IRWIN FINANCIAL CORP
Form 10-Q
August 01, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

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

For the transition period from __________to __________.

Commission File Number: 0-6835

IRWIN FINANCIAL CORPORATION

(Exact Name of Corporation as Specified in its Charter)

Indiana	**35-1286807**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
500 Washington Street Columbus, Indiana	**47201**
(Address of Principal Executive Offices)	(Zip Code)
(812) 376-1909	**www.irwinfinancial.com**
(Corporation s Telephone Number, Including Area Code)	(Web Site)

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.
þ Yes o No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

As of July 27, 2007, there were outstanding 29,330,993 common shares, no par value, of the Registrant.

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PART I. FINANCIAL INFORMATION.
Item 1. Financial Statements.

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Unaudited)

	June 30, 2007	December 31, 2006
	(Dollars in thousands)	
Assets:		
Cash and cash equivalents	$ 80,234	$ 145,765
Interest-bearing deposits with financial institutions	40,922	53,106
Residual interests	10,414	10,320
Investment securities- held-to-maturity (Fair value: $17,335 at June 30, 2007 and $17,893 at December 31, 2006)	17,431	18,066
Investment securities- available-for-sale	124,882	110,364
Loans held for sale	26,886	237,510
Loans and leases, net of unearned income Note 3	5,511,756	5,238,193
Less: Allowance for loan and lease losses Note 4	(92,140)	(74,468)
	5,419,616	5,163,725
Servicing assets Note 5	27,920	31,949
Accounts receivable	70,898	208,585
Accrued interest receivable	25,143	26,470
Premises and equipment	41,990	36,211
Other assets	184,324	139,314
Assets held for sale Note 2	27,262	56,573
Total assets	$ 6,097,922	$ 6,237,958
Liabilities and Shareholders Equity:		
Deposits		
Noninterest-bearing	$ 336,801	$ 687,626
Interest-bearing	1,799,748	1,756,109
Certificates of deposit over $100,000	1,181,234	1,107,781
	3,317,783	3,551,516
Short-term borrowings Note 6	613,200	602,443
Collateralized debt Note 7	1,327,897	1,173,012
Other long-term debt	233,881	233,889
Other liabilities	97,516	146,596
Total liabilities	5,590,277	5,707,456
Commitments and contingencies Note 11		
Shareholders equity		
Preferred stock, no par value authorized 4,000,000 shares; none issued		
Noncumulative perpetual preferred stock 15,000 shares authorized and issued	14,441	14,518
	116,246	116,192

Common stock, no par value authorized 40,000,000 shares; issued 29,895,483 shares and 29,879,773 shares as of June 30, 2007 and December 31, 2006; 715,599 shares 143,543 shares in treasury as of June 30, 2007 and December 31, 2006		
Additional paid-in capital	2,401	1,583
Accumulated other comprehensive loss, net of deferred income tax benefit of $4,785 and $4,813 as of June 30, 2007 and December 31, 2006	(932)	(4,364)
Retained earnings	389,349	405,835
	521,505	533,764
Less treasury stock, at cost	(13,860)	(3,262)
Total shareholders equity	507,645	530,502
Total liabilities and shareholders equity	$ 6,097,922	$ 6,237,958

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the Three Months Ended June 30,	
	2007	2006
	(Dollars in thousands, except per share)	
Interest income:		
Loans and leases	$ 124,198	$ 105,096
Loans held for sale	1,136	9,804
Residual interests	280	467
Investment securities	2,562	2,221
Federal funds sold	787	21
Total interest income	128,963	117,609
Interest expense:		
Deposits	34,980	34,618
Short-term borrowings	7,096	3,393
Collateralized debt	17,113	11,596
Other long-term debt	3,930	4,130
Total interest expense	63,119	53,737
Net interest income	65,844	63,872
Provision for loan and lease losses Note 4	19,454	6,826
Net interest income after provision for loan and lease losses	46,390	57,046
Other income:		
Loan servicing fees	5,116	10,849
Amortization and impairment of servicing assets	(2,288)	(5,643)
Gain (loss) from sales of loans and loans held for sale	3,268	(3,591)
Trading gains	256	1
Derivative (losses) gains, net	(3,252)	672
Other	6,481	6,758
	9,581	9,046
Other expense:		
Salaries	23,538	26,479
Pension and other employee benefits	6,696	7,627
Office expense	2,539	2,190
Premises and equipment	5,288	5,438
Marketing and development	1,368	722
Professional fees	2,681	2,469
Other	4,954	6,370
	47,064	51,295

