periods presented are itemized in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
Other real estate owned	2015	2014	2015	2014
Balance at beginning of period	$ 35,461	$ 40,220	$ 31,982	$ 41,537
Property additions	907	4,655	7,015	9,343
Property improvements	-	131	-	131
Less:				
Property disposals, net of gains/losses	2,316	4,949	4,336	10,518
Period valuation adjustments	2,088	825	2,697	1,261
Balance at end of period	$ 31,964	$ 39,232	$ 31,964	$ 39,232

Activity in the valuation allowance was as follows:

	2015	2014	2015	2014
Balance at beginning of period	$ 19,456	$ 19,484	$ 19,229	$ 22,284
Provision for unrealized losses	2,088	825	2,697	1,261
Reductions taken on sales	(1,568)	(2,436)	(1,950)	(5,083)
Other adjustments	93	-	93	(589)
Balance at end of period	$ 20,069	$ 17,873	$ 20,069	$ 17,873

Expenses related to OREO, net of lease revenue includes:

	2015	2014	2015	2014
Gain on sales, net	$ (242)	$ (23)	$ (337)	$ (409)
Provision for unrealized losses	2,088	825	2,697	1,261
Operating expenses	749	1,011	1,750	2,248
Less:				
Lease revenue	207	163	370	442
	$ 2,388	$ 1,650	$ 3,740	$ 2,658

Note 6 – Deposits

Major classifications of deposits were as follows:

	June 30, 2015	December 31, 2014
Noninterest bearing demand	$ 432,773	$ 400,447
Savings	251,307	239,845
NOW accounts	330,897	328,641
Money market accounts	295,383	296,617
Certificates of deposit of less than $100,000	242,870	251,108
Certificates of deposit of $100,000 through $250,000	109,204	112,515
Certificates of deposit of more than $250,000	51,118	55,882
	$ 1,713,552	$ 1,685,055

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Note 7 – Borrowings

The following table is a summary of borrowings as of June 30, 2015, and December 31, 2014. Junior subordinated debentures are discussed in detail in Note 8:

	June 30, 2015	December 31, 2014
Securities sold under repurchase agreements	$ 32,415	$ 21,036
FHLBC advances	20,000	45,000
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
	$ 156,293	$ 169,914

The Company enters into deposit sweep transactions where the transaction amounts are secured by pledged securities. These transactions consistently mature overnight from the transaction date and are governed by sweep repurchase agreements. All sweep repurchase agreements are treated as financings secured by U.S. government agencies and collateralized mortgage-backed securities and have a carrying amount of $32.4 million at June 30, 2015, and $21.0 million at December 31, 2014. The fair value of the pledged collateral was $47.1 million at June 30, 2015 and $43.4 million at December 31, 2014. At June 30, 2015, there were no customers with secured balances exceeding 10% of stockholders' equity.

The Company's borrowings at the FHLBC require the Bank to be a member and invest in the stock of the FHLBC. Total borrowings are generally limited to the lower of 35% of total assets or 60% of the book value of certain mortgage loans. As of June 30, 2015, the Bank had taken an advance of $20.0 million on the FHLBC stock valued at $3.5 million, collateralized by securities with a fair value of $74.3 million and loans with a principal balance of $46.8 million, which carry a FHLBC calculated combined collateral value of $121.5 million. The Company has excess collateral of $100.2 million available to secure borrowings. At December 31, 2014, the Bank had an advance of $45.0 million on FBLBC stock valued at $4.3 million.

One of the Company's most significant borrowing relationships continued to be the $45.5 million credit facility with a correspondent bank. That credit began in January 2008 and was originally composed of a $30.5 million senior debt facility, which included $500,000 in term debt, and $45.0 million of subordinated debt. The subordinated debt and the term debt portion of the senior debt facility mature on March 31, 2018. The interest rate on the senior debt facility resets quarterly and at the Company's option, is based on, either the lender's prime rate or three-month LIBOR plus 90 basis points. The interest rate on the subordinated debt resets quarterly, and is equal to three-month LIBOR plus 150 basis points. The Company had no principal outstanding balance on the senior line of credit portion of the senior debt facility when it matured and was terminated. The Company had $500,000 in principal outstanding in term debt and $45.0 million in principal outstanding in subordinated debt at the end of both June 30, 2015, and December 31, 2014. The term debt is secured by all of the outstanding capital stock of the Bank. The Company has made all required interest payments on the outstanding principal balance on a timely basis.

The credit facility agreement contains usual and customary provisions regarding acceleration of the senior debt upon the occurrence of an event of default by the Company under the senior debt agreement. The senior debt agreement also contains certain customary representations and warranties, and financial covenants. At June 30, 2015, and December 31, 2014, the Company was in compliance with all covenants contained within the credit agreement.

