Stock Yards Bancorp, Inc.
Form 10-K
March 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-K

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

For the Fiscal Year Ended	**Commission File Number**
December 31, 2015	**1-13661**

STOCK YARDS BANCORP, INC.

1040 East Main Street
Louisville, Kentucky 40206
(502) 582-2571

Incorporated in Kentucky	**I.R.S. No. 61-1137529**

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

Title of each class:	*Name of each exchange on which registered:*
Common Stock, no par value	NASDAQ

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

None

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

Yes **No**

The aggregate market value of registrant's voting stock (Common Stock, no par value) held by non-affiliates of the registrant as of June 30, 2015 (the last business day of the registrant's most recently completed second fiscal quarter) was $502,112,000.

The number of shares of the registrant's Common Stock, no par value, outstanding as of February 24, 2016, was 14,921,250.

Documents Incorporated By Reference

Portions of Registrant's definitive proxy statement related to Registrant's Annual Meeting of Shareholders to be held on April 28, 2016 (the "Proxy Statement"), to be filed with the Securities and Exchange Commission, are incorporated by reference into Part III of this Form 10-K.

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Glossary of Acronyms and Terms

The following listing provides a comprehensive reference of common acronyms and terms used throughout the document:

ASU	Accounting Standards Update
Bancorp	Stock Yards Bancorp, Inc.
Bank	Stock Yards Bank & Trust Company
BOLI	Bank Owned Life Insurance
BP	Basis Point = 1/100th of one percent
COSO	Committee of Sponsoring Organizations
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EPS	Earnings Per Share
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHC	Financial Holding Company
FHLB	Federal Home Loan Bank
FHLMC	Federal Home Loan Mortgage Corporation
FNMA	Federal National Mortgage Association
GLB Act	Gramm-Leach-Bliley Act
GNMA	Government National Mortgage Association
IM&T	Investment Management and Trust
KSOP	Combined employee profit sharing and stock ownership plan

LIBOR	London Interbank Offered Rate
MSA	Metropolitan Statistical Area
MSR	Mortgage Servicing Right
OAEM	Other Assets Especially Mentioned
Oldham	THE BANCORP, Inc.
OREO	Other Real Estate Owned
OTTI	Other-Than-Temporary Impairment
PSU	Performance Stock Unit
RSU	Restricted Stock Unit
SAR	Stock Appreciation Right
SEC	Securities and Exchange Commission
TDR	Troubled Debt Restructuring
US GAAP	United States Generally Accepted Accounting Principles
VA	U.S. Department of Veterans Affairs

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Part I

Item 1. Business

Stock Yards Bancorp, Inc. (“Bancorp” or “Company”), headquartered in Louisville, Kentucky, is the holding company for Stock Yards Bank & Trust Company (“Bank”). Bancorp, which was incorporated in 1988 in Kentucky, is registered with, and subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System. The Bank is wholly owned and is a state chartered bank. Because Bancorp has no significant operations of its own, its business and that of the Bank are essentially the same. The operations of the Bank are fully reflected in the consolidated financial statements of Bancorp. Accordingly, references to “Bancorp” in this document may encompass both the holding company and the Bank. At the 2014 annual meeting, shareholders approved a resolution to amend Bancorp’s restated articles of incorporation to change its name from S.Y. Bancorp, Inc. to Stock Yards Bancorp, Inc.

Stock Yards Bank & Trust Company

Stock Yards Bank & Trust Company is the banking subsidiary of Bancorp and was chartered in 1904. The Bank is headquartered in Louisville, Kentucky and provides commercial and personal banking services in the Louisville, Kentucky, Indianapolis, Indiana and Cincinnati, Ohio metropolitan markets through 37 full service banking offices. The Bank is chartered under the laws of the Commonwealth of Kentucky. In addition to traditional commercial and personal banking activities, the Bank has an investment management and trust department offering a wide range of investment management, trust, employee benefit plan and estate administration, and financial planning services. The Bank also originates and sells single-family residential mortgages. Additionally, the Bank offers securities brokerage services via its branch network through an arrangement with a third party broker-dealer. See Note 25 to Bancorp’s consolidated financial statements for information relating to the Bank’s business segments and “Item 2. Properties” for information regarding owned and leased properties.

In April, 2013, Bancorp completed the acquisition of 100% of the outstanding shares of THE BANCorp, Inc. (“Oldham”), parent company of THE BANK – Oldham County, Inc. As a result of the transaction, THE BANK – Oldham County merged into Stock Yards Bank & Trust Company. Since the acquisition date, results of operations acquired in the Oldham transaction have been included in Bancorp’s financial results. The Oldham transaction has been accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration transferred were recorded at estimated fair value on the acquisition date. See Note 3 to Bancorp’s consolidated financial statements for information relating to the acquisition.

At December 31, 2015, Stock Yards Bank & Trust Company had 555 full-time equivalent employees. Employees of Stock Yards Bank & Trust Company are entitled to participate in a variety of employee benefit programs including a combined employee profit sharing and stock ownership plan (“KSOP”). Management of Bancorp strives to be an employer of choice and considers the relationship with employees to be good.

Supervision and Regulation

Bank holding companies and commercial banks are extensively regulated under both federal and state laws. Changes in applicable laws or regulations may have a material effect on the business and prospects of Bancorp.

Bancorp, as a registered bank holding company, is subject to the supervision of and regulation by the Federal Reserve Board under the Bank Holding Company Act of 1956. In addition, Bancorp is subject to the provisions of Kentucky’s banking laws regulating bank acquisitions and certain activities of controlling bank shareholders.

Kentucky and federal banking statutes delineate permissible activities for Kentucky state-chartered banks. Kentucky’s statutes, however, contain a super parity provision for Kentucky chartered banks having one of the top two ratings in its most recent regulatory examination. This provision allows these state banks to engage in any banking activity in which a national bank in Kentucky, a state bank operating in any other state, or a federally chartered thrift could engage. The bank must first obtain a legal opinion specifying the statutory or regulatory provisions that permit the activity.

The Bank is subject to the supervision of the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Federal Deposit Insurance Corporation (“FDIC”) insures the deposits of the Bank to the current maximum of $250,000 per depositor.

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The Gramm-Leach-Bliley Act (the "GLB Act") allows for affiliations among banks, securities firms and insurance companies by means of a financial holding company ("FHC"). The GLB Act requires that, at the time of establishment of an FHC, all depository institutions within that corporate group must be "well managed" and "well capitalized" and must have received a rating of "satisfactory" or better under its most recent Community Reinvestment Act examination. Further, non-banking financial firms (for example an insurance company or securities firm) may establish an FHC and acquire a depository institution. While the distinction between banks and non-banking financial firms has been blurring over recent years, the GLB Act makes it less cumbersome for banks to offer services "financial in nature" but beyond traditional commercial banking activities. Likewise, non-banking financial firms may find it easier to offer services that had, heretofore, been provided primarily by depository institutions. In 2012, management of Bancorp chose to become an FHC after evaluating the benefits and costs.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was signed into law in 2010. Generally, the Dodd-Frank Act was effective the day after it was signed into law, but different effective dates apply to specific sections of the law. This new extensive and complex legislation contained many new provisions affecting the banking industry, including:

- Creation of a new Bureau of Consumer Financial Protection overseeing banks with assets totaling $10 billion or greater while writing and maintaining several regulations that apply to all banks,
- Determination of debit card interchange rates by the Federal Reserve Board,
- New regulation over derivative instruments,
- Phase outs of certain forms of trust preferred debt and hybrids previously included as bank capital, and
- Increases to FDIC deposit coverage, revised calculations for assessing bank premiums, and numerous other provisions affecting financial institution regulation, oversight of certain non-banking organizations, investor protection, etc.

Uncertainty remains as to the ultimate impact of the Dodd-Frank Act, which we expect will have a continued adverse impact on the financial services industry as a whole and on Bancorp's business, results of operations and financial condition due to regulatory costs and increased regulatory scrutiny over products and practices.

In 2013, the Federal Reserve Board and the FDIC approved rules that substantially amended the regulatory risk-based capital rules applicable to Bancorp and Bank. The rules implemented the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" ("Basel III") and changes required by the Dodd-Frank Act. The Basel III regulatory capital reforms became effective for Bancorp and Bank on January 1, 2015, and included new minimum risk-based capital and leverage ratios. The new minimum capital level requirements applicable to bank holding companies and banks subject to the rules are:

- a new common equity Tier 1 capital ratio of 4.5%,

a Tier 1 risk-based capital ratio of 6% (increased from 4%),
a total risk-based capital ratio of 8% (unchanged from previous rules), and
a Tier 1 leverage ratio of 4% for all institutions.

The rules also established a "capital conservation buffer" of 2.5%, to be phased in over three years, above the new regulatory minimum risk-based capital ratios, and will result in the following minimum ratios once the capital conservation buffer is fully phased in:

a common equity Tier 1 risk-based capital ratio of 7.0%,
a Tier 1 risk-based capital ratio of 8.5%, and
a total risk-based capital ratio of 10.5%.

The capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

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Under these new rules, Tier 1 capital will generally consist of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital will generally consist of common stock, additional paid-in capital and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

The final rules allowed banks and their holding companies with less than $250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Bancorp opted-out of this requirement.

As of December 31, 2015, Bancorp meets the requirements to be considered well-capitalized under the new rules, and is not subject to limitations due to the capital conservation buffer.

Available Information

Bancorp files reports with the SEC including the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current event reports on Form 8-K, and proxy statements, as well as any amendments to those reports. The public may read and copy any materials the Registrant files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. Bancorp's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are also accessible at no cost on Bancorp's web site at http://www.syb.com after they are electronically filed with the SEC.

Item 1A. Risk Factors

Investment in Bancorp's common stock involves risk, and Bancorp's profitability and success may be affected by a number of factors including those discussed below.

Financial condition and profitability depend significantly on local and national economic conditions.

Our success depends on general economic conditions both locally and nationally. Most of Bancorp's customers are in the Louisville, Indianapolis, and Cincinnati metropolitan areas. Compared to regional or national financial institutions, we are less able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Some of Bancorp's customers are directly impacted by the local economy while others have more national or global business dealings. Some of the factors influencing general economic conditions include tepid economic recovery, and government regulation. Poor economic conditions have an unfavorable impact on the demand of customers for loans and the ability of some borrowers to repay these loans. Deterioration in the quality of the credit portfolio could have a material adverse effect on financial condition, results of operations, and ultimately capital.

Financial condition and profitability depend on real estate values in our market area.

Bancorp offers a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, home equity, consumer and other loans. Bancorp's loans are secured by real estate (both residential and commercial) primarily in Bancorp's market area. In instances where borrowers are unable to repay their loans from us and there has been deterioration in the value of the loan collateral, Bancorp could experience higher loan losses which could have a material adverse effect on financial condition, results of operations, and ultimately capital.

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If actual loan losses are greater than Bancorp's assumption for loan losses, earnings could decrease.