Income before income taxes from continuing operations		8,907		14,797
Provision for income taxes		3,436		5,828
Net income from continuing operations		5,471		8,969
Loss from discontinued operations, net of $3,968 and $4,054 income tax benefit, respectively Note 2		(5,860)		(6,098)
Net (loss) income	$	(389)	$	2,871
Earnings per share from continuing operations: Note 9				
Basic	$	0.18	$	0.30
Diluted	$	0.17	$	0.30
Earnings per share: Note 9				
Basic	$	(0.02)	$	0.10
Diluted	$	(0.03)	$	0.09
Dividends per share	$	0.12	$	0.11

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the Six Months Ended June 30, 2007	2006
	(Dollars in thousands, except per share)	
Interest income:		
Loans and leases	$ 243,547	$ 202,981
Loans held for sale	6,078	21,210
Residual interests	549	1,130
Investment securities	5,019	3,706
Federal funds sold	807	48
Total interest income	256,000	229,075
Interest expense:		
Deposits	68,431	64,299
Short-term borrowings	14,902	7,499
Collateralized debt	32,928	22,707
Other long-term debt	7,768	9,121
Total interest expense	124,029	103,626
Net interest income	131,971	125,449
Provision for loan and lease losses Note 4	42,662	16,019
Net interest income after provision for loan and lease losses	89,309	109,430
Other income:		
Loan servicing fees	11,028	18,957
Amortization and impairment of servicing assets	(7,237)	(11,545)
Loss from sales of loans and loans held for sale	(2,639)	(823)
Trading losses	(8)	(217)
Derivative (losses) gains, net	(4,341)	3,439
Other	11,964	13,231
	8,767	23,042
Other expense:		
Salaries	49,273	50,143
Pension and other employee benefits	14,434	15,400
Office expense	4,876	4,284
Premises and equipment	10,915	10,473
Marketing and development	2,577	1,390
Professional fees	4,767	4,867
Other	12,507	17,551
	99,349	104,108

(Loss) income before income taxes from continuing operations		(1,273)		28,364
(Benefit) provision for income taxes		(650)		10,705
Net (loss) income from continuing operations		(623)		17,659
Loss from discontinued operations, net of $6,710 and $11,080 income tax benefit, respectively Note 2		(9,895)		(16,646)
Net (loss) income	$	(10,518)	$	1,013
Earnings per share from continuing operations: Note 9				
Basic	$	(0.04)	$	0.60
Diluted	$	(0.06)	$	0.59
Earnings per share: Note 9				
Basic	$	(0.38)	$	0.03
Diluted	$	(0.39)	$	0.03
Dividends per share	$	0.24	$	0.22

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)
For the Six Months Ended June 30, 2007, and 2006

			Accumulated Other Comprehensive Income							
	Total	**Retained Earnings**	**Foreign Currency**	**Unrealized Gain/Loss Securities**	**Derivatives**	**Defined Benefit Plans**	**Additional Paid in Capital**	**Common Stock**	**Treasury Stock**	**Perpetual Preferred Stock**
					(Dollars in thousands)					
Balance at January 1, 2007	$530,502	$405,835	$2,884	$(344)	$ (30)	$(6,874)	$1,583	$116,192	$ (3,262)	$14,518
Net loss	(10,518)	(10,518)								
Unrealized loss on investment securities net of $307 tax benefit	(461)			(461)						
Unrealized gain on derivatives net of $355 tax liability	533				533					
Foreign currency adjustment	3,360		3,360							
Other comprehensive income	3,432									
Total comprehensive income	(7,086)									
Cash dividends common stock	(7,033)	(7,033)								
Cash dividends preferred stock	(678)	(678)								
FAS 156 adoption	1,743	1,743								
Tax benefit on stock option exercises	114						114			
Stock compensation expense	986						986			
Stock issuance costs	(77)									(77)