Note 8 – Junior Subordinated Debentures

The Company completed the sale of $27.5 million of cumulative trust preferred securities by its unconsolidated subsidiary, Old Second Capital Trust I in June 2003. An additional $4.1 million of cumulative trust preferred securities were sold in July 2003. The trust preferred securities may remain outstanding for a 30-year term but, subject to regulatory approval, can be called in whole or in part by the Company after June 30, 2008. When not in deferral, distributions on the securities are payable quarterly at an annual rate of 7.80%. The Company issued a new $32.6 million subordinated debenture to Old Second Capital Trust I in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

The Company issued an additional $25.0 million of cumulative trust preferred securities through a private placement completed by an additional, unconsolidated subsidiary, Old Second Capital Trust II, in April 2007. These trust preferred securities also mature in 30 years, but subject to the aforementioned regulatory approval, can be called in whole or in part on a quarterly basis commencing June 15, 2017. The quarterly cash distributions on the securities are fixed at 6.77% through June 15, 2017, and float at 150 basis points over three-month LIBOR thereafter. The Company issued a new $25.8 million subordinated debenture to Old Second Capital Trust II in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

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Both of the debentures issued by the Company are disclosed on the Consolidated Balance Sheet as junior subordinated debentures and the related interest expense for each issuance is included in the Consolidated Statements of Income. As of June 30, 2015, the Company is current on the payments due on these securities.

Note 9 – Equity Compensation Plans

There are stock-based awards outstanding under the Company's 2008 Equity Incentive Plan (the "2008 Plan") and the Company's 2014 Equity Incentive Plan (the "2014 Plan," and together with the 2008 Plan, the "Plans"). The 2014 Plan was approved at the 2014 annual meeting of stockholders. Following approval of the 2014 Plan, no further awards will be granted under the 2008 Plan or any other Company equity compensation plan. A maximum of 375,000 shares may be issued under the 2014 Plan. The Plan authorizes the granting of qualified stock options, non-qualified stock options, restricted stock, restricted stock units, and stock appreciation rights. Awards may be granted to selected directors and officers or employees under the 2014 Plan at the discretion of the Compensation Committee of the Company's Board of Directors. As of June 30, 2015, 125,000 shares remained available for issuance under the 2014 Plan.

Total compensation cost that has been charged for the Plans was $344,000 in the first half of 2015.

There were no stock options granted in the second quarter of 2015 and 2014 or for the first half of 2015 and 2014. All stock options are granted for a term of ten years. There were no stock options exercised during the second quarter of 2015 and 2014 or for the first half of 2015 and 2014. There is no unrecognized compensation cost related to unvested stock options as all stock options of the Company's common stock have vested.

A summary of stock option activity in the Plans for the six months ending June 30, 2015, is as follows:

	Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Beginning outstanding	229,000	$ 28.28		
Canceled	-	-		
Expired	-	-		
Ending outstanding	229,000	$ 28.28	1.7	$ -
Exercisable at end of period	229,000	$ 28.28	1.7	$ -

Generally, restricted stock and restricted stock units granted under the Plans vest three years from the grant date, but the Compensation Committee of the Company's Board of Directors has discretionary authority to change some terms including the amount of time until the vest date.

Awards under the 2008 Plan will become fully vested upon a merger or change in control of the Company. Under the 2014 Plan, upon a change in control of the Company, if (i) the 2014 Plan is not an obligation of the successor entity following the change in control, or (ii) the 2014 Plan is an obligation of the successor entity following the change in control and the participant incurs an involuntary termination, then the stock options, stock appreciation rights, stock awards and cash incentive awards under the 2014 Plan will become fully exercisable and vested. Performance-based awards generally will vest based upon the level of achievement of the applicable performance measures through the change in control.

The Company granted restricted stock under its equity compensation plans beginning in 2005 and it began granting restricted stock units in February 2009. Restricted stock awards under the Plans generally entitle holders to voting and dividend rights upon grant and are subject to forfeiture until certain restrictions have lapsed including employment for a specific period. Restricted stock units under the Plans are also subject to forfeiture until certain restrictions have lapsed including employment for a specific period, and generally entitle holders to receive dividend equivalents during the restricted period but do not entitle holders to voting rights until the restricted period ends and shares are transferred in connection with the units.

There were 101,500 restricted awards issued under the Plans during the six months ending June 30, 2015. There were 184,500 restricted awards issued during the six months ending June 30, 2014. Compensation expense is recognized over the vesting period of the restricted award based on the market value of the award on the issue date.

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A summary of changes in the Company's unvested restricted awards for the six months ending June 30, 2015, is as follows:

	June 30, 2015	
	Restricted Stock Shares and Units	Weighted Average Grant Date Fair Value
Nonvested at January 1	325,000	$ 4.15
Granted	101,500	5.38
Vested	(57,500)	4.04
Forfeited	(16,000)	4.43
Nonvested at June 30	353,000	$ 4.51

Total unrecognized compensation cost of restricted awards was $989,000 as of June 30, 2015, which is expected to be recognized over a weighted-average period of 2.35 years. Total unrecognized compensation cost of restricted awards was $1.1 million as of June 30, 2014, which was expected to be recognized over a weighted-average period of 2.71 years.