Bancorp's loan customers may not repay their loans according to the terms of these loans, the collateral securing the payment of these loans may be insufficient to ensure repayment and the wealth of guarantors providing guarantees to support these loans may be insufficient to aid in the repayment of these loans. Accordingly, Bancorp may experience significant credit losses which could have a material adverse effect on operating results. Bancorp makes various assumptions and judgments about the collectability of the loan portfolio, including the creditworthiness of borrowers and the value of collateral for repayment of many loans. In determining the adequacy of the allowance for loan losses, Bancorp considers, among other factors, an evaluation of economic conditions and Bancorp's loan loss experience. If Bancorp's assumptions prove to be incorrect or economic problems are worse than projected, the current allowance may not be sufficient to cover loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. Such additions to the allowance, if necessary, could have a material adverse impact on financial results.

In addition, federal and state regulators annually review Bancorp's allowance for loan losses and may require an increase in the provision for loan losses or loan charge-offs. If the regulatory agencies require any increase in the provision for loan losses or loan charge-offs for which Bancorp had not allocated, it would have a negative effect on net income.

Fluctuations in interest rates could reduce profitability.

Our primary source of income is from the net interest spread, the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. Bancorp expects to periodically experience gaps in the interest rate sensitivities of Bancorp's assets and liabilities, meaning that either interest-bearing liabilities will be more sensitive to changes in market interest rates than interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to Bancorp's position, this gap will work against Bancorp and earnings will be negatively affected.

Many factors affect the fluctuation of market interest rates, including, but not limited to the following:

- inflation or deflation
- recession
- a rise in unemployment
- tightening money supply
- international disorder and instability in foreign financial markets

the Federal Reserve's actions to control interest rates

Bancorp's interest rate sensitivity analysis indicates an increase in interest rates of up to 4% would decrease net interest income, primarily because the majority of Bancorp's variable rate loans have floors of 4% or higher, and are indexed to the prime rate. Since the prime rate is currently 3.50%, rates would have to increase more than 50 bp before the rates on such loans will rise. This effect negatively impacts the effect of rising rates. Deposit rates generally do not reprice as quickly as loans which negatively affects earnings as rates decline. Bancorp's asset-liability management strategy, which is designed to mitigate risk from changes in market interest rates, may not be able to prevent changes in interest rates from having a material adverse effect on Bancorp's results of operations and financial condition. Bancorp's most recent earnings simulation model estimating the impact of changing interest rates on earnings indicates net interest income will decrease approximately 3.1% if interest rates immediately decrease 100 basis points for the next 12 months and decrease approximately 1.9% if rates increase 100 basis points.

Significant stock market volatility could negatively affect Bancorp's financial results.

Capital and credit markets experience volatility and disruption from time to time. These conditions place downward pressure on credit availability, credit worthiness and customers' inclinations to borrow. Prolonged volatility or a significant disruption could negatively impact customers' ability to seek new loans or to repay existing loans. The personal wealth of many borrowers and guarantors has historically added a source of financial strength to certain loans and would be negatively impacted by severe market declines. Sustained reliance on their personal assets to make loan payments would result in deterioration of their liquidity, and could result in loan defaults.

Income from investment management and trust services constitutes approximately 45% of non-interest income. Trust assets under management are expressed in terms of market value, and a significant portion of fee income is based upon those values. A large majority of investment management and trust fees are based on market values which generally fluctuate with the overall stock market.

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Competition with other financial institutions could adversely affect profitability.

Bancorp operates in a highly competitive industry that could become even more so as a result of earnings pressure of contending banks, legislative, regulatory and technological changes and continued consolidation. Bancorp faces vigorous competition in price and structure of financial products from banks and other financial institutions. Bancorp also competes with other non-traditional providers of financial services, such as brokerage firms and insurance companies. As internet-based financial services continue to grow in acceptance, Bancorp must remain relevant as a place where consumers and businesses value personal service while our competition offers these services without human interaction. These sources of competition may reduce or limit margins on banking services, reduce market share and adversely affect results of operations and financial condition.

Credit unions continue to grow in popularity and size, and their expansion into business lending is growing. Because credit unions are not subject to federal income tax, and Bancorp pays federal income tax at a marginal rate of 35%, these companies have a significant competitive advantage over Bancorp. This advantage may have a negative impact on Bancorp’s growth and resultant financial results as these credit unions continue to expand.

Decreased residential mortgage origination, volume and pricing decisions of competitors could affect net income

Bancorp originates, sells and services residential mortgage loans. Changes in interest rates and pricing decisions by our loan competitors affect demand for Bancorp’s residential mortgage loan products, the revenue realized on the sale of loans and revenues received from servicing such loans for others, ultimately reducing Bancorp’s net income. New regulations, increased regulatory reviews, and/or changes in the structure of the secondary mortgage markets which Bancorp utilizes to sell mortgage loans may be introduced and may increase costs and make it more difficult to operate a residential mortgage origination business.

An extended disruption of vital infrastructure or a security breach could negatively impact Bancorp’s business, results of operations, and financial condition.

Bancorp’s operations depend upon, among other things, infrastructure, including equipment and facilities. Extended disruption of vital infrastructure by fire, power loss, natural disaster, telecommunications failure, information systems breaches, terrorist activity or the domestic and foreign response to such activity, or other events outside of Bancorp’s control could have a material adverse impact on the financial services industry as a whole and on Bancorp’s business, results of operations and financial condition. Bancorp’s business continuity plan may not work as intended or may not prevent significant interruption of operations. The occurrence of any failures, interruptions, or security breaches of information systems could damage Bancorp's reputation, result in the loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have an adverse effect on Bancorp's financial condition and results of operation.

Bancorp's assets which are at risk for cyber-attacks include financial assets and non-public information belonging to customers. Cyber security risks include cyber espionage, blackmail, ransom, theft, and corporate account takeovers. Bancorp employs many preventive and detective controls to protect its assets, and provides mandatory recurring information security training to all employees. Bancorp utilizes multiple third-party vendors who have access to our assets via electronic media. Bancorp requires third parties to have similar or superior controls in place.

Bancorp's accounting policies and methods are critical to how Bancorp reports its financial condition and results of operations. They require management to make estimates about matters that are uncertain.

Accounting policies and methods are fundamental to how Bancorp records and reports its financial condition and results of operations. Bancorp must exercise judgment in selecting and applying these accounting policies and methods so they comply with United States generally accepted accounting principles ("US GAAP").

Bancorp has identified certain accounting policies as being critical because they require management's judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset, or reducing a liability. Bancorp has established detailed policies and control procedures that are intended to ensure these critical accounting estimates and judgments are well controlled and applied consistently.

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A credit impairment standard based on the current expected credit loss (CECL) model is expected to be issued in a future period and could significantly change the way Bancorp recognizes credit impairment on financial assets. The initial recognition of CECL differs from current US GAAP because recognition of credit losses will not be based on any triggering event. This should generally result in credit impairment being recognized earlier and immediately after the financial asset is originated or purchased. Under current US GAAP, credit impairment losses are determined using an incurred-loss model, which recognizes credit losses only when it is probable that all contractual cash flows will not be collected. Bancorp may need to develop or revise accounting processes and internal controls. These processes and controls will require significant judgment, collection of additional data, and use of estimates. Technology also may need to be upgraded or modified to capture additional data to support the accounting and disclosure requirements.

The policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding Bancorp's judgments and the estimates pertaining to these matters, there can be no assurances that actual results will not differ from those estimates. See the "Critical Accounting Policies" in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more information.

Bancorp operates in a highly regulated environment and may be adversely affected by changes in federal, state and local laws and regulations.

Bancorp is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal or state legislation could have a substantial impact on Bancorp and its operations. Additional legislation and regulations may be enacted or adopted in the future that could significantly affect Bancorp's powers, authority and operations, which could have a material adverse effect on Bancorp's financial condition and results of operations. The exercise of regulatory power may have negative impact on Bancorp's results of operations and financial condition.

Bancorp's ability to stay current on technological changes in order to compete and meet customer demands is constantly being challenged.

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. The future success of Bancorp will depend, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional operational efficiencies and greater privacy and security protection for customers and their personal information. Many of Bancorp's competitors have substantially greater resources to invest in technological improvements. Bancorp may not be able to effectively implement new technology-driven products and services as quickly as competitors or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could impair Bancorp’s ability to effectively compete to retain or acquire new business and could have an adverse impact on its business, financial position, results of operations and liquidity.

Bancorp may not be able to attract and retain skilled people.

Bancorp’s success depends, in large part, on our ability to attract and retain key people. Competition for the best people in the industry and the markets in which we engage can be intense, and we may not be able to retain or hire the people we want or need. In order to attract and retain qualified employees, we must compensate them at market levels. If we are unable to continue to attract and retain qualified employees, or do so at rates necessary to maintain our competitive position, our performance, including our competitive position, could suffer, and, in turn, adversely affect our business, financial condition or results of operations.

Item 1B. Unresolved Staff Comments

Bancorp has no unresolved SEC staff comments.

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Item 2. Properties

The principal offices of Bancorp are located at 1040 East Main Street, Louisville, Kentucky. Bancorp's operations center is at a separate location. In addition to the main office complex and the operations center, Bancorp owned 19 branch properties at December 31, 2015, two of which are located on leased land. At that date, Bancorp also leased 17 branch facilities. Of the 37 banking locations, 28 are located in the Louisville Metropolitan Statistical Area ("MSA"), four are located in the Indianapolis MSA and five are located in the Cincinnati MSA. See Notes 6 and 19 to Bancorp's consolidated financial statements for the year ended December 31, 2015, for additional information relating to amounts invested in premises and equipment and lease commitments**.**

Item 3. Legal Proceedings

See Note 19 to Bancorp's consolidated financial statements for the year ended December 31, 2015, for information relating to legal proceedings.

Item 4. Mine Safety Disclosures

Not applicable.

Executive Officers of the Registrant

The following table lists the names and ages as of December 31, 2015 of all current executive officers of Bancorp and the Bank. Each executive officer is appointed by Bancorp's Board of Directors to serve at the discretion of the Board. There is no arrangement or understanding between any executive officer of Bancorp or the Bank and any other person(s) pursuant to which he/she was or is to be selected as an officer.

Name and Age of Executive Officer	**Position and Offices with Bancorp and/or the Bank**
David P. Heintzman Age 56	Chairman of the Board of Directors and Chief Executive Officer of Bancorp and the Bank
James A. Hillebrand Age 47	President and Director of Bancorp and the Bank
Kathy C. Thompson Age 54	Senior Executive Vice President and Director of Bancorp and the Bank

Nancy B. Davis Age 60	Executive Vice President, Treasurer and Chief Financial Officer of Bancorp and the Bank
William M. Dishman III Age 52	Executive Vice President and Chief Risk Officer of the Bank
Philip S. Poindexter Age 49	Executive Vice President and Chief Lending Officer of the Bank
T. Clay Stinnett Age 42	Executive Vice President and Chief Strategic Officer of Bancorp and the Bank
Michael J. Croce Age 46	Executive Vice President and Director of Retail Banking of the Bank

Mr. Heintzman was appointed Chairman and Chief Executive Officer in January 2006. Prior thereto, he served as President of Bancorp and the Bank since 1992. Mr. Heintzman joined the Bank in 1985.