Stock:										
Purchase of 668,308 shares	(12,753)								(12,753)	
Sales of 97,376 shares	1,927						(282)	54	2,155	
Balance at June 30, 2007	$507,645	$389,349	$6,244	$(805)	$503	$(6,874)	$2,401	$116,246	$(13,860)	$14,441
Balance at January 1, 2006	$512,334	$418,784	$3,341	$(373)	$754	$ (274)	$ 50	$112,000	$(21,948)	$
Net income	1,013	1,013								
Unrealized loss on investment securities net of $249 tax benefit	(374)			(374)						
Unrealized loss on derivative net of $38 tax benefit	(57)				(57)					
Foreign currency adjustment	1,020		1,020							
Other comprehensive income	589									
Total comprehensive income	1,602									
Cash dividends	(6,541)	(6,541)								
Tax benefit on stock option exercises	319						319			
Stock option expense	1,107						1,107			
Conversion of trust preferred shares to 1,013,938 shares of common stock	19,513	(1,058)						1,070	19,501	
Stock:										
Purchase of 48,433 shares	(952)								(952)	
Sales of 147,636 shares	2,199	(508)					(406)	603	2,510	
	$529,581	$411,690	$4,361	$(747)	$697	$ (274)	$1,070	$113,673	$ (889)	$

Balance at
June 30, 2006

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	For the Six Months ended June 30,	
	2007	2006
	(Dollars in thousands)	
(Loss) Income from continuing operations	$ (623)	$ 17,659
Loss from discontinued operations	(9,895)	(16,646)
Net (loss) income	(10,518)	1,013
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Depreciation, amortization, and accretion, net	4,834	3,229
Amortization and impairment of servicing assets	7,487	30,663
Provision for loan and lease losses	42,662	16,048
Loss (gain) from sales of loans held for sale	10,071	(32,333)
Originations and purchases of loans held for sale	(368,697)	(5,063,058)
Proceeds from sales and repayments of loans held for sale	419,859	5,573,814
Net decrease in residuals	456	8,210
Net decrease in accounts receivable	137,687	50,136
Other, net	(90,289)	(39,893)
Net cash provided by operating activities	153,552	547,829
Investing activities:		
Proceeds from maturities/calls of investment securities:		
Held-to-maturity	2,114	895
Available-for-sale	1,962	1,810
Purchase of investment securities:		
Held-to-maturity	(1,482)	(1,426)
Available-for-sale	(17,278)	(13,184)
Net decrease in interest-bearing deposits	12,184	855
Net increase in loans, excluding sales	(156,541)	(463,668)
Proceeds from sale of loans	34,385	26,062
Other, net	(9,213)	(5,938)
Net cash used by investing activities	(133,869)	(454,594)
Financing activities:		
Net decrease in deposits	(233,733)	(30,640)
Net increase (decrease) in short-term borrowings	10,757	(243,564)
Proceeds from issuance of collateralized debt	331,781	351,325
Repayments of collateralized debt	(176,924)	(166,109)
Proceeds from the issuance of trust preferred securities		31,500
Repayments of long term debt	(7)	(32,116)
Purchase of treasury stock for employee benefit plans	(12,753)	(952)
Proceeds from sale of stock for employee benefit plans	2,091	2,518
Dividends paid	(7,711)	(6,541)