Note 10 – Earnings Per Share

The earnings per share – both basic and diluted – are included below as of June 30 (in thousands except for share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Basic earnings per share:				
Weighted-average common shares outstanding	29,475,682	28,181,519	29,473,004	21,090,665
Weighted-average common shares less stock based awards	29,475,682	28,181,519	29,473,004	21,086,438
Weighted-average common shares stock based awards	-	179,874	-	174,522
Net income	$ 4,129	$ 2,021	$ 7,628	$ 4,223
Gain on preferred stock redemption	-	(1,348)	-	(1,348)
Preferred stock dividends and accretion, net of dividends waived	710	(4,085)	1,534	(2,513)
Net earnings available to common stockholders	3,419	7,454	6,094	8,084
Basic earnings per share common undistributed earnings	N/A	0.26	N/A	0.38

Basic earnings per share	0.12	0.26	0.21	0.38
Diluted earnings per share:				
Weighted-average common shares outstanding	29,475,682	28,181,519	29,473,004	21,090,665
Dilutive effect of nonvested restricted awards1	271,571	179,874	239,948	170,295
Diluted average common shares outstanding	29,747,253	28,361,393	29,712,952	21,260,960
Net earnings available to common stockholders	$ 3,419	$ 7,454	$ 6,094	$ 8,084
Diluted earnings per share	$ 0.12	$ 0.26	$ 0.21	$ 0.38
Number of antidilutive options and warrants excluded from the diluted earnings per share calculation	1,044,339	1,140,839	1,044,339	1,140,839

1 Includes the common stock equivalents for restricted share rights that are dilutive.

The above earnings per share calculation did not include a warrant for 815,339 shares of common stock, at an exercise price of $13.43,that was outstanding as of June 30, 2015, and June 30, 2014 because the warrant was anti-dilutive. Of note, the warrant was sold at auction by the Treasury in June 2013 to a third party investor.

The Company completed the redemption of 25,669 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series B (the “Series B Stock”) in the second quarter of 2014. As previously disclosed, the Company completed a public offering of 15,525,000 shares of common stock in April of 2014. Net proceeds of over $64.0 million were used to pay the accrued but unpaid interest on the Company’s trust preferred securities or junior subordinated debentures discussed in Note 8, the accumulated but unpaid dividends on the Series B Stock and to complete the 2014 redemption of the Series B Stock. The amount remaining after the completion of these transactions was retained at the Company for use in addressing general corporate matters. The redemption price for such Series B Stock was 94.75% of the liquidation value of the shares and the holders of the redeemed shares agreed to forebear payment of dividends due and waived any rights to such dividend upon redemption. The Company redeemed all shares of Series B Stock held by directors of the Company on the same terms.

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On January 31, 2015, the Company redeemed 15,778 shares of its Series B Stock at a redemption price equal to the stated liquidation value of $1,000 per share, together with accrued and unpaid dividends accumulated to, but excluding, the redemption date. As of December 30, 2014, there were 47,331 shares of the Series B Stock outstanding, and redeeming one-third of the Series B Stock resulted in the redemption of 15,778 shares of Series B Stock. The redemption was successfully completed in the first quarter. As of June 30, 2015, 31,553 shares of the Series B Stock remained outstanding.

In July 2015, the Company announced that it would redeem the remaining 31,553 outstanding shares of Series B Stock on August 14, 2015 at the redemption price, equal to the stated liquidation value of $1,000 per share, together with any accrued and unpaid dividends accumulated to, but excluding, the redemption date. Please see the Capital section of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations capital section for further information on this topic.

Note 11 – Regulatory & Capital Matters

The Bank is subject to the risk-based capital regulatory guidelines, which include the methodology for calculating the risk-weighted Bank assets, developed by the Office of the Comptroller of the Currency (the "OCC") and the other bank regulatory agencies. In connection with the current economic environment, the Bank's current level of nonperforming assets and the risk-based capital guidelines, the Bank's board of directors has determined that the Bank should maintain a Tier 1 leverage capital ratio at or above eight percent (8%) and a total risk-based capital ratio at or above twelve percent (12%). At June 30, 2015, the Bank exceeded those thresholds.

At June 30, 2015, the Bank's Tier 1 capital leverage ratio was 12.33%, up 31 basis points from December 31, 2014, and well above the 8.00% objective. The Bank's total capital ratio was 18.68%, down 5 basis points from December 31, 2014, and also well above the objective of 12.00%.

Bank holding companies are required to maintain minimum levels of capital in accordance with capital guidelines implemented by the Board of Governors of the Federal Reserve System. The general bank and holding company capital adequacy guidelines are shown in the accompanying table, as are the capital ratios of the Company and the Bank, as of June 30, 2015, and December 31, 2014.

In July 2013, the U.S. federal banking authorities issued final rules (the "Basel III Rules") establishing more stringent regulatory capital requirements for U.S. banking institutions, which went into effect on January 1, 2015. A detailed discussion of the Basel III Rules is included in Part I, Item 1 of the Company's Form 10-K for the year ended December 31, 2014, under the heading "Supervision and Regulation."

At June 30, 2015, the Company, on a consolidated basis, exceeded the minimum thresholds to be considered “adequately capitalized” under current regulatory defined capital ratios. For all periods prior to 2015, all capital ratios displayed were calculated without giving effect to the final Basel III capital rules.