Mr. Hillebrand was appointed President in July 2008. Prior thereto, he served as Executive Vice President and Director of Private Banking of the Bank since 2005. From 2000 to 2004, he served as Senior Vice President of Private Banking. Mr. Hillebrand joined the Bank in 1996.

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Ms. Thompson was appointed Senior Executive Vice President in January 2006. Prior thereto, she served as Executive Vice President of Bancorp and the Bank. She joined the Bank in 1992 and is Manager of the Investment Management and Trust Department.

Ms. Davis was appointed Executive Vice President of Bancorp and the Bank in 1999 and Chief Financial Officer in 1993. She joined the Bank in 1991.

Mr. Dishman joined the Bank and was appointed Executive Vice President and Chief Risk Officer in February 2009.

Mr. Poindexter was appointed Chief Lending Officer in July 2008. Prior thereto, he served as Executive Vice President and Director of Commercial Banking. Mr. Poindexter joined the Bank in 2004.

Mr. Stinnett was appointed Executive Vice President and Chief Strategic Officer in February 2011. Prior thereto, he served as Senior Vice President and Chief Strategic Officer since 2005. Mr. Stinnett joined the Bank in 2000.

Mr. Croce was appointed Executive Vice President and Director of Retail Banking in July 2014. Prior thereto, he served as Senior Vice President and Division Manager of Business Banking. Mr. Croce joined the Bank in 2004.

Part II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Bancorp’s common stock is traded on the NASDAQ Global Select Market under the ticker symbol SYBT. The table below sets forth the quarterly high and low market closing prices of Bancorp’s common stock and dividends declared per share. The payment of dividends by the Bank to Bancorp is subject to the restriction described in Note 18 to the consolidated financial statements. Management believes that Bancorp will continue to generate adequate earnings to continue to pay dividends on a quarterly basis. On December 31, 2015, Bancorp had approximately 1,500 shareholders of record, and approximately 4,800 non-objecting beneficial owners holding shares in nominee or “street” name.

	2015			2014		
Quarter	**High**	**Low**	**Cash Dividends Declared**	**High**	**Low**	**Cash Dividends Declared**
First	$34.81	$30.87	$ 0.23	$32.14	$27.92	$ 0.21
Second	38.10	33.75	0.24	32.04	27.44	0.22
Third	38.43	33.95	0.24	30.75	28.62	0.22
Fourth	40.65	35.75	0.25	34.16	30.07	0.23

The following table shows information relating to the repurchase of shares of common stock by Bancorp during the three months ended December 31, 2015.

	Total number of shares purchased (1)	**Average price paid per share**	**Total number of shares purchased as part of publicly announced plan**	**Maximum number of shares that may yet be purchased under the plan**
October 1-October 31	101	$ 39.93	-	-
November 1-November 30	70	40.50	-	-
December 1-December 31	-	-	-	-
Total	171	$ 40.16	-	-

(1) Activity represents shares of stock withheld to pay taxes due upon the exercise of stock appreciation rights. This activity has no impact on the number of shares that may be purchased under a Board-approved plan.

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The following performance graph and data shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed soliciting material or subject to Regulation 14A of the Exchange Act or incorporated by reference in any filing under the Exchange Act or the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

The first graph below compares the performance of Bancorp Common Stock to the Russell 2000 index, the SNL NASDAQ Bank index and the SNL Midwest Bank index for Bancorp's last five fiscal years. The graph assumes the value of the investment in Bancorp Common Stock and in each index was $100 at December 31, 2010 and that all dividends were reinvested.

The ten-year period is presented in addition to the five-year period required by the SEC because it provides additional perspective, and Bancorp management believes that longer-term performance is of greater interest to Bancorp shareholders. In 2008 and 2009, Bancorp's stock did not experience a decline in value as precipitous as illustrated by the referenced bank indices, nor did it decrease or suspend cash dividends. Accordingly, Bancorp's stock price increases since 2008 have not been as steep as the referenced bank indices. The ten-year graph assumes the value of the investment in Bancorp Common Stock and in each index was $100 at December 31, 2005 and that all dividends were reinvested.

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Index	***Period Ending*** 12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15
Stock Yards Bancorp, Inc.	100.00	86.43	97.66	143.43	154.19	179.46
Russell 2000	100.00	95.82	111.49	154.78	162.35	155.18
SNL Midwest Bank	100.00	94.46	113.69	155.65	169.21	171.78
SNL Bank NASDAQ	100.00	88.73	105.75	152.00	157.42	169.94

Index	***Period Ending*** 12/31/05	12/31/06	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15
Stock Yards Bancorp, Inc.	100.00	120.06	105.31	124.32	99.47	117.73	101.75	114.97	168.83	181.52	211.27
Russell 2000	100.00	118.37	116.51	77.15	98.11	124.46	119.26	138.76	192.63	202.06	193.14
SNL Midwest Bank	100.00	115.59	90.09	59.27	50.23	62.37	58.91	70.91	97.08	105.54	107.14
SNL Bank NASDAQ	100.00	112.27	88.14	64.01	51.93	61.26	54.36	64.79	93.12	96.44	104.11

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Item 6. Selected Financial Data

Selected Consolidated Financial Data

(Amounts in thousands except per share data and ratios)	Years ended December 31 2015	2014	2013	2012	2011
Income statement data					
Interest income	$93,170	$89,087	$86,464	$86,901	$86,039
Interest expense	4,852	5,330	9,166	12,951	15,307
Net interest income	88,318	83,757	77,298	73,950	70,732
Provision (credit) for loan losses	750	(400)	6,550	11,500	12,600
Non-interest income	39,950	39,155	39,002	38,457	33,244
Non-interest expenses	73,398	73,209	71,352	65,472	59,581
Income before income taxes	54,120	50,103	38,398	35,435	31,795
Income tax expense	16,933	15,281	11,228	9,634	8,191
Net income	$37,187	$34,822	$27,170	$25,801	$23,604
Per share data					
Net income, basic	$2.53	$2.39	$1.91	$1.86	$1.71
Net income, diluted	2.48	2.36	1.89	1.85	1.71
Cash dividends declared	0.96	0.88	0.81	0.77	0.72
Book value	19.20	17.63	15.71	14.74	13.58
Market value	37.79	33.34	31.92	22.42	20.53
Weighted average common and common equivalent shares - diluted	14,973	14,762	14,353	13,932	13,834
Balance sheet data					
Total assets	$2,816,801	$2,563,868	$2,389,262	$2,148,262	$2,053,097
Loans	2,033,007	1,868,550	1,721,350	1,584,594	1,544,845
Allowance for loan losses	22,441	24,920	28,522	31,881	29,745
Available for sale securities	565,876	513,056	490,031	386,440	352,185
Deposits	2,371,702	2,123,627	1,980,937	1,781,693	1,617,739
Federal Home Loan Bank advances	43,468	36,832	34,329	31,882	60,431
Subordinated debentures	-	-	-	30,900	40,900
Stockholders' equity	286,519	259,895	229,444	205,075	187,686
Average balances					
Stockholders' equity	$274,451	$245,425	$220,107	$197,551	$179,638
Assets	2,573,901	2,398,430	2,232,868	2,070,967	1,959,609
Federal Home Loan Bank advances	41,041	35,709	32,518	60,113	60,436
Long-term debt	-	-	30,477	31,474	40,900

Selected ratios					
Return on average assets	1.44 %	1.45 %	1.22 %	1.25 %	1.20 %
Return on average stockholders' equity	13.55	14.19	12.34	13.06	13.14
Average stockholders' equity to average assets	10.66	10.23	9.86	9.54	9.17
Net interest rate spread	3.59	3.67	3.59	3.74	3.79
Net interest rate margin, fully tax-equivalent	3.67	3.75	3.74	3.94	3.99
Efficiency ratio	56.81	59.09	60.82	57.38	56.47
Non-performing loans to total loans	0.44	0.64	1.33	1.90	1.51
Non-performing assets to total assets	0.48	0.70	1.19	1.74	1.51
Net charge offs to average loans	0.17	0.18	0.60	0.60	0.55
Allowance for loan losses to total loans	1.10	1.33	1.66	2.01	1.93

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Section Summary

The financial section of this Form 10-K includes management's discussion and analysis, consolidated financial statements, and the notes to those financial statements. Bancorp has prepared the following summary to assist in your review of the financial section. It is designed to give you an overview of Stock Yards Bancorp, Inc. and summarize some of the more important activities and events that occurred during 2015.

The financial section includes the following:

Management's discussion and analysis, or MD&A provides information as to the analysis of the consolidated financial condition and results of operations of Bancorp. It contains management's view about industry trends, risks, uncertainties, accounting policies that Bancorp views as critical in light of its business, results of operations including discussion of the key performance drivers, financial position, cash flows, commitments and contingencies, important events, transactions that have occurred over the last three years, and forward-looking information, as appropriate.

Financial statements include Consolidated Balance Sheets as of the end of the last two years, and Consolidated Statements of Income, Comprehensive Income, Changes in Stockholders' Equity, and Cash Flows, for each of the last three years. Bancorp's financial statements are prepared in accordance with US GAAP.

Notes to the financial statements provide insight into, and are an integral part of, the financial statements. The notes contain explanations of significant accounting policies, details about certain captions on the financial statements, information about significant events or transactions that have occurred, discussions about legal proceedings, commitments and contingencies, and selected financial information relating to business segments. The notes to the financial statements also are prepared in accordance with US GAAP.

Reports related to the financial statements and internal control over financial reporting include the following:

- A report from KPMG LLP, an independent registered public accounting firm, which includes their opinion on the presentation of Bancorp's consolidated financial statements in conformity with US GAAP based on their audits;
- A report from management indicating Bancorp's responsibility for financial reporting and the financial statements;
- A report from management indicating Bancorp's responsibility for the system of internal control over financial reporting, including an assessment of the effectiveness of those controls; and

A report from KPMG LLP, which includes their opinion on the effectiveness of Bancorp’s internal control over financial reporting.

Our Business

Stock Yards Bancorp, Inc., incorporated in 1988, and its business is substantially the same as that of its wholly owned subsidiary, Stock Yards Bank & Trust Company. The Bank has operated continuously since it opened in 1904. The Bank conducted business at one location for 85 years and began branching in 1989. At December 31, 2015, the Bank had 28 full service banking locations in the Louisville MSA, four full service banking locations in the Indianapolis MSA, and five full service banking locations in the Cincinnati MSA. In 2015, Bancorp opened two full-service branches in the Cincinnati MSA and one full-service branch in the Indianapolis MSA. Bancorp’s focus on flexible, attentive customer service has been key to its growth and profitability. The wide range of services provided by investment management and trust, securities brokerage, and mortgage origination helps support the corporate philosophy of capitalizing on full service customer relationships.