Net cash used by financing activities		(86,499)		(94,579)
Effect of exchange rate changes on cash		1,285		538
Net decrease in cash and cash equivalents		(65,531)		(806)
Cash and cash equivalents at beginning of period		145,765		155,486
Cash and cash equivalents at end of period	$	80,234	$	154,680
Supplemental disclosures of cash flow information:				
Cash flow during the period:				
Interest paid	$	122,412	$	115,450
Income taxes paid	$	11,491	$	21,231
Noncash transactions:				
Adoption of FAS 156	$	2,905	$	
Loans transferred from held-for-sale to held-for-investment	$	166,773	$	
Other real estate owned	$	7,703	$	4,437
Conversion of trust preferred stock to common stock	$		$	19,513

The accompanying notes are an integral part of the consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Accounting Policies, Management Judgments and Accounting Estimates

Consolidation: Irwin Financial Corporation and its subsidiaries (the Corporation) provide financial services throughout the United States (U.S.) and Canada. We are engaged in commercial banking, commercial finance and home equity lending. We are in the process of exiting the mortgage banking segment. Our direct and indirect subsidiaries include, Irwin Union Bank and Trust Company, Irwin Union Bank, F.S.B., Irwin Commercial Finance Corporation, Irwin Home Equity Corporation and Irwin Mortgage Corporation (IMC). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the financial statements reflect all material adjustments necessary for a fair presentation. The Corporation does not meet the criteria as primary beneficiary for our wholly-owned trusts holding our company-obligated mandatorily redeemable preferred securities established by Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. As a result, these trusts are not consolidated.

Because we are in the process of exiting the mortgage banking line of business, the financial statements and footnotes within this report conform to the presentation required in Statement of Financial Accounting Standard (SFAS) 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Certain of the balance sheet assets related to this line of business are being reported as assets held for sale. See Note 2 for additional information.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents Defined: For purposes of the statement of cash flows, we consider cash and due from banks to be cash equivalents.

Allowance for Loan and Lease Losses: The allowance for loan and lease losses is an estimate based on management s judgment applying the principles of SFAS 5, Accounting for Contingencies, SFAS 114, Accounting by Creditors for Impairment of a Loan, and SFAS 118, Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures. The allowance is maintained at a level we believe is adequate to absorb probable losses inherent in the loan and lease portfolio. We perform an assessment of the adequacy of the allowance on a quarterly basis.

Within the allowance, there are specific and expected loss components. The specific loss component is assessed for loans we believe to be impaired in accordance with SFAS 114. We have defined impairment as nonaccrual loans. For loans determined to be impaired, we measure the level of impairment by comparing the loan s carrying value to fair value using one of the following fair value measurement techniques: present value of expected future cash flows, observable market price, or fair value of the associated collateral. An allowance is established when the fair value implies a value that is lower than the carrying value of that loan. In addition to establishing allowance levels for specifically identified impaired loans, management determines an allowance for all other loans in the portfolio for which historical experience indicates that certain losses exist. These loans are segregated by major product type, and in some instances, by aging, with an estimated loss ratio applied against each product type and aging category. The loss ratio is generally based upon historic loss experience for each loan type as adjusted for certain environmental factors management believes to be relevant.

It is our policy to promptly charge off any commercial loan, or portion thereof, which is deemed to be uncollectible. This includes, but is not limited to, any loan rated Loss by the regulatory authorities. Impaired commercial credits are considered on a case-by-case basis. The amount charged off includes any accrued interest. Unless there is a significant reason to the contrary, consumer loans are charged off when deemed uncollectible, but generally no later than when a loan is past due 180 days.

Servicing Assets: When we securitize or sell loans, we periodically retain the right to service the underlying loans sold. A portion of the cost basis of loans sold is allocated to this servicing asset based on its fair value relative to the loans sold and the servicing asset combined. Prior to the January 1, 2007, all servicing rights were carried at lower of cost or fair market value. We use a combination of observed pricing on similar, market-traded servicing rights and internal valuation models that calculate the present value of future cash flows to determine the fair value of the servicing assets. These models are supplemented and calibrated to market prices using inputs from independent servicing brokers, industry surveys and valuation experts. In using this valuation method, we incorporate assumptions that we believe market participants would use in estimating future net servicing income, which include estimates of the

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cost of servicing per loan, the discount rate, float value, an inflation rate, ancillary income per loan, prepayment speeds, and default rates. Prior to January 1, 2007, all servicing assets were amortized over the period of and in proportion to estimated net servicing income.