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Capital levels and industry defined regulatory minimum required levels:

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized 1	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2015						
Common equity tier 1 capital to risk weighted assets						
Consolidated	$ 141,573	9.78 %	$ 65,141	4.50%	N/A	N/A
Old Second Bank	252,436	17.42	65,210	4.50	$ 94,193	6.50 %
Total capital to risk weighted assets						
Consolidated	246,680	17.04	115,812	8.00	N/A	N/A
Old Second Bank	270,662	18.68	115,915	8.00	144,894	10.00
Tier 1 capital to risk weighted assets						
Consolidated	204,856	14.15	86,865	6.00	N/A	N/A
Old Second Bank	252,436	17.42	86,947	6.00	115,929	8.00
Tier 1 capital to average assets						
Consolidated	204,856	10.02	81,779	4.00	N/A	N/A
Old Second Bank	252,436	12.33	81,893	4.00	102,367	5.00
December 31, 2014						
Total capital to risk weighted assets						
Consolidated	$ 240,566	17.68%	$ 108,853	8.00%	N/A	N/A
Old Second Bank	254,897	18.73	108,872	8.00	$ 136,090	10.00 %
Tier 1 capital to risk weighted assets						
Consolidated	196,499	14.44	54,432	4.00	N/A	N/A
Old Second Bank	237,828	17.47	54,454	4.00	81,681	6.00
Tier 1 capital to average assets						
Consolidated	196,499	9.93	79,154	4.00	N/A	N/A
Old Second Bank	237,828	12.02	79,144	4.00	98,930	5.00

1 The Bank exceeded the general minimum regulatory requirements to be considered “well capitalized”.

The Company’s credit facility with a correspondent bank includes $45.0 million in subordinated debt. That debt obligation qualifies at 40% and 60% of the original amount for Tier 2 regulatory capital at June 30, 2015 and December 31, 2014, respectively. In addition, the trust preferred securities continue to qualify as Tier 1 regulatory capital, and the Company treats the maximum amount of this security type allowable under regulatory guidelines as Tier 1 capital. At June 30, 2015 $51.2 million and $5.4 million of the trust preferred proceeds qualified as Tier 1 regulatory capital and Tier 2 regulatory capital, respectively. All $56.6 million of the trust preferred proceeds qualified as Tier 1 regulatory capital as of December 31, 2014. All of the Series B Stock qualified as Tier 1 regulatory capital as of June 30, 2015, and December 31, 2014.

Dividend Restrictions

In addition to the above requirements, banking regulations and capital guidelines generally limit the amount of dividends that may be paid by a bank without prior regulatory approval. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's profits, combined with the retained profit of the previous two years, subject to the capital requirements described above. Pursuant to the Basel III rules that came into effect January 1, 2015, the Bank must keep a buffer of 0.625% for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter of Common Equity Tier 1 minimum requirement in order to avoid additional limitations on capital distributions. The Bank has the ability and the authority to pay dividends to the Company to pay debt and to meet preferred dividend requirements.

As discussed in Note 8, as of June 30, 2015, the Company had $58.4 million of junior subordinated debentures held by two statutory business trusts that it controls. The Company has the right to defer interest payments on the debentures for a period of up to 20 consecutive quarters, and elected to begin such a deferral in August 2010. However, all deferred interest must be paid before the Company may pay dividends on its common stock. In the second quarter of 2014, the Company terminated the deferral period and paid all accumulated and unpaid interest on the junior subordinated debentures which totaled $19.7 million. The Company is currently paying interest as it comes due.

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Note 12 – Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy established by the Company also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs that may be used to measure fair value are:

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

Level 2: Significant observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

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

Transfers between levels are deemed to have occurred at the end of the reporting period. For the quarters ended June 30, 2015 and 2014 there were no significant transfers between levels.

The majority of securities (available-for-sale and held-to-maturity) are valued by external pricing services or dealer market participants and are classified in Level 2 of the fair value hierarchy. Both market and income valuation approaches are utilized. The Company evaluates the methodologies used by the external pricing services or dealer market participants to develop the fair values to determine whether the results of the valuations are representative of an exit price in the Company's principal markets and an appropriate representation of fair value. The Company uses the following methods and significant assumptions to estimate fair value:

- Government-sponsored agency debt securities are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.
- Other government-sponsored agency securities, MBS and some of the actively traded real estate mortgage investment conduits and collateralized mortgage obligations are priced using available market information including benchmark yields, prepayment speeds, spreads, volatility of similar securities and trade date.
- State and political subdivisions are largely grouped by characteristics (e.g., geographical data and source of revenue in trade dissemination systems). Because some securities are not traded daily and due to other grouping limitations,

active market quotes are often obtained using benchmarking for like securities.