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Forward-Looking Statements

This report contains forward-looking statements under the Private Securities Litigation Reform Act that involve risks and uncertainties. These forward-looking statements may be identified by the use of words such as “expect”, “anticipate”, “plan”, “foresee”, “believe” or other words with similar meaning. Although Bancorp believes the assumptions underlying the forward-looking statements contained herein are reasonable, any of these assumptions could be inaccurate. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: economic conditions both generally and more specifically in the markets in which Bancorp and its subsidiaries operate; competition for Bancorp’s customers from other providers of financial services; government legislation and regulation which change from time to time and over which Bancorp has no control; changes in interest rates; material unforeseen changes in liquidity, deterioration in the real estate market, results of operations or financial condition of Bancorp’s customers; or other risks detailed in Bancorp’s filings with the Securities and Exchange Commission and Item 1A of this Form 10-K, all of which are difficult to predict and many of which are beyond the control of Bancorp.

Critical Accounting Policies

Bancorp has prepared the consolidated financial information in this report in accordance with US GAAP. In preparing the consolidated financial statements in accordance with US GAAP, Bancorp makes estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurances that actual results will not differ from those estimates.

Management has identified the accounting policy related to the allowance and provision for loan losses as critical to the understanding of Bancorp’s results of operations and discussed this conclusion with the Audit Committee of the Board of Directors. Since the application of this policy requires significant management assumptions and estimates, it could result in materially different amounts to be reported if conditions or underlying circumstances were to change. The provision reflects an allowance methodology that is driven by risk ratings, historical losses, and qualitative factors. Assumptions include many factors such as changes in borrowers’ financial condition which can change quickly or historical loss ratios related to certain loan portfolios which may or may not be indicative of future losses. In the second quarter of 2015, Bancorp extended the historical period used to capture Bancorp’s historical loss ratios from 12 quarters to 24 quarters. Management believes the extension of the look-back period is appropriate to capture the impact of a full economic cycle and more accurately represents the current level of risk inherent in the loan portfolio. To the extent that management’s assumptions prove incorrect, the results from operations could be materially affected by a higher or lower provision for loan losses. The accounting policy related to the allowance for loan losses is applicable to the commercial banking segment of Bancorp. The impact and any associated risks related to this policy on Bancorp’s business operations are discussed in the “Allowance for Loan Losses” section below.

The allowance for loan losses is management’s estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Bancorp’s allowance calculation includes allocations to loan portfolio segments at December 31, 2015 for qualitative factors including, among other factors, local economic and business conditions, the quality and experience of lending staff and management, exceptions to lending policies, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, changes in the value of underlying collateral for collateral-dependent loans, effect of other external factors such as the national economic and business trends, and the quality and depth of the loan review function. Bancorp utilizes the sum of all allowance amounts derived as described above as the appropriate level of allowance for loan and lease losses. Changes in the criteria used in this evaluation or the availability of new information could cause the allowance to be increased or decreased in future periods. In addition, bank regulatory agencies, as part of their examination process, may require adjustments to the allowance for loan and lease losses based on their judgments and estimates.

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Overview of 2015

The following discussion should be read in conjunction with Bancorp’s consolidated financial statements and accompanying notes and other schedules presented elsewhere in this report.

In 2015, Bancorp completed a year of earnings, asset and deposit growth with net income totaling $37.2 million, an increase of 7% over 2014. Diluted earnings per share for 2015 increased 5% over 2014 to $2.48, marking the fifth consecutive year of record earnings per diluted share. Increased profitability was primarily due to an increase in net interest income and non-interest income. These increases were partially offset by a return to a provision for loan loss in 2015, and higher non-interest expenses and income tax expense.

As is the case with most banks, the primary source of Bancorp’s revenue is net interest income and fees from various financial services provided to customers. Net interest income is the difference between interest income earned on loans, investment securities and other interest earning assets less interest expense on deposit accounts and other interest bearing liabilities. Loan volume and the interest rates earned on those loans are critical to overall profitability. Similarly, deposit volume is crucial to funding loans and rates paid on deposits directly impact profitability. Business volumes are influenced by economic factors including market interest rates, business spending, consumer confidence and competitive conditions within the marketplace.

Bancorp’s loan portfolio increased $164 million, or 9%, during 2015 to $2.0 billion as a result of record loan production. Increased volume of loans and investments contributed to higher interest income in 2015; this was partially offset by declining interest rates on loans. As a result, interest income for 2015 increased $4.1 million over 2014. Even with significant deposit growth, interest expense declined due to lower funding costs on deposits and borrowings. Rates on assets decreased more than the rates on liabilities, resulting in a decreased net interest spread and net interest margin compared to 2014. Net interest margin in 2015 decreased to 3.67% compared to 3.75% in 2014.

Total non-interest income in 2015 increased $795 thousand compared to 2014, and remained consistent at 31% of total revenues, reflecting increases in mortgage banking and bankcard transaction revenue which was largely offset by decreases in most other areas of non-interest income.

Higher non-interest expenses for 2015 resulted from increases in losses on other real estate owned and other non-interest expenses including a provision for losses on unfunded credit commitments. This was partially offset by decreases in amortization expense on investments in tax credit partnerships and mortgage servicing rights. Net losses on sales of other real estate owned totaled $147 thousand compared to net gains of $271 thousand for 2014. Bancorp's efficiency ratio for 2015 of 56.8% decreased from 59.1% in 2014.

In 2015, Bancorp recorded a $750 thousand provision for loan losses, compared to a release of $400 thousand in 2014. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for the inherent losses on outstanding loans. Bancorp's allowance for loan losses was 1.10% of total loans at December 31, 2015, compared with 1.33% of total loans at December 31, 2014.

Bancorp's effective tax rate increased to 31.3% in 2015 from 30.5% in 2014. The increase in income tax expense from 2014 to 2015 is the result of higher earnings and lower nontaxable income from the increase in cash value of life insurance and municipal securities.

Tangible common equity (TCE), a non-GAAP measure, is a measure of a company's capital which is useful in evaluating the quality and adequacy of capital. It is calculated by subtracting the value of intangible assets and any preferred equity from the book value of Bancorp's stockholders' equity. The ratio of tangible common equity to total tangible assets was 10.10% as of December 31, 2015, compared to 10.05% at December 31, 2014. See the Non-GAAP Financial Measures section for details on reconcilement to US GAAP measures.

Challenges for 2016 will include maintaining a stable net interest margin, achieving continued loan growth, managing credit quality and increasing regulatory requirements.

Bancorp expects net interest margin to decline somewhat in 2016. Loan prepayments are expected to diminish below 2015 levels while competitive pressure on rates for new loans will likely result in a pressure on the net interest margin for 2016. Increased deposit rate competition could negatively impact this expectation, as could a decrease in longer term interest rates.

The Federal Reserve Board increased its key short term rate in December 2015 for the first time since 2008. Indications are that the Federal Reserve may increase short term rates during 2016 if market conditions warrant. Approximately 20% of Bancorp's loans are indexed to the prime interest rate and reprice immediately with Federal Reserve rate changes. However, approximately 15% of total loans have reached their contractual floor of 4% or higher, meaning they will not reprice until the prime rate increases 50 bp from today's levels. Deposit rates generally do not reprice as quickly as loans.

Bancorp's goals for 2016 include net loan growth at a pace comparable to that experienced in 2015. This will be impacted by competition, prevailing economic conditions, line of credit utilization and the impact of prepayments in the loan portfolio. Bancorp believes there is continued opportunity for loan growth, and Bancorp's ability to deliver attractive loan growth over the long-term is linked to Bancorp's success.

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Bancorp expects growth of our investment management and trust services revenue in 2016. However, the overall market is a significant driver of investment and trust revenue, which could decline if the broader market continues to experience a decline.

Bancorp expects a modest decrease in non-interest income for 2016 from gains on sales of mortgage loans held for sale; expected refinance activity tends to slow as rates rise.

Bancorp expects year-over-year increases in non-interest expense including personnel, data processing and occupancy expenses to support overall growth of the company. Bancorp also anticipates higher amortization of investments in partnerships which generate historic and new markets federal income tax credits.

The following sections provide more details on subjects presented in this overview.

Results of Operations

Net income was $37.2 million or $2.48 per share on a diluted basis for 2015 compared to $34.8 million or $2.36 per share for 2014 and $27.2 million or $1.89 per share for 2013.

Net income for 2015 was positively impacted by:

- a $4.6 million or 5% increase in net interest income, and
- a $795 thousand or 2% increase in non-interest income.

Net income for 2015 was negatively impacted by:

- a $189 thousand or 0.3% increase in non-interest expenses,
- a $750 thousand provision for loan losses in 2015, compared to a release of $400 thousand in 2014, and
- a $1.7 million or 11% increase in income tax expense.

The following paragraphs provide a more detailed analysis of significant factors affecting operating results.

Net Interest Income

Net interest income, the most significant component of Bancorp's earnings, represents total interest income less total interest expense. Net interest spread is the difference between the taxable equivalent rate earned on average interest earning assets and the rate expensed on average interest bearing liabilities. Net interest margin represents net interest income on a taxable equivalent basis as a percentage of average earning assets. Net interest margin is affected by both the interest rate spread and the level of non-interest bearing sources of funds. The level of net interest income is determined by the mix and volume of interest earning assets, interest bearing deposits and interest bearing liabilities and by changes in interest rates. The discussion that follows is based on tax-equivalent interest data.

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Comparative information regarding net interest income follows:

(Dollars in thousands)	2015		2014		2013		2015/2014 Change		2014/2013 Change	
Net interest income, tax-equivalent basis	$ 89,246		$ 84,730		$ 78,306		5.3	%	8.2	%
Net interest spread	3.59	%	3.67	%	3.59	%	(8	)bp	8	bp
Net interest margin	3.67	%	3.75	%	3.74	%	(8	)bp	1	bp
Average earning assets	$ 2,430,400		$ 2,259,843		$ 2,096,088		7.5	%	7.8	%
Five year Treasury bond rate at year end	1.76	%	1.65	%	1.75	%	11	bp	(10	)bp
Average five year Treasury bond rate	1.53	%	1.63	%	1.17	%	(10	)bp	46	bp
Prime rate at year end	3.50	%	3.25	%	3.25	%	25	bp	0	bp
Average prime rate	3.26	%	3.25	%	3.25	%	1	bp	0	bp

bp = basis point = 1/100th of a percent

All references above to net interest margin and net interest spread exclude the sold portion of certain participation loans from calculations. Such loans remain on Bancorp's balance sheet as required by US GAAP because Bancorp retains some form of effective control; however, Bancorp receives no interest income on the sold portion of these loans. These participation loans sold are excluded in the calculation of margins, because Bancorp believes it provides a more accurate determination of the performance of its loan portfolio.