For servicing assets associated with second mortgages and high loan-to-value first mortgages, the fair value measurement method of reporting these servicing rights was elected beginning January 1, 2007, in accordance with SFAS 156, Accounting for Servicing of Financial Assets. Under the fair value method, we measure servicing assets at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur. All remaining servicing rights follow the amortization method for subsequent measurement whereby these servicing rights are amortized in proportion to and over the period of estimated net servicing income.

Incentive Servicing Fees: For whole loan sales of certain home equity loans, in addition to our normal servicing fee, we have the right to an incentive servicing fee (ISF) that will provide cash payments to us if a pre-established return for the certificate holders and certain structure-specific loan credit and servicing performance metrics are met. Generally the structure-specific metrics involved both a delinquency and a loss test. The delinquency test is satisfied if, as of the last business day of the preceding month, delinquencies on the current pool of mortgage loans are less than or equal to a given percentage. The loss test is satisfied if, on the last business day of the preceding month, the percentage of cumulative losses on the original pool of mortgage loans is less than or equal to the applicable percentage as outlined in the specific deal documents. We receive ISF payments monthly, once the pre-established return has been paid to the certificate holder, if the delinquency and loss percentages are within guidelines. If we are terminated or replaced for cause as servicer under the securitization, the cash flow stream under the ISF contract terminates.

We account for ISFs similar to management contracts under Emerging Issues Task Force Topic No. D-96, Accounting for Management Fees Based on a Formula. Accordingly, we recognize revenue on a cash basis as the pre-established performance metrics are met and cash is due.

Income Taxes: A consolidated tax return is filed for all eligible entities. In accordance with SFAS 109, deferred income taxes are computed using the liability method, which establishes a deferred tax asset or liability based on temporary differences between the tax basis of an asset or liability and the basis recorded in the financial statements.

Recent Accounting Developments: In March 2006, the FASB issued SFAS 156, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140. This statement requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of classes of servicing assets and servicing liabilities at fair value, to better align with the use of derivatives used to mitigate the inherent risks of these assets and liabilities. Offsetting changes in fair value are recognized through income. This statement is effective as of January 1, 2007. We elected the fair value treatment for servicing rights associated with second mortgage and high loan to value first mortgage loans at our home equity lending line of business. Implementation of the fair value treatment under SFAS 156 resulted in a one-time increase to retained earnings of $1.7 million. This represents the after-tax effect of the $2.9 million fair value adjustment to the mortgage servicing asset as of January 1, 2007.

In September 2006, the FASB issued SFAS 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating this new statement and have not yet determined the ultimate impact it will have on our financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. This statement permits entities to choose to measure certain financial instruments at fair value. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. Early adoption is permitted as of January 1, 2007. We elected not to early adopt this statement. We are currently evaluating this new statement and have not yet determined the ultimate impact it will have on our financial statements once it becomes effective in 2008.

Effective January 1, 2007, we adopted FASB Interpretation Number 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, (FIN No. 48), which prescribes a single, comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on its tax returns. Upon adoption of FIN No. 48, we did not recognize any material adjustment in our liability for unrecognized tax benefits. As of January 1, 2007, our unrecognized tax benefits were $10.7 million, $0.7 million of which would, if

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recognized, favorably affect the effective tax rate in future periods. As of June 30, 2007, our unrecognized tax benefits were $15.9 million, $0.7 million of which would, if recognized, favorably affect the effective tax rate in future periods.

Our continuing practice is to recognize interest and penalties related to unrecognized tax benefits in income tax expense. As of January 1, 2007, we had approximately $0.8 million accrued for interest and no accrual for penalties related to unrecognized tax benefits. As of June 30, 2007, we have approximately $1.2 million accrued for interest related to unrecognized tax benefits.