- From December 31, 2013, to December 31, 2014, the Company utilized pricing data from a nationally recognized valuation firm providing specialized securities valuation services for auction rate asset-backed securities. Beginning March 31, 2015, these securities are priced using market spreads, cash flows, prepayment speeds, and loss analytics. Therefore, the valuations of auction rate asset-backed securities are considered Level 2 valuations.
- During the third quarter of 2014, asset-backed collateralized loan obligations were acquired and priced using data from a pricing matrix support by our bond accounting service provider and are therefore considered Level 2 valuations.
- Residential mortgage loans eligible for sale in the secondary market are carried at fair market value. The fair value of loans held-for-sale is determined using quoted secondary market prices.
- Lending related commitments to fund certain residential mortgage loans, e.g. residential mortgage loans with locked interest rates to be sold in the secondary market and forward commitments for the future delivery of mortgage loans to third party investors as well as forward commitments for future delivery of MBS are considered derivatives. Fair values are estimated based on observable changes in mortgage interest rates including prices for MBS from the date of the commitment and do not typically involve significant judgments by management.
- The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income to derive the resultant value. The Company is able to compare the valuation model inputs, such as the discount rate, prepayment speeds, weighted average delinquency and foreclosure/bankruptcy rates to widely available published industry data for reasonableness.
- Interest rate swap positions, both assets and liabilities, are based on valuation pricing models using an income approach reflecting readily observable market parameters such as interest rate yield curves.
- Both the credit valuation reserve on current interest rate swap positions and on receivables related to unwound customer interest rate swap positions were determined based upon management's estimate of the amount of credit risk exposure, including by available collateral protection and/or by utilizing an estimate related to a probability of default as indicated in the Bank credit policy. Such adjustments would result in a Level 3 classification.
- The fair value of impaired loans with specific allocations of the allowance for loan losses is essentially based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are made in the appraisal process by the appraisers to reflect

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differences between the available comparable sales and income data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

- Nonrecurring adjustments to certain commercial and residential real estate properties classified as OREO are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The tables below present the balance of assets and liabilities at June 30, 2015, and December 31, 2014, respectively, measured by the Company at fair value on a recurring basis:

	June 30, 2015			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale				
U.S. Treasury	$ 1,520	$ -	$ -	$ 1,520
U.S. government agencies	-	1,595	-	1,595
U.S. government agencies mortgage-backed	-	5,545	-	5,545
States and political subdivisions	-	13,131	118	13,249
Corporate Bonds	-	30,605	-	30,605
Collateralized mortgage obligations	-	74,994	-	74,994
Asset-backed securities	-	178,655	-	178,655
Collateralized loan obligations	-	93,673	-	93,673
Loans held-for-sale	-	6,208	-	6,208
Mortgage servicing rights	-	-	5,884	5,884
Other assets (Interest rate swap agreements)	-	28	-	28
Other assets (Mortgage banking derivatives)	-	257	-	257
Total	$ 1,520	$ 404,691	$ 6,002	$ 412,213
Liabilities:				
Other liabilities (Interest rate swap agreements)	$ -	$ 28	$ -	$ 28
Total	$ -	$ 28	$ -	$ 28

	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale				
U.S. Treasury	$ 1,527	$ -	$ -	$ 1,527

U.S. government agencies	-	1,624	-	1,624
States and political subdivisions	-	21,900	118	22,018
Corporate bonds	-	30,985	-	30,985
Collateralized mortgage obligations	-	63,627	-	63,627
Asset-backed securities	-	120,555	52,941	173,496
Collateralized loan obligations	-	92,209	-	92,209
Loans held-for-sale	-	5,072	-	5,072
Mortgage servicing rights	-	-	5,462	5,462
Other assets (Interest rate swap agreements net of swap credit valuation)	-	30	-	30
Other assets (Mortgage banking derivatives)	-	143	-	143
Total	$ 1,527	$ 336,145	$ 58,521	$ 396,193
Liabilities:				
Other liabilities (Interest rate swap agreements)	$ -	$ 30	$ -	$ 30
Total	$ -	$ 30	$ -	$ 30

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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are as follows:

	Six months ended June 30, 2015 Securities available-for-sale Asset-backed	States and Political Subdivisions	Mortgage Servicing Rights
Beginning balance January 1, 2015	$ 52,941	$ 118	$ 5,462
Transfers out of Level 3	(24,917)	-	-
Total gains or losses			
Included in earnings (or changes in net assets)	(28)	-	(137)
Included in other comprehensive income	(541)	-	-
Purchases, issuances, sales, and settlements			
Issuances	-	-	935
Settlements	-	-	(376)
Sales	(27,455)	-	-
Ending balance June 30, 2015	$ -	$ 118	$ 5,884

	Six months ended June 30, 2014 Securities available-for-sale Asset-backed	States and Political Subdivisions	Mortgage Servicing Rights	Interest Rate Swap Valuation
Beginning balance January 1, 2014	$ 154,137	$ 125	$ 5,807	$ (6)
Total gains or losses				
Included in earnings (or changes in net assets)	1,671	-	(630)	6
Included in other comprehensive income	513	-	-	-
Purchases, issuances, sales, and settlements				
Purchases	58,047	-	-	-
Issuances	-	-	324	-
Settlements	-	-	-	-
Sales	(77,282)	-	-	-
Ending balance June 30, 2014	$ 137,086	$ 125	$ 5,501	$ -

The following table and commentary presents quantitative and qualitative information about Level 3 fair value measurements as of June 30, 2015:

Weighted

Measured at fair value on a recurring basis:	Fair Value	Valuation Methodology	Unobservable Inputs	Range of Input	Average of Inputs
Mortgage Servicing rights	$ 5,884	Discounted Cash Flow	Discount Rate	10.0-15.5%	10.2 %
			Prepayment Speed	6.0-34.1%	9.7 %

The following table and commentary presents quantitative and qualitative information about Level 3 fair value measurements as of December 31, 2014:

Measured at fair value on a recurring basis:	Fair Value	Valuation Methodology	Unobservable Inputs	Range of Input	Weighted Average of Inputs
Mortgage Servicing rights	$ 5,462	Discounted Cash Flow	Discount Rate	9.7-108.2%	10.2 %
			Prepayment Speed	5.0-78.4%	10.9 %
Asset-backed securities	52,941	Discounted Cash Flow	Credit Risk Premium	0.9-0.9%	0.9 %
		with comparable transaction yields	Liquidity Discount	3.5-3.7%	3.6 %

The $118,000 on the state and political subdivisions line at June 30, 2015, under Level 3 represents a security from a small, local municipality. Given the small dollar amount and size of the municipality involved, this is categorized as Level 3 based on the payment stream received by the Company from the municipality. That payment stream is otherwise an unobservable input.

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

The Company may be required, from time to time, to measure certain other assets at fair value on a nonrecurring basis in accordance with GAAP. These assets consist of impaired loans and OREO. For assets measured at fair value on a nonrecurring basis at June 30, 2015, and December 31, 2014, respectively, the following tables provide the level of valuation assumptions used to determine each valuation and the carrying value of the related assets:

	June 30, 2015			
	Level 1	Level 2	Level 3	Total
Impaired loans1	$ -	$ -	$ 451	$ 451
Other real estate owned, net2	-	-	31,964	31,964
Total	$ -	$ -	$ 32,415	$ 32,415

1 Represents carrying value and related write-downs of loans for which adjustments are substantially based on the appraised value of collateral for collateral-dependent loans, had a carrying amount of $589,000, with a valuation allowance of $138,000 resulting in an increase of specific allocations within the allowance for loan losses of $140,000 for the six months ending June 30, 2015.

2 OREO is measured at the lower of carrying or fair value less costs to sell, and had a net carrying amount of $32.0 million, which is made up of the outstanding balance of $53.8 million, net of a valuation allowance of $20.1 million and participations of $1.7 million, at June 30, 2015.

	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Impaired loans1	$ -	$ -	$ 564	$ 564
Other real estate owned, net2	-	-	31,982	31,982
Total	$ -	$ -	$ 32,546	$ 32,546

1 Represents carrying value and related write-downs of loans for which adjustments are substantially based on the appraised value of collateral for collateral-dependent loans, had a carrying amount of $842,000, with a valuation allowance of $278,000, resulting in a decrease of specific allocations within the provision for loan losses of $2.1 million for the year ending December 31, 2014.

2 OREO is measured at the lower of carrying or fair value less costs to sell, and had a net carrying amount of $32.0 million, which is made up of the outstanding balance of $53.0 million, net of a valuation allowance of

$19.2 million and participations of $1.8 million, at December 31, 2014.

The Company also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include OREO and impaired loans. The Company has estimated the fair values of these assets based primarily on Level 3 inputs. OREO and impaired loans are generally valued using the fair value of collateral provided by third party appraisals. These valuations include assumptions related to cash flow projections, discount rates, and recent comparable sales. The numerical range of unobservable inputs for these valuation assumptions are not meaningful.

Note 13 – Financial Instruments with Off-Balance Sheet Risk and Derivative Transactions

To meet the financing needs of its customers, the Bank, as a subsidiary of the Company, is a party to various financial instruments with off-balance-sheet risk in the normal course of business. These off-balance-sheet financial instruments include commitments to originate and sell loans as well as financial standby, performance standby and commercial letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Bank's exposure to credit loss for loan commitments and letters of credit is represented by the dollar amount of those instruments. Management generally uses the same credit policies and collateral requirements in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Interest Rate Swaps

The Bank also has interest rate derivative positions to assist with risk management that are not designated as hedging instruments. These derivative positions relate to transactions in which the Bank enters an interest rate swap with a client while at the same time entering into an offsetting interest rate swap with another financial institution. Per contractual requirements with the correspondent financial institution, the Bank had $1.0 million in investment securities pledged to support interest rate swap activity with one correspondent financial institution at June 30, 2015. The Bank had $3.0 million in investment securities pledged to support interest rate swap activity with three correspondent financial institutions at December 31, 2014.