Prime rate and the five year Treasury bond rate are included above to provide a general indication of the interest rate environment in which Bancorp operated. Approximately $701 million, or 35%, of Bancorp’s loans are variable rate; most of these loans are indexed to the prime rate and may reprice as that rate changes. However, approximately $296 million of variable rate loans, have reached their contractual floor of 4% or higher. As noted above, interest rates must rise above the level of the floors before these loans will begin to reprice. Approximately $138 million of variable rate loans have contractual floors below 4%. The remaining $267 million of variable rate loans have no contractual floor. Bancorp intends to establish floors whenever possible upon acquisition of new customers. Bancorp’s variable rate loans are primarily comprised of commercial lines of credit and real estate loans. At inception, most of Bancorp’s fixed rate loans are priced in relation to the five year Treasury bond.

Average loan balances increased $147 million or 8.4% in 2015. However, competition and the sustained low interest rate environment drove average loan yields lower by 17 basis points. Increased interest income from higher volumes was partially offset by these lower rates. Bancorp grew average interest bearing deposits $46 million or 2.9%. Average interest costs on interest bearing deposits decreased 5 basis points, reflecting the sustained low interest rate environment and a more favorable mix of deposits. Average Federal Home Loan Bank ("FHLB") advances increased by $5.3 million or 14.9%, with average rates decreasing by 6 basis points.

Time deposit maturities of approximately $187 million, or 70% of total time deposits, in 2016 are not likely to spark improvement in interest expense as prevailing market rates are similar to existing rates on those deposits. Overall, management expects the net interest margin to remain under pressure in 2016. Excess liquidity resulting from seasonal short-term deposits, while profitable, will likely contribute to a decreased net interest margin for 2016. The margin could be affected negatively if competition causes increases in deposit rates or a greater than expected decline in loan pricing in Bancorp's markets.

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Asset/Liability Management and Interest Rate Risk

Managing interest rate risk is critical to Bancorp. The primary objective of interest rate risk management is to neutralize effects of interest rate changes on net income. By considering both on and off-balance sheet financial instruments, management evaluates interest rate sensitivity while attempting to optimize net interest income within the constraints of prudent capital adequacy, liquidity needs, market opportunities and customer requirements.

Interest Rate Simulation Sensitivity Analysis

Bancorp uses an earnings simulation model to estimate and evaluate the impact of an immediate change in interest rates on earnings in a one year forecast. The simulation model is designed to reflect dynamics of interest earning assets, interest bearing liabilities and off-balance sheet financial instruments. By estimating the effects of interest rate increases and decreases, the model can reveal approximate interest rate risk exposure. The simulation model is used by management to gauge approximate results given a specific change in interest rates at a given point in time. The model is therefore a tool to indicate earnings trends in given interest rate scenarios and may not indicate actual expected results.

The December 31, 2015 simulation analysis, which shows very little interest rate sensitivity, indicates that an increase in interest rates of 100 to 200 basis points would have a negative effect on net interest income, and a decrease of 100 basis points in interest rates would also have a negative effect on net interest income. These estimates are summarized below. The scenario of rates decreasing 200 bp is not reasonably possible given current low rates for short-term instruments and most deposits

	Net interest income % change
Increase 200 bp	(2.38)
Increase 100 bp	(1.85)
Decrease 100 bp	(3.11)
Decrease 200 bp	N/A

Management expects that net interest margin will remain under pressure through 2016, and any near-term increases in prevailing interest rates will not immediately benefit Bancorp. Approximately 65% of its loan portfolio has fixed rates and 15% of its loan portfolio is priced at variable rates with floors of 4% or higher. Since the prime rate is currently 3.50%, a rise in rates would have a short-term negative impact on net interest income since rates would have to increase more than 50 bps before the rates on such loans will rise to compensate for higher interest costs. This effect is captured in the simulation analysis above. The extent of margin compression also will be affected by the need to respond to competitive pressures on funding sources.

Undesignated derivative instruments described in Note 22 to Bancorp's consolidated financial statements are recognized on the consolidated balance sheet at fair value, with changes in fair value due to changes in prevailing interest rates, recorded in other non-interest income. Because of matching terms of offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings, and are therefore not included in the simulation analysis results above.

Derivatives designated as cash flow hedges described in Note 22 to Bancorp's consolidated financial statements are recognized on the consolidated balance sheet at fair value, with changes in fair value due to changes in prevailing interest rates, recorded net of tax in other comprehensive income.

The following table presents the increases in net interest income due to changes in rate and volume computed on a tax-equivalent basis and indicates how net interest income in 2015 and 2014 was impacted by volume increases and the lower average interest rate environment. The tax-equivalent adjustments are based on a 35% federal tax rate. The change in interest due to both rate and volume has been allocated to the change due to rate and the change due to volume in proportion to the relationship of the absolute dollar amounts of the change in each.

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Taxable Equivalent Rate/Volume Analysis

(In thousands)	2015/2014 Increase (decrease) due to Net change	Rate	Volume	2014/2013 Increase (decrease) due to Net change	Rate	Volume
Interest income						
Loans	$3,444	$(3,099)	$6,543	$1,136	$(4,335)	$5,471
Federal funds sold	(29)	2	(31)	(3)	20	(23)
Mortgage loans held for sale	75	19	56	(45)	27	(72)
Securities						
Taxable	555	(113)	668	1,466	316	1,150
Tax-exempt	(7)	(33)	26	34	(59)	93
Total interest income	4,038	(3,224)	7,262	2,588	(4,031)	6,619
Interest expense						
Deposits						
Interest bearing demand deposits	97	24	73	108	21	87
Savings deposits	3	(1)	4	1	(4)	5
Money market deposits	15	(10)	25	62	(35)	97
Time deposits	(697)	(375)	(322)	(861)	(565)	(296)
Securities sold under agreements to repurchase	9	1	8	(6)	(8)	2
Federal funds purchased and other short-term borrowings	(4)	1	(5)	(3)	(1)	(2)
Federal Home Loan Bank advances	99	(24)	123	(47)	(129)	82
Long-term debt	-	-	-	(3,090)	-	(3,090)
Total interest expense	(478)	(384)	(94)	(3,836)	(721)	(3,115)
Net interest income	$4,516	$(2,840)	$7,356	$6,424	$(3,310)	$9,734

Bancorp’s tax equivalent net interest income increased $4.5 million for the year ended December 31, 2015 compared to the same period of 2014, while 2014 increased $6.4 million compared to 2013. Net interest income for 2015 compared to 2014 was positively impacted by an increase in loan volume, securities volume, a decrease in deposit rates, a more favorable mix of deposits, and a decrease in rates of FHLB advances. Net interest income was negatively impacted by a decline in the average rate earned on assets and higher volume of FHLB advances. Volume increases of loans and securities boosted net interest income by $7.3 million, while declining rates on liabilities contributed $0.4 million to the increase of net interest income. Partially offsetting the increases, declining rates on assets negatively impacted net interest income by $3.2 million. FHLB advance interest increased $99 thousand attributable to higher volume, net of the effect of lower rates.

For the year 2014 compared to 2013, net interest income was positively impacted by an increase in loan volume, securities volume and rates, a decrease in deposit rates, a more favorable mix of deposits, and decreases in the rates of FHLB advances, and the redemption of long-term debt. Net interest income was negatively impacted by a decline in the average rate earned on loans and higher volume of FHLB advances. Volume increases of loans and securities increased net interest income by $6.6 million, while redemption of long-term debt contributed $3.0 million to net interest income for 2014. Higher rates on securities resulted in $0.26 million while declining rates on deposits, particularly time deposits, contributed $0.6 million to the increase of net interest income. Partially offsetting the increases, declining rates on loans negatively impacted net interest income by $4.3 million. FHLB advance interest decreased $47 thousand attributable to lower rates, net of the effect of higher volume.

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Provision for Loan Losses

In determining the provision for loan losses, management considers many factors. Among these are the quality and underlying collateral of the loan portfolio, previous loss experience, the size and composition of the loan portfolio and an assessment of the impact of current economic conditions on borrowers' ability to pay. The provision for loan losses and resulting ratios are summarized below:

(Dollars in thousands)	2015	2014	2013
Provision (credit) for loan losses	$750	$(400)	$6,550
Allowance to loans at year end	1.10%	1.33%	1.66 %
Allowance to average loans for year	1.17	1.41	1.72

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for inherent losses on outstanding loans. The allowance for loan losses is calculated after considering credit quality factors, and ultimately relies on an overall internal analysis of risk in the loan portfolio. Based on this analysis, the provision for loan losses is determined and recorded. The provision reflects the results of an allowance methodology that is driven by risk ratings, historical losses, and qualitative factors. Levels of non-performing loans have trended downward in 2015 and many key indicators of loan quality continue to show improvement. Over the past year, non-performing loans have declined 25%, while non-performing assets have also declined 25%. More information on this process can be found in the "Allowance for loan losses" section.

Non-performing loans decreased to $8.9 million at December 31, 2015 from $11.9 million at year-end 2014, primarily due to a decrease in loans classified as troubled debt restructurings ("TDR"), partially offset by an increase in non-accrual loans. TDRs, which are currently accruing interest, decreased from $6.4 million at December 31, 2014 to $1.1 million at December 31, 2015, reflecting the migration of one lending relationship to performing status. The ratio of non-performing loans to total loans was 0.44% at December 31, 2015, down from 0.64% at December 31, 2014. Net charge-offs totaled 0.17% of average loans for 2015 compared to 0.18% for 2014. See "Financial Condition-Non-performing Loans and Assets" for further discussion of non-performing loans. See "Financial Condition-Summary of Loan Loss Experience" for further discussion of loans charged off during the year.

Bancorp's loan portfolio is diversified with no significant concentrations of credit. Geographically, most loans are extended to borrowers in the metropolitan areas of Louisville, Indianapolis and Cincinnati. The adequacy of the allowance is monitored on an ongoing basis and it is the opinion of management that the balance of the allowance for loan losses at December 31, 2015 is adequate to absorb probable losses inherent in the loan portfolio as of the financial statement date. See “Financial Condition-Allowance for Loan Losses” for more information on the allowance for loan losses.

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Non-Interest Income and Non-Interest Expenses

The following table provides a comparison of components of non-interest income for 2015, 2014 and 2013. Below the table is a discussion of significant changes and trends.