Tax years 2003-2006 remain open to examination by major taxing jurisdictions. Certain state tax returns remain open to examination for tax years 2002-2006.

Reclassifications: Certain amounts in the 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation. These changes had no impact on previously reported net income or shareholders equity.

Note 2 Discontinued Operations

In 2006, we sold the mortgage banking line of business origination operation, including the majority of this segment s loans held for sale, as well as the majority of this segment s capitalized mortgage servicing rights to five separate buyers. In January 2007, we transferred a nominal amount of assets associated with this segment s servicing platform (but not mortgage servicing rights) to a sixth buyer. The majority of the cash proceeds from the sales have been collected. We have staff continuing to work at IMC through the wind-down of our remaining assets, such as construction loans and repurchased loans.

In accordance with the provisions of SFAS 144, the results of operations of the mortgage banking line of business for the current and prior periods have been reported as discontinued operations. In addition, certain of the remaining assets for this segment have been reclassified as held for sale in the consolidated balance sheet.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
Net revenues	$ (3,955)	$ 21,153	$ (8,676)	$ 29,514
Other expense	(5,873)	(31,305)	(7,929)	(57,240)
Loss before income taxes	(9,828)	(10,152)	(16,605)	(27,726)
Income taxes	3,968	4,054	6,710	11,080
Net loss from discontinued operations	$ (5,860)	$ (6,098)	$ (9,895)	$ (16,646)

	June 30, 2007	December 31, 2006
	(Dollars in thousands)	
Loans, net of allowance, and Loans held for sale	$ 21,248	$ 48,555
Net servicing asset	35	385
Other assets	5,979	7,633
Assets held for sale	$ 27,262	$ 56,573

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Note 3 Loans and Leases

Loans and leases are summarized as follows:

	June 30, 2007	December 31, 2006
	(Dollars in thousands)	
Commercial, financial and agricultural	$2,291,303	$2,249,988
Residential real estate-construction	337,156	377,601
Residential real estate-mortgage	1,698,084	1,522,616
Consumer	25,274	31,581
Commercial financing		
Franchise financing	783,102	699,969
Domestic leasing	303,102	296,056
Canadian leasing	417,460	358,783
Unearned income		
Franchise financing	(248,889)	(211,480)
Domestic leasing	(42,873)	(42,782)
Canadian leasing	(51,963)	(44,139)
Total	$5,511,756	$5,238,193

Note 4 Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses are summarized below:

	June 30, 2007 And the Six Months Then Ended	December 31, 2006 And the Year Then Ended
	(Dollars in thousands)	
Balance at beginning of year	$ 74,468	$ 59,223
Provision for loan and lease losses	42,662	35,101
Charge-offs	(29,837)	(30,810)
Recoveries	5,326	11,208
Reduction due to reclassification or sale of loans	(796)	(246)
Foreign currency adjustment	317	(8)
Balance at end of period	$ 92,140	$ 74,468

Note 5 Servicing Assets

We adopted the fair value treatment for servicing assets associated with our second mortgage and high loan-to-value first mortgage portfolios as of January 1, 2007. The effect of remeasuring the selected servicing assets at fair value was reported as a cumulative-effect adjustment to retained earnings, increasing retained earnings $1.7 million, net of tax. Changes in fair value subsequent to adoption were recorded through amortization and impairment of servicing assets. All other first mortgage loans continue to be accounted for using the amortization method with impairment recognized. These mortgage servicing assets are recorded at lower of their allocated cost basis or fair value and a valuation allowance is recorded for any stratum that is impaired.