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In connection with each transaction, the Bank agreed to pay interest to the client on a notional amount at a variable interest rate and receive interest from the client on the same notional amount at a fixed interest rate. At the same time, the Bank agreed to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the client to convert a variable rate loan to a fixed rate loan and is part of the Company's interest rate risk management strategy. Because the Bank acts as an intermediary for the client, changes in the fair value of the underlying derivative contracts offset each other and do not generally affect the results of operations. Fair value measurements include an assessment of credit risk related to the client's ability to perform on their contract position, however, and valuation estimates related to that exposure are discussed in Note 12 above. At June 30, 2015, the notional amount of non-hedging interest rate swaps was $9.8 million with a weighted average maturity of 2.7 years. At December 31, 2014, the notional amount of non-hedging interest rate swaps was $16.3 million with a weighted average maturity of 2.7 years. The Bank offsets derivative assets and liabilities that are subject to a master netting arrangement.

The Bank also grants mortgage loan interest rate lock commitments to borrowers, subject to normal loan underwriting standards. The interest rate risk associated with these loan interest rate lock commitments is managed with contracts for future deliveries of loans as well as selling forward mortgage-backed securities contracts. Loan interest rate lock commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments to originate residential mortgage loans held-for-sale and forward commitments to sell residential mortgage loans or forward MBS contracts are considered derivative instruments and changes in the fair value are recorded to mortgage banking revenue. Fair values are estimated based on observable changes in mortgage interest rates including mortgage-backed securities prices from the date of the commitment.

The following table presents derivatives not designated as hedging instruments as of June 30, 2015, and periodic changes in the values of the interest rate swaps are reported in other noninterest income. Periodic changes in the value of the forward contracts related to mortgage loan origination are reported in the net gain on sales of mortgage loans.

		Asset Derivatives		Liability Derivatives	
	Notional or Contractual Amount	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate swap contracts	$ 9,765	Other Assets	$ 28	Other Liabilities	$ 28
Commitments1	211,192	Other Assets	257	N/A	-
Forward contracts2	20,500	N/A	-	Other Liabilities	-
Total			$ 285		$ 28

1Includes unused loan commitments and interest rate lock commitments.

2Includes forward MBS contracts and forward loan contracts.

The following table presents derivatives not designated as hedging instruments as of December 31, 2014.

		Asset Derivatives		Liability Derivatives	
	Notional or Contractual Amount	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate swap contracts net of credit valuation	$ 16,334	Other Assets	$ 30	Other Liabilities	$ 30
Commitments1	201,946	Other Assets	143	N/A	-
Forward contracts2	14,000	N/A	-	Other Liabilities	-
Total			$ 173		$ 30

1Includes unused loan commitments and interest rate lock commitments.

2Includes forward MBS contracts.

The Bank also issues letters of credit, which are conditional commitments that guarantee the performance of a customer to a third party. The credit risk involved and collateral obtained in issuing letters of credit are essentially the same as that involved in extending loan commitments to our customers. In addition to customer related commitments, the Company is responsible for letters of credit commitments that relate to properties held in OREO. The following table represents the Company’s contractual commitments due to letters of credit as of June 30, 2015, and December 31, 2014.

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The following table is a summary of letter of credit commitments (in thousands):

	June 30, 2015			December 31, 2014		
	Fixed	Variable	Total	Fixed	Variable	Total
Letters of credit:						
Borrower:						
Financial standby	$ 55	$ 3,697	$ 3,752	$ 55	$ 4,745	$ 4,800
Commercial standby	-	47	47	-	49	49
Performance standby	404	6,603	7,007	416	5,690	6,106
	459	10,347	10,806	471	10,484	10,955
Non-borrower:						
Performance standby	-	576	576	-	572	572
	-	576	576	-	572	572
Total letters of credit	$ 459	$ 10,923	$ 11,382	$ 471	$ 11,056	$ 11,527

Note 14 – Fair Values of Financial Instruments

The estimated fair values approximate carrying amount for all items except those described in the following table. Investment security fair values are based upon market prices or dealer quotes, and if no such information is available, on the rate and term of the security. The carrying value of FHLBC stock approximates fair value as the stock is nonmarketable and can only be sold to the FHLBC or another member institution at par. During the years ended December 31, 2014, and 2013, the Company participated in multiple redemptions with the FHLBC and, using the redemption values as the carrying value, FHLBC stock is carried at a Level 2 fair value since December 31, 2012. The Company had redemptions of $1.2 million in the year 2014. The Company redeemed $787,000 in April of 2015. Fair values of loans were estimated for portfolios of loans with similar financial characteristics, such as type and fixed or variable interest rate terms. Cash flows were discounted using current rates at which similar loans would be made to borrowers with similar ratings and for similar maturities. The fair value of time deposits is estimated using discounted future cash flows at current rates offered for deposits of similar remaining maturities. The fair values of borrowings were estimated based on interest rates available to the Company for debt with similar terms and remaining maturities. The fair value of off balance sheet volume is not considered material.