(Dollars in thousands)	2015	2014	2013	2015/2014 Change	%	2014/2013 Change	%
Investment management and trust services	$18,026	$18,212	$16,287	$(186)	(1.0)%	$1,925	11.8%
Service charges on deposit accounts	8,906	8,883	8,986	23	0.3	(103)	(1.1)
Bankcard transaction revenue	4,876	4,673	4,378	203	4.3	295	6.7
Mortgage banking revenue	3,488	2,653	3,978	835	31.5	(1,325)	(33.3)
Loss on sales of securities available-for-sale	-	(9)	(5)	9	(100.0)	(4)	80.0
Brokerage commissions and fees	1,994	2,060	2,159	(66)	(3.2)	(99)	(4.6)
Bank owned life insurance income	889	927	1,031	(38)	(4.1)	(104)	(10.1)
Gain on acquisition	-	-	449	-	-	(449)	100.00
Other	1,771	1,756	1,739	15	0.9	17	1.0
	$39,950	$39,155	$39,002	$795	2.0%	$153	0.4%

The largest component of non-interest income is investment management and trust ("IM&T") revenue. The magnitude of IM&T revenue distinguishes Bancorp from other community banks of similar asset size. Trust assets under management totaled $2.24 billion at December 31, 2015, compared to $2.27 billion at December 31, 2014 and $2.23 billion at December 31, 2013. Assets under management are stated at market value and the 2015 decline arose from a departure of some accounts near the end of 2014. IM&T services revenue, which constitutes an average of 44% of non-interest income, decreased $186 thousand, or 1.0%, for 2015 compared to 2014. Recurring fees, which generally comprise over 95% of the IM&T revenue, increased $231 thousand, or 1%, in 2015, compared to 2014. Most recurring fees earned for managing accounts are based on a percentage of market value on a monthly basis. Some revenues of the IM&T department, most notably executor, insurance, and some employee benefit plan-related fees, are non-recurring in nature and the timing of these revenues corresponds with the related administrative activities. Total non-recurring fees decreased $417 thousand for 2015, compared to 2014. For 2015, 2014 and 2013 executor fees totaled approximately $390 thousand, $739 thousand and $437 thousand, respectively. Management believes the IM&T department will continue to factor significantly in Bancorp's financial results and provide strategic diversity to revenue streams. Management is optimistic that the IM&T department will deliver stronger growth in 2016, but notes that increased market volatility could affect near-term results.

Service charges on deposit accounts were virtually flat for 2015 compared to 2014. Service charge income is driven by transaction volume, which can fluctuate throughout the year. A significant component of service charges is related to fees earned on checking account overdrafts. Management expects this source of revenue to slowly decline due to anticipated changes in customer behavior and ongoing regulatory restrictions.

Bankcard transaction revenue increased $203 thousand, or 4.3%, for 2015 compared to 2014, and primarily represents income the Bank derives from customers' use of debit cards. The increase in 2015 reflects an increase in the volume of transactions, partially offset by a decrease in interchange rates received. Interchange income is based on rates set by service providers in a competitive market. Volume, which is dependent on consumer behavior, is expected to continue to increase slowly. However, management expects interchange rates to continue to decrease, resulting in income from this source remaining consistent with levels experienced in 2015.

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Mortgage banking revenue includes primarily gains on sales of mortgage loans. Bancorp's mortgage banking department originates residential mortgage loans to be sold in the secondary market. Interest rates on the loans sold are locked with the investor prior to closing the loans, thus Bancorp bears no interest rate risk related to these loans. The department offers conventional, VA and FHA financing, for purchases and refinances, as well as programs for first-time home buyers. Interest rates on mortgage loans directly impact the volume of business transacted by the mortgage banking division. Mortgage banking revenue increased $835 thousand, or 31.5%, in 2015 compared to 2014. Market rates for mortgage loans decreased during 2015, resulting in increased refinance activity compared to the same period in 2014. This was coupled with an increase in home purchase activity in 2015, an indicator of improving consumer confidence.

In 2015, Bancorp sold securities with total fair market value of $5.9 million, generating no gain or loss. These securities consisted of agency and mortgage-backed securities with small remaining balances. In 2014, Bancorp sold securities with total fair market value of $7.7 million, generating a net loss of $9 thousand. These securities consisted of mortgage-backed securities with small remaining balances, obligations of state and political subdivisions, and agency securities. In 2013, Bancorp sold obligations of state and political subdivisions with total fair market value of $696 thousand, generating a loss of $5 thousand. All sales were made in the ordinary course of portfolio management.

Brokerage commissions and fees decreased $66 thousand, or 3.2%, in 2015 compared to 2014, corresponding to overall brokerage volume. Brokerage commissions and fees earned consist primarily of stock, bond and mutual fund sales as well as wrap fees on accounts. Wrap fees are charges for investment programs that bundle together a suite of services, such as brokerage, advisory, research and management, and are based on a percentage of assets. Bancorp deploys its brokers primarily through its branch network via an arrangement with a third party broker-dealer, while larger managed accounts are serviced in the Bank's IM&T department.

Income related to bank-owned life insurance ("BOLI") declined to $889 thousand in 2015 compared to $927 million for 2014, reflecting a lower interest crediting rate in 2015 due to the prevailing low interest rate environment. BOLI represents the cash surrender value for life insurance policies on certain key employees who have provided consent for Bancorp to be the beneficiary of a portion of such policies. The related change in cash surrender value and any death benefits received under the policies are recorded as non-interest income. This income helps offset the cost of various employee benefits.

Gain on acquisition totaled $449 thousand in 2013. The Oldham transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration transferred were recorded at estimated fair value on the acquisition date. See Note 3 to Bancorp's consolidated financial statements for information relating to the acquisition. The fair value adjustments resulted in net assets acquired in excess of the consideration paid. Accordingly, a non-taxable gain was recognized in 2013. No such transactions occurred in 2015 or 2014.

Other non-interest income increased $15 thousand, or 0.9%, during 2015 compared to 2014 due to a variety of factors, none of which were individually significant.

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The following table provides a comparison of components of non-interest expenses for 2015, 2014 and 2013. Below the table is a discussion of significant changes and trends.

(Dollars in thousands)	2015	2014	2013	2015/2014 Change	%	2014/2013 Change	%
Salaries and employee benefits	$44,709	$44,687	$41,145	$22	0.0 %	$3,542	8.6 %
Net occupancy expense	5,912	5,963	5,615	(51)	(0.9)	348	6.2
Data processing expense	6,348	6,393	6,319	(45)	(0.7)	74	1.2
Furniture and equipment expense	1,074	1,016	1,126	58	5.7	(110)	(9.8)
FDIC insurance	1,258	1,314	1,431	(56)	(4.3)	(117)	(8.2)
Loss (gain) on other real estate owned	147	(271)	652	418	(154.2)	(923)	(141.6)
Acquisition costs	-	-	1,548	-	-	(1,548)	100.0
Amortization of investment in tax credit partnerships	634	1,095	-	(461)	(42.1)	1,095	100.0
Other	13,316	13,012	13,516	304	2.3	(504)	(3.7)
	$73,398	$73,209	$71,352	$189	0.3 %	$1,857	2.6 %

Salaries and benefits, the largest component of non-interest expenses were virtually flat for 2015 compared to 2014, largely due to the effect of increased staffing levels and normal increases in salaries being offset by lower cash incentive expense. Staff additions included senior staff with higher per capita salaries in IM&T and lending functions as well as personnel to support overall growth. Executive incentive payments are primarily tied to earnings per share ("EPS") growth. EPS growth was 5% when comparing 2015 to 2014. EPS growth was 25% when comparing 2014 to 2013. This decline resulted in lower cash incentive expense for 2015. At December 31, 2015, Bancorp had 555 full-time equivalent employees compared to 524 at the same date in 2014 and 519 for 2013.

Net occupancy expense decreased $51 thousand or 0.9% from 2014 to 2015. While Bancorp added three branches in 2015, the higher associated rent, depreciation and utilities expenses were more than offset by the effect of a branch lease termination expense in 2014. At December 31, 2015 Bancorp had 37 banking center locations including the main office.

Data processing expense decreased $45 thousand or 0.7% from 2014 to 2015, largely due to decreases in expenses for bank card processing/reissuance. Debit card fraud decreased from 2014 to 2015, resulting in lower card reissuance expense in 2015. This category includes ongoing computer software amortization and maintenance related to investments in new technology needed to maintain and improve the quality of delivery channels and internal resources.

Furniture and equipment expense increased $58 thousand or 5.7% in 2015, as compared to 2014, due to a variety of factors, none of which is individually significant. Costs of capital asset additions flow through the statement of income over the lives of the assets in the form of depreciation expense.

FDIC insurance expense decreased $56 thousand, or 4.3% for the year ended December 31, 2015, as compared to the same period in 2014. The assessment is calculated by the FDIC, and the decline in expense is due primarily to a reduction in the assessment rate driven by improved credit metrics.

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In connection with the Oldham acquisition in 2013, Bancorp incurred $1.5 million in expenses related to executing the transaction and integrating and conforming acquired operations with and into Bancorp. Those expenses consisted largely of systems conversions and/or integration of operations. No such transactions occurred in 2015 or 2014. A summary of acquisition costs included in the consolidated statement of income for 2013 follows:

(in thousands)	**Amount**
Data conversion expenses	$ 906
Consulting	262
Salaries and employee benefits	103
Legal	96
All other	181
Total acquisition costs	$ 1,548

Amortization of investments in tax credit partnerships decreased $461 thousand or 42.1% for the year ended December 31, 2015 compared to the same period of 2014. This expense reflects amortization of investments in partnerships which generate historic and new markets federal income tax credits and can vary widely depending upon the timing of investments and related amortization. See the Income Taxes section below for details on amortization and income tax impact for these credits.

Other non-interest expenses increased $304 thousand, or 2.3% for the year ended December 31, 2015 compared to the same period of 2014. The increase was largely due to a $432 thousand provision to establish a reserve for estimated losses on unfunded credit commitments and a $103 thousand impairment charge for other-than-temporary impairment (“OTTI”) on an available-for-sale equity security. These increases were partially offset by a $319 thousand decrease in mortgage servicing rights amortization, a $113 thousand decrease in core deposit intangible amortization and a variety of other factors, none of which were individually significant. This category also includes legal and professional fees, donations, state bank taxes, marketing, OREO maintenance, printing, and mail and telecommunications expenses.

Bancorp's efficiency ratio for 2015 of 56.8% decreased from 59.1% in 2014. Excluding the amortization of the investments in tax credit partnerships, the adjusted efficiency ratio, a non-GAAP measure, would have been 56.3% and 58.2% for 2015 and 2014, respectively. See the Non-GAAP Financial Measures section for details on reconcilement to US GAAP measures.

Income Taxes

A three year comparison of income tax expense and effective tax rate follows:

(Dollars in thousands)	**2015**	**2014**	**2013**
Income tax expense	$16,933	$15,281	$11,228
Effective tax rate	31.3 %	30.5 %	29.2 %

The increase in the effective tax rate from 2014 to 2015 arose from lower nontaxable income from the increase in cash value of life insurance and municipal securities. The reclassification of tax credit investment amortization expense explained below reduced 2014 income tax expense by $788 thousand. Similarly, the increase in the effective tax rate from 2013 to 2014 is primarily due to lower nontaxable income from the increase in cash value of life insurance and municipal securities. For more information regarding income taxes and the effective tax rate see Note 8 to Bancorp's consolidated financial statements.