We estimate the fair value of the servicing assets using a cash flow model to project future expected cash flows based upon a set of valuation assumptions we believe market participants would use for similar assets. The primary assumptions we use for valuing our mortgage servicing assets include prepayment speeds, default rates, cost to service and discount rates. We review these assumptions on a regular basis to ensure that they remain consistent with current market conditions. Additionally, we periodically receive third party estimates of the portfolio value from independent valuation firms. Inaccurate assumptions in valuing mortgage servicing rights could adversely affect our results of operations. For servicing rights accounted for under the amortization method, we also review these mortgage servicing assets for other-than-temporary impairment each quarter and recognize a direct write-down when the recoverability of a recorded valuation allowance is determined to be remote. Unlike a valuation allowance, a direct write-down permanently reduces the unamortized cost of the mortgage servicing rights asset and the valuation allowance, precluding subsequent reversals.

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Changes in our fair value servicing assets are shown below:

	June 30, 2007 And the Six Months Then Ended	December 31, 2006 And the Year Then Ended
	(Dollars in thousands)	
Beginning balance	$ 27,725	NA
Gain from initial adoption of SFAS 156	2,905	NA
Changes in fair value	(6,554)	NA
Mortgage servicing asset from continuing operations	$ 24,076	NA

Changes in our amortizing servicing assets are shown below:

	June 30, 2007 And the Six Months Then Ended	December 31, 2006 And the Year Then Ended
	(Dollars in thousands)	
Beginning balance	$ 31,949	$ 34,445
Initial adoption of SFAS 156	(27,725)	
Additions	303	17,884
Amortization	(637)	(21,027)
(Impairment) recovery	(46)	647
Mortgage servicing asset from continuing operations	$ 3,844	$ 31,949

We have established a valuation allowance to record amortizing servicing assets at their lower of cost or market value. Changes in the allowance are summarized below:

	June 30, 2007 And the Six Months Then Ended	December 31, 2006 And the Year Then Ended
Balance at beginning of year	$ 483	$ 1,152
Transfer of assets from amortizing to fair value	(332)	
Impairment (recovery)	46	(647)
Reclass for sales of servicing and clean up calls		(22)
Valuation allowance from continuing operations	$ 197	$ 483

Note 6 Short-Term Borrowings

Short-term borrowings are summarized as follows:

	June 30, 2007	December 31, 2006
	(Dollars in thousands)	
Federal Home Loan Bank borrowings	$ 490,173	$ 371,693
Federal funds	123,000	230,500
Other	27	250
Total	$ 613,200	$ 602,443
Weighted average interest rate	4.77%	4.49%

Federal Home Loan Bank borrowings are collateralized by loans and loans held for sale.

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We also have lines of credit available to fund loan originations and operations with variable rates ranging from 5.6% to 5.8% at June 30, 2007.

Note 7 Collateralized Debt

We pledge or sell loans structured as secured financings at our home equity and commercial finance lines of business. Sale treatment is precluded on these transactions because we fail the true-sale requirements of SFAS 140 as we maintain effective control over the loans and leases securitized. This type of structure results in cash being received, debt being recorded, and the establishment of an allowance for credit losses. The notes associated with these transactions are collateralized by $1.5 billion in home equity loans, home equity lines of credit, and leases. The principal and interest on these debt securities are paid using the cash flows from the underlying loans and leases. Accordingly, the timing of the principal payments on these debt securities is dependent on the payments received on the underlying collateral. The interest rates on the bonds are both fixed and floating.

Collateralized debt is summarized as follows:

	Contractual Maturity	Weighted Average Interest Rate at June 30, 2007	June 30, 2007	December 31, 2006
			(Dollars in thousands)	
Commercial finance line of business				
Domestic asset backed note			$	$ 5,797
Canadian asset backed notes:				
Note 1	revolving	5.5	39,727	30,611
Note 2	6/2012	4.4	206,013	179,508
Note 3	10/2009	4.5	5,919	8,157
Home equity line of business				
2004-1 asset backed notes:				
Variable rate senior note	12/2024-12/2034	5.7	36,692	50,072
Variable rate subordinate note	12/2034	6.5	24,775	24,775
2005-1 asset backed notes:				
Variable rate senior note	6/2025-6/2035	5.5	27,156	40,972
Fixed rate senior note	6/2035	5.1	78,169	94,129
Variable rate subordinate note	6/2035	7.1	10,785	10,785
Fixed rate subordinate note	6/2035	5.6	52,127	52,127
Unamortized premium/discount			(74)	(90)
2006-1 asset backed notes:				
Variable rate senior note	9/2035	5.5	67,871	102,252
Fixed rate senior note	9/2035	5.5	96,561	96,561
Fixed rate lockout senior note	9/2035	5.6	24,264	24,264
Unamortized premium/discount			(14)	(19)
2006-2 asset backed notes:				
Variable rate senior note	2/2036	5.4	104,476	136,386
Fixed rate senior note	2/2036	6.3	80,033	80,033
Fixed rate lockout senior note	2/2036	6.2	21,348	21,348
Unamortized premium/discount			(16)	(21)
2006-3 asset backed notes:				
Variable rate senior note	1/2037-9/2037	5.5	101,645	130,326

Fixed rate senior note	9/2037	5.9	67,050	67,050
Fixed rate lockout senior note	9/2037	5.9	18,000	18,000
Unamortized premium/discount			(9)	(11)
2007-1 asset backed notes:				
Variable rate senior note	8/2037	5.5	152,074	
Fixed rate senior note	8/2037	6.0	91,346	
Fixed rate lockout senior note	8/2037	5.9	22,000	
Unamortized premium/discount			(21)	
Total			$1,327,897	$1,173,012

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Note 8 Employee Retirement Plans

Components of net periodic cost of pension benefit:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
Service cost	$ 1,016	$ 926	$ 2,145	$ 1,979
Interest cost	728	645	1,414	1,226
Expected return on plan assets	(616)	(523)	(1,254)	(1,126)
Amortization of transition obligation	3	3	5	5
Amortization of prior service cost	9	9	19	20
Amortization of actuarial loss	136	200	312	484
Net periodic benefit cost	$ 1,276	$ 1,260	$ 2,641	$ 2,588

As of June 30, 2007, we have not made any contributions to our pension plan in the current year and currently do not need to contribute to this plan in 2007 to maintain its funding status.

Note 9 Earnings Per Share

Earnings per share calculations are summarized as follows:

	Three Months ended June 30, 2007				
	Net Income (Loss)	Preferred Dividends	Basic Earnings Per Share	Effect of Stock Options	Diluted Earnings Per Share
	(Dollars in thousands, except per share amounts)				
Net income (loss) available to common shareholders:					
From Continuing Operations	$ 5,471	$(326)	$ 5,145	$ (215)	$ 4,930
From Discontinued Operations	(5,860)		(5,860)		(5,860)
Total Net Loss for All Operations	$ (389)	$(326)	(715)	(215)	(930)
Shares			29,361	14	29,375
Per-share from Continuing Operations			$ 0.18	$ (0.01)	$ 0.17
Per-share amount for All Operations			$ (0.02)	$ (0.01)	$ (0.03)

	Three Months ended June 30, 2006				
	Net Income (Loss)	Preferred Dividends	Basic Earnings Per Share	Effect of Stock Options	Diluted Earnings Per Share
	(Dollars in thousands, except per share amounts)				

Net income (loss) available to common shareholders:					
From Continuing Operations	$ 8,969	$	$ 8,969	$ (71)	$ 8,898
From Discontinued Operations	(6,098)		(6,098)		(6,098)
Total Net Income for All Operations	$ 2,871	$	2,871	(71)	2,800
Shares			29,694	168	29,862
Per-share from Continuing Operations			$ 0.30	$	$ 0.30
Per-share amount for All Operations			$ 0.10	$ (0.01)	$ 0.09

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	Six Months ended June 30, 2007				
	Net Loss	Preferred Dividends	Basic Earnings Per Share	Effect of Stock Options	Diluted Earnings Per Share
	(Dollars in thousands, except per share amounts)				
Net loss available to common shareholders:					