The carrying amount and estimated fair values of financial instruments were as follows:

	June 30, 2015 Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 29,164	$ 29,164	$ 29,164	$ -	$ -
Interest bearing deposits with financial institutions	9,352	9,352	9,352	-	-
Securities available-for-sale	399,836	399,836	1,520	398,198	118
Securities held-to-maturity	253,419	257,967	-	257,967	-
FHLBC and Reserve Bank Stock	8,271	8,271	-	8,271	-
Bank-owned life insurance	57,444	57,444	-	57,444	-
Loans held-for-sale	6,208	6,208	-	6,208	-
Loans, net	1,140,562	1,147,129	-	-	1,147,129
Accrued interest receivable	4,192	4,192	-	4,192	-
Financial liabilities:					
Noninterest bearing deposits	$ 432,773	$ 432,773	$ 432,773	$ -	$ -
Interest bearing deposits	1,280,779	1,282,979	-	1,282,979	-
Securities sold under repurchase agreements	32,415	32,415	-	32,415	-
Other short-term borrowings	20,000	20,000	-	20,000	-
Junior subordinated debentures	58,378	55,181	32,734	22,447	-
Subordinated debenture	45,000	40,143	-	40,143	-
Note payable and other borrowings	500	432	-	432	-
Borrowing interest payable	75	75	-	75	-
Deposit interest payable	413	413	-	413	-

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	December 31, 2014				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 30,101	$ 30,101	$ 30,101	$ -	$ -
Interest bearing deposits with financial institutions	14,096	14,096	14,096	-	-
Securities available-for-sale	385,486	385,486	1,527	330,900	53,059
Securities held-to-maturity	259,670	263,266	-	263,266	-
FHLBC and Reserve Bank Stock	9,058	9,058	-	9,058	-
Bank-owned life insurance	56,807	56,807	-	56,807	-
Loans held-for-sale	5,072	5,072	-	5,072	-
Loans, net	1,137,695	1,151,223	-	-	1,151,223
Accrued interest receivable	4,888	4,888	-	4,888	-
Financial liabilities:					
Noninterest bearing deposits	$ 400,447	$ 400,447	$ 400,447	$ -	$ -
Interest bearing deposits	1,284,608	1,284,887	-	1,284,887	-
Securities sold under repurchase agreements	21,036	21,036	-	21,036	-
Other short-term borrowings	45,000	45,000	-	45,000	-
Junior subordinated debentures	58,378	54,686	32,441	22,245	-
Subordinated debenture	45,000	39,366	-	39,366	-
Note payable and other borrowings	500	422	-	422	-
Borrowing interest payable	75	75	-	75	-
Deposit interest payable	467	467	-	467	-

Note 15 – Series B Preferred Stock (“Series B Stock”)

The Series B Stock was issued as part of the Treasury’s Troubled Asset Relief Program and Capital Purchase Program (the “CPP”). The Series B Stock qualifies as Tier 1 capital and pays cumulative dividends on the liquidation preference amount on a quarterly basis at a rate of 5% per annum for the first five years, and 9% per annum thereafter effective in February 2014. Concurrent with issuing the Series B Stock, the Company issued to the Treasury a ten year warrant to purchase 815,339 shares of the Company’s common stock at an exercise price of $13.43 per share.

Subsequent to the Company’s receipt of the $73.0 million in proceeds from the Treasury in the first quarter of 2009, the Company allocated the proceeds between the Series B Stock and the warrant that was issued. The Company recorded the warrant as equity, and the allocation was based on their relative fair values in accordance with accounting guidance. The fair value was determined for both the Series B Stock and the warrant as part of the allocation process in the amounts of $68.2 million and $4.8 million, respectively.

On August 31, 2010, the Company announced that it would begin deferring quarterly cash dividends on its outstanding Series B Stock. Further, the Company also elected to defer interest payments on certain of its subordinated debentures. However, under the terms of the Series B Stock, if the Company failed to pay dividends for an aggregate of six quarters on the Series B Stock, whether or not consecutive, the holders would have the right to appoint representatives to the Company's board of directors. As the Company elected to defer dividends for more than six quarters, a new director was appointed by the Treasury to join the board during the fourth quarter of 2012. The terms of the Series B Stock also prevented the Company from paying cash dividends or generally repurchasing its common stock while Series B Stock dividends were in arrears.

The Treasury sold all of the Series B Stock held to third parties, including certain of our directors, in auctions that were completed in the first quarter of 2013. The Treasury also sold the warrant to a third party at a subsequent auction. Upon completion by Treasury of the auction, the Company's board affirmed the director appointed by Treasury to ongoing board membership, and the Series B director was elected by the holders of the Series B Stock at the Company's 2013 annual meeting.

As a result of the completed 2013 auctions, the Company's Board elected to stop accruing the dividend on the Series B Stock in the first quarter of 2013. Previously, the Company had accrued the dividend on the Series B Stock quarterly throughout the deferral period. Given the discount reflected in the results of the auction, the board believed that the Company would likely be able to redeem the Series B Stock at a price less than the face amount of the Series B Stock plus accrued and unpaid dividends. While the Company did not fully accrue the dividend on the Series B Stock in the first quarter of 2013 and did not accrue for it in subsequent quarters, the Company continued to evaluate whether accruing dividends on the Series B Stock was appropriate. In the second quarter of 2014, the Company completed redemption of 25,669 shares of its Series B Stock at a price equal to 94.75% of liquidation value, or an aggregate of $24.3 million, and the holders of shares agreed to forebear payment of dividends due and waived any rights to such dividends upon redemption. Following the redemption, the Company resumed accrual in the second quarter of 2014.