Bancorp invests in certain partnerships that yield low-income housing, historic and new market tax credits. As a result of updated accounting guidance, beginning with periods after 2013, the tax benefits and related investment amortization expenses for low-income housing credits are recognized in income tax expense using a proportional amortization method which amortizes the investment in proportion to the tax credits and other tax benefits received. Prior to 2014, the tax benefits and related investment amortization expenses for low-income housing credits were recognized in income tax expense using an effective yield method over the life of the investment. In 2014, the amortization method for investments in new markets and historic tax credit partnerships was changed from the effective yield method to the cost method which matches the amortization period with the time frame over which the credits are realized. At the same time, the amortization for investments in new market and historic tax credit partnerships was reclassified from income tax expense to other non-interest expense resulting in a decrease in the effective tax rate. For each of Bancorp's investments in tax credit partnerships, when taken as a whole, the tax benefit compared to the amortization results in a positive effect on net income.

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Financial Condition

Earning Assets and Interest Bearing Liabilities

Summary information with regard to Bancorp's financial condition follows:

(Dollars in thousands)	2015	2014	2013	2015/2014 Change	%	2014/2013 Change	%
Average earning assets	$ 2,430,400	$ 2,259,843	$ 2,096,088	$ 170,557	7.5 %	$ 163,755	7.8 %
Average interest bearing liabilities	1,715,584	1,664,406	1,582,591	51,178	3.1	81,815	5.2
Average total assets	2,573,901	2,398,430	2,232,868	175,471	7.3	165,562	7.4
Total year end assets	2,816,801	2,563,868	2,389,262	252,933	9.9	174,606	7.3

Bancorp has experienced growth in earning assets over the last several years primarily in the area of loans. From 2014 to 2015, average loans increased 8.4%, or $147.5 million, compared to 7.1% or $117.3 million from 2013 to 2014. Record loan production during 2015 and 2014 was offset as expected by loan payoffs, including the effects of amortization and scheduled maturities. Utilization rates on lines of credit were 48%, 52% and 54% as of December 31 2015, 2014 and 2013, respectively. Average securities available-for-sale increased $31.8 million, or 8.1% from 2014 to 2015, compared to $55.8 million, or 16.6% from 2013 to 2014 as Bancorp deployed funds from deposit growth into longer-term earning assets.

The increase in average interest bearing liabilities from 2014 to 2015 occurred primarily in money market and demand deposits as clients have excess cash and few short-term investment alternatives in the current rate environment. Average total interest bearing deposit accounts increased 2.9% and non-interest bearing deposit accounts increased 20.8% in 2015. Time deposits decreased 13.9% or $46.0 million in 2015, as Bancorp intentionally did not renew higher cost deposits. Customers have migrated from time deposits to demand deposits as low rates did not compensate them for giving up liquidity. Bancorp continued to utilize fixed rate advances from the FHLB during 2015 as these compared favorably to similar term time deposits. Bancorp had an average of $41.0 million in outstanding FHLB advances in 2015 compared to $35.7 million and $32.5 million in 2014 and 2013, respectively. At December 31, 2015 and 2014, federal funds purchased from correspondent banks totaled $22.5 million and $47.4 million, respectively.

At December 31, 2015, Bancorp had seasonal deposits with excess balances of approximately $100 million. These funds are invested in federal funds sold or other short-term investments, as the deposits are expected to return to normal levels during the first two quarters of 2016. While profitable, the excess federal funds sold is expected to have a negative effect on net interest margin for the first six months of 2016.

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Average Balances and Interest Rates – Taxable Equivalent Basis

(Dollars in thousands)	Year 2015 Average balances	Interest	Average rate	Year 2014 Average balances	Interest	Average rate	Year 2013 Average balances	Interest	Average rate
Earning assets									
Federal funds sold	$82,405	$263	0.32 %	$91,970	$292	0.32 %	$99,381	$295	0.30 %
Mortgage loans held for sale	5,345	249	4.66	4,120	174	4.22	5,885	219	3.72
Securities									
Taxable	365,188	7,867	2.15	334,293	7,308	2.19	281,734	5,836	2.07
Tax-exempt	59,535	1,670	2.81	58,605	1,677	2.86	55,385	1,643	2.97
FHLB stock and other securities	6,347	253	3.99	6,755	257	3.80	6,916	263	3.80
Loans, net of unearned income	1,911,580	83,796	4.38	1,764,100	80,352	4.55	1,646,787	79,216	4.81
Total earning assets	2,430,400	94,098	3.87 %	2,259,843	90,060	3.99 %	2,096,088	87,472	4.17 %
Less allowance for loan losses	23,827			28,954			32,282		
	2,406,573			2,230,889			2,063,806		
Non-earning assets									
Cash and due from banks	38,952			37,504			33,888		
Premises and equipment	39,957			39,223			38,691		
Accrued interest receivable and other assets	88,419			90,814			96,483		
Total assets	$2,573,901			$2,398,430			$2,232,868		

(Dollars in thousands)	Year 2015 Average balances	Interest	Average rate	Year 2014 Average balances	Interest	Average rate	Year 2013 Average balances	Interest	Average rate

Interest bearing liabilities									
Deposits									
Interest bearing demand deposits	$545,158	$593	0.11 %	$477,434	$496	0.10 %	$392,939	$388	0.10 %
Savings deposits	119,821	43	0.04	108,386	40	0.04	96,515	39	0.04
Money market deposits	645,215	1,305	0.20	632,810	1,290	0.20	585,512	1,228	0.21
Time deposits	284,062	1,798	0.63	330,108	2,495	0.76	364,347	3,356	0.92
Securities sold under agreements to repurchase	65,140	149	0.23	61,748	140	0.23	60,737	146	0.24
Federal funds purchased and other short-term borrowings	15,147	25	0.17	18,211	29	0.16	19,546	32	0.16
FHLB advances	41,041	939	2.29	35,709	840	2.35	32,518	887	2.73
Long-term debt	-	-	-	-	-	-	30,477	3,090	10.14
Total interest bearing liabilities	1,715,584	4,852	0.28 %	1,664,406	5,330	0.32 %	1,582,591	9,166	0.58
Non-interest bearing liabilities									
Non-interest bearing demand deposits	558,185			462,085			404,113		
Accrued interest payable and other liabilities	25,681			26,514			26,057		
Total liabilities	2,299,450			2,153,005			2,012,761		
Stockholders' equity	274,451			245,425			220,107		
Total liabilities and stockholders' equity	$2,573,901			$2,398,430			$2,232,868		
Net interest income		$89,246			$84,730			$78,306	
			3.59 %			3.67 %			3.59 %

Net interest spread			
Net interest margin	3.67 %	3.75 %	3.74 %

Notes:

Yields on municipal securities have been computed on a fully tax-equivalent basis using the federal income tax rate of 35%.
The approximate tax-equivalent adjustments to interest income were $928,000, $973,000 and $1,008,000 for the years ended December 31, 2015, 2014 and 2013, respectively.
Average balances for loans include the principal balance of non-accrual loans and exclude participation loans accounted for as secured borrowings. These participation loans totaled $7,621,000, $8,910,000 and $9,990,000 for the years ended December 31, 2015, 2014 and 2013.
Loan interest income includes loan fees and is computed on a fully tax-equivalent basis using the federal income tax rate of 35%. Loan fees, net of deferred costs, included in interest income amounted to $825,000, $790,000 and $1,390,000 in 2015, 2014 and 2013, respectively.

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Securities

The primary purpose of the securities portfolio is to provide another source of interest income, as well as liquidity management. In managing the composition of the balance sheet, Bancorp seeks a balance between earnings sources and credit and liquidity considerations.

Securities available-for-sale include securities that may be sold in response to changes in interest rates, resultant prepayment risk and other factors related to interest rate and prepayment risk changes. Securities available-for-sale are carried at fair value with unrealized gains or losses, net of tax effect, included in stockholders' equity.

The carrying value of securities available-for-sale is summarized as follows:

	December 31	
(In thousands)	**2015**	**2014**
U.S. Treasury and other U.S. government obligations	$80,000	$70,000
Government sponsored enterprise obligations	251,893	204,986
Mortgage-backed securities – government agencies	169,628	174,270
Obligations of states and political subdivisions	63,702	62,834
Corporate equity securities	653	966
	$565,876	$513,056

Corporate equity securities consist of common stock in a publicly-traded small business investment company.

There were no securities held-to-maturity as of December 31, 2015, 2014 or 2013.

The maturity distribution and weighted average interest rates of debt securities available-for-sale at December 31, 2015 are as follows:

After ten years

(Dollars in thousands)	Within one year Amount	Rate	After one but within five years Amount	Rate	After five but within ten years Amount	Rate	Amount	Rate
U.S. Treasury and other U.S. government obligations	$80,000	0.08%	$-	-	$-	-	$-	-
Government sponsored enterprise obligations	35,339	0.74	97,564	1.24%	10,771	2.01%	108,219	2.65%
Mortgage-backed securities – government agencies	-	-	5,617	2.03	13,743	1.90	150,268	2.31
Obligations of states and political subdivisions	6,538	1.78	45,312	1.90	11,433	2.37	419	1.95
	$121,877	0.36%	$148,493	1.47%	$35,947	2.08%	$258,906	2.45%

U.S. Treasury securities consisted of short-term treasury bills, which matured in January 2016. Similarly, $20 million of the government sponsored enterprise obligations consisted of short-term discount notes, which matured in January 2016. All were purchased in late December 2015 as a tax strategy. Actual maturities for mortgage-backed securities may differ from contractual maturities due to prepayments on underlying collateral.

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Loan Portfolio

Bancorp's primary source of income is interest on loans. The composition of loans as of December 31 for each of the last five years follows:

(In thousands)	**2015**	**2014**	**2013**	**2012**	**2011**
Commercial and industrial	$644,398	$571,754	$510,739	$426,930	$393,729
Construction and development, excluding undeveloped land	134,482	95,733	99,719	85,456	116,622
Undeveloped land (1)	21,185	21,268	29,871	45,797	31,015
Real estate mortgage:					
Commercial investment	482,639	487,822	430,047	414,084	399,655
Owner occupied commercial	375,016	340,982	329,422	304,114	297,121
1-4 family residential	226,575	211,548	183,700	166,280	154,565
Home equity - first lien	50,115	43,779	40,251	39,363	38,637
Home equity - junior lien	63,066	66,268	63,403	65,790	76,687
Subtotal: Real estate mortgage	1,197,411	1,150,399	1,046,823	989,631	966,665
Consumer	35,531	29,396	34,198	36,780	36,814
Total loans	$2,033,007	$1,868,550	$1,721,350	$1,584,594	$1,544,845

(1) Undeveloped land consists of land initially acquired for development by the borrower, but for which no development has yet taken place.

Bancorp's loan portfolio increased $164 million, or 9%, during 2015 as a result of record loan production. Record loan production was offset by loan payoffs, including amortization and the effects of loan maturities. Increases in the commercial and industrial and commercial real estate categories are the result of a consistent relationship-driven business strategy to serve existing and new clients in Bancorp's local markets.

Junior lien home equity loans, which comprise 3% of the loan portfolio at December 31, 2015, are typically underwritten with consideration of the borrower's overall financial strength as a primary payment source, with some reliance on value of collateral. The overall level of home equity junior liens as a percentage of the overall portfolio and the level of related outstanding commitments have been declining over the last several years. Demand has declined as consumers seek to refinance debt into first-lien position loans at historic low rates.

Bancorp occasionally enters into loan participation agreements with other banks to diversify credit risk. For certain sold participation loans, Bancorp has retained effective control of the loans, typically by restricting the participating institutions from pledging or selling their share of the loan without permission from Bancorp. US GAAP requires the participated portion of these loans to be recorded as secured borrowings. These participated loans are included in commercial and industrial and real estate mortgage loan totals above, and a corresponding liability is recorded in other liabilities. At December 31, 2015 and 2014, total participated portions of loans of this nature were $7.2 million and $8.1 million respectively.

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The following tables detail amounts of loans at December 31, 2015 which, based on remaining scheduled repayments of principal, are due in the periods indicated. Also shown are commercial and industrial loans due after one year classified according to sensitivity to changes in interest rates.

(In thousands)	**Maturing** Within one year	After one but within five years	After five years	**Total**
Commercial and industrial	$245,310	$276,501	$122,587	$644,398
Construction and development including undeveloped land	61,372	74,899	19,396	155,667
Real estate mortgage	129,700	693,053	374,658	1,197,411
Consumer	17,735	17,025	771	35,531
Total loans	$454,117	$1,061,478	$517,412	$2,033,007

Commercial and industrial loans (In thousands)	**Interest sensitivity** Fixed rate	Variable rate
Due after one but within five years	$154,297	$122,204
Due after five years	68,385	54,202
	$222,682	$176,406

To limit interest rate sensitivity on commercial and commercial real estate loans, whenever possible, Bancorp seeks to structure loans with maturity dates longer than five years with a rate adjustment occurring no longer than five years from origination date.

Non-performing Loans and Assets

Information summarizing non-performing assets, including non-accrual loans follows:

December 31

(Dollars in thousands)	2015	2014	2013	2012	2011
Non-accrual loans	$7,693	$5,199	$15,258	$18,360	$18,737
Troubled debt restructuring	1,060	6,352	7,249	10,969	3,402
Loans past due 90 days or more and still accruing	176	329	437	719	1,160
Non-performing loans	8,929	11,880	22,944	30,048	23,299
Foreclosed property	4,541	5,977	5,592	7,364	7,773
Non-performing assets	$13,470	$17,857	$28,536	$37,412	$31,072
Non-performing loans as a percentage of total loans	0.44 %	0.64 %	1.33 %	1.90 %	1.51 %
Non-performing assets as a percentage of total assets	0.48 %	0.70 %	1.19 %	1.74 %	1.51 %
Allowance for loan loss as a percentage of non- performing loans	251 %	210 %	124 %	106 %	128 %

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At December 31, 2015, loans accounted for as TDR included modifications from original terms such as those due to bankruptcy proceedings, certain changes to amortization periods or extended suspension of principal payments due to customer financial difficulties. To the extent that Bancorp chooses to work with borrowers by providing reasonable concessions rather than initiating collection, this would result in an increase in loans accounted for as TDR. Loans accounted for as TDR, which have not defaulted, are individually evaluated for impairment and at December 31, 2015, had a total allowance allocation of $177 thousand, compared to $703 thousand at December 31, 2014.

The following table sets forth the major classifications of non-accrual loans:

Non-accrual loans by type	**December 31, 2015**		**2014**	
(in thousands)				
Commercial and industrial	$	3,643	$	1,381
Construction and development, excluding undeveloped land		-		516
Undeveloped land		-		-
Real estate mortgage - commercial investment		278		235
Real estate mortgage - owner occupied commercial		2,761		2,081
Real estate mortgage - 1-4 family residential		906		950
Home equity		105		36
Consumer		-		-
Total	$	7,693	$	5,199

Loans are placed in a non-accrual income status when prospects for recovering both principal and accrued interest are considered doubtful or when a default of principal or interest has existed for 90 days or more unless such a loan is well secured and in the process of collection. Interest income recorded on non-accrual loans was $521 thousand, $284 thousand, and $185 thousand for 2015, 2014, and 2013, respectively. Interest income that would have been recorded if non-accrual loans were on a current basis in accordance with their original terms was $465 thousand, $376 thousand, and $1.2 million for 2015, 2014, and 2013, respectively.

In addition to non-performing loans discussed above, there were loans, which are accruing interest, for which payments were current or less than 90 days past due where borrowers are experiencing elevated financial difficulties. These potential problem loans totaled approximately $12.2 million, $18.1 million, and $22.3 million at December 31, 2015, 2014, and 2013, respectively. These relationships are monitored closely for possible future inclusion in non-performing loans. Management believes it has adequately reflected credit exposure in these loans in its determination of the allowance for loan losses.

Non-performing assets as a percentage of total assets decreased 22 basis points from 2014 to 2015, reflecting decreases in loans classified as troubled debt restructuring and foreclosed property, partially offset by an increase in non-accrual loans. At December 31, 2015 and December 31, 2014, the carrying value of other real estate owned was $4.5 million and $6.0 million, respectively. In 2015, Bancorp recorded impairment charges on such OREO totaling $210 thousand, compared to $157 thousand in 2014 and $904 thousand in 2013.

Allowance for Loan Losses

An allowance for loan losses has been established to provide for probable losses on loans that may not be fully repaid. The allowance for loan losses is increased by provisions charged to expense and decreased by charge-offs, net of recoveries. Loans are typically charged off when management deems them uncollectible and after underlying collateral has been liquidated; however, collection efforts continue and future recoveries may occur. Periodically, loans are partially charged off to the net realizable value based upon evaluation of related underlying collateral, including Bancorp’s bias for resolution.

Bancorp’s lending policies and procedures center on mitigating credit risk and include procedures to identify and measure this risk. These procedures begin with lenders assigning a risk rating to each of their credits, and this rating is confirmed in the loan approval process. Internal loan review, through a year-round process of examining individually significant obligor relationships, concentrations, and a sample of each lender’s portfolio, tests the reliability of these risk assessments. Additionally, a review of this process is an integral part of regulatory bank examinations.

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Adversely rated credits are included on a loan watch list which incorporates loans requiring closer monitoring due to borrower's circumstances. However, these loans have generally not reached a level of deterioration which would cause them to be criticized credits by regulators. Loans are added to the watch list when circumstances are detected which might affect the borrower's ability to comply with terms of the loan. This could include any of the following:

- Delinquency of a scheduled loan payment,
- Severe deterioration in the borrower's or guarantor's financial condition identified in a review of periodic financial statements,
- Decrease in the value of collateral securing the loan, or
- Change in the economic environment in which the borrower operates.

Loans on the watch list require detailed status reports, including recommended corrective actions, prepared periodically by the responsible loan officer. These reports are reviewed by management. The watch list is also discussed in quarterly meetings with Bancorp's Credit Risk Committee of the Board of Directors.

Changes in loan risk ratings are typically initiated by the responsible loan officer, but may also be initiated by internal loan review or Bancorp's Loan Committees at any time.

In determining the allowance and related provision for loan losses, these principal elements are considered:

- Specific allocations are based upon probable losses on individually evaluated impaired loans. These loans are measured based on the present value of future cash flows discounted at the loans' effective interest rate or at the estimated fair value of the loans' collateral, if applicable. Other objective factors such as payment history and financial condition of the borrower or guarantor may be used as well.
- Allocations for loans not defined as impaired are based on estimates needed for pools of loans with similar risk based upon Bancorp's historical net loss percentages by loan type.
- Additional allowance allocations are based on environmental or qualitative factors not necessarily associated with a specific credit or loan category and represent management's effort to ensure that the overall allowance for loan losses appropriately reflects changes in trends, conditions and other relevant factors that may cause estimated credit losses to differ from historical experience. Management considers a number of environmental or qualitative factors, including local and general economic business factors and trends and portfolio concentrations.

Allocation of the allowance for loan losses by loan category is a result of the analysis above. The same procedures used to determine requirements for the allowance for loan losses establish the distribution of the allowance by loan category. Distribution of the allowance will change from period to period due to changes in the identified risk in each loan segment, changes in the aggregate loan balances by loan category, and changes in management's view of the environmental or qualitative factors noted above. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses.

Historical net loss percentages are updated quarterly based on actual losses experienced by each loan type. The perception of risk with respect to particular loans within the portfolio will change over time as a result of characteristics and performance of those loans, overall economic and market trends, and actual and expected trends in non-performing loans. In the second quarter of 2015, Bancorp extended the historical period used to capture Bancorp's historical loss ratios from 12 quarters to 24 quarters. Management believes the extension of the look-back period is appropriate to capture the impact of a full economic cycle and provides sufficient loss observations to develop a reliable estimate.

Bancorp's allowance calculation includes allocations to loan portfolio segments at December 31, 2015 for qualitative factors including, among other factors, local economic and business conditions, quality and experience of lending staff and management, exceptions to lending policies, levels of and trends in past due loans and loan classifications, concentrations of credit such as collateral type, trends in portfolio growth, changes in the value of underlying collateral for collateral-dependent loans, effect of other external factors such as the national economic and business trends, and the quality and depth of the loan review function. Bancorp utilizes the sum of all allowance amounts derived as described above as the appropriate level of allowance for loan and lease losses. Changes in criteria used in this evaluation or availability of new information could cause the allowance to be increased or decreased in future periods. Based on this quantitative and qualitative analysis, provisions (credits) are made to the allowance for loan losses. Such provisions (credits) are reflected as a charge against (benefit to) current earnings in Bancorp's consolidated statements of income.

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The adequacy of the allowance for loan losses is monitored by Executive Management and reported quarterly to the Audit Committee of the Board of Directors. This committee has approved the overall allowance methodology. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the adequacy of Bancorp's allowance for loan losses. Such agencies may require Bancorp to make additional provisions to the allowance based upon their judgments about information available to them at the time of their examinations. Management believes that the allowance for loan losses is adequate to absorb probable inherent losses as of the balance sheet date on existing loans that may become uncollectible. See "Provision for Loan Losses" for further discussion of the allowance for loan losses.

Summary of Loan Loss Experience

The following table summarizes average loans outstanding, changes in the allowance for loan losses arising from loans charged off and recoveries on loans previously charged off by loan category and additions to the allowance charged (credited) to expense.

	Year ended December 31				
(Dollars in thousands)	**2015**	**2014**	**2013**	**2012**	**2011**
Average loans	$1,919,201	$1,773,011	$1,656,777	$1,563,918	$1,529,556
Balance of allowance for loan losses at beginning of year	$				