

UNITED COMMUNITY BANKS INC

Form 10-Q

November 07, 2008

Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Quarterly Period Ended September 30, 2008**  
**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_**  
**Commission file number 0-21656**  
**UNITED COMMUNITY BANKS, INC.**  
**(Exact name of registrant as specified in its charter)**

**Georgia**

**58-1807304**

**(State of Incorporation)**

**(I.R.S. Employer Identification No.)**

**63 Highway 515  
Blairsville, Georgia**

**30512**

**Address of Principal  
Executive Offices**

**(Zip Code)**

**(706) 781-2265**

**(Telephone Number)**

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company. See 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  Smaller Reporting Company**   
**(Do not check if a smaller reporting company)**

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

**YES  NO**

**Common stock, par value \$1 per share: 47,596,119 shares  
outstanding as of September 30, 2008**



**INDEX**

**PART I Financial Information**

**Item 1. Financial Statements.** 2

**Consolidated Statement of Income (unaudited) for the Three and Nine Months Ended September 30, 2008 and 2007** 2

**Consolidated Balance Sheet at September 30, 2008 (unaudited), December 31, 2007 (audited) and September 30, 2007 (unaudited)** 3

**Consolidated Statement of Changes in Shareholders' Equity (unaudited) for the Nine Months Ended September 30, 2008 and 2007** 4

**Consolidated Statement of Cash Flows (unaudited) for the Nine Months Ended September 30, 2008 and 2007** 5

**Notes to Consolidated Financial Statements** 6

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.** 11

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.** 29

**Item 4. Controls and Procedures.** 29

**PART II Other Information**

**Item 1. Legal Proceedings.** 30

**Item 1A. Risk Factors.** 30

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.** 30

**Item 3. Defaults Upon Senior Securities.** 30

**Item 4. Submission of Matters to a Vote of Security Holders.** 30

**Item 5. Other Information.** 30

**Item 6. Exhibits.** 30

Exhibit 31.1

Exhibit 31.2

Exhibit 32



**Table of Contents****Part I Financial Information****Item 1 Financial Statements****UNITED COMMUNITY BANKS, INC.****Consolidated Statement of Income (Unaudited)**

<i>(in thousands, except per share data)</i>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Interest revenue:</b>				
Loans, including fees	\$ 93,233	\$ 127,213	\$ 299,550	\$ 361,085
Investment securities:				
Taxable	18,258	16,637	55,765	46,081
Tax exempt	348	428	1,140	1,313
Federal funds sold and deposits in banks	100	134	372	272
<b>Total interest revenue</b>	<b>111,939</b>	<b>144,412</b>	<b>356,827</b>	<b>408,751</b>
<b>Interest expense:</b>				
Deposits:				
NOW	6,778	12,046	22,581	34,143
Money market	2,296	5,002	7,519	11,082
Savings	153	553	560	1,236
Time	39,044	42,862	116,756	126,466
<b>Total deposit interest expense</b>	<b>48,271</b>	<b>60,463</b>	<b>147,416</b>	<b>172,927</b>
Federal funds purchased, repurchase agreements, & other short-term borrowings	1,116	4,738	7,254	10,226
Federal Home Loan Bank advances	2,105	5,902	10,668	15,738
Long-term debt	2,227	2,100	6,366	6,505
<b>Total interest expense</b>	<b>53,719</b>	<b>73,203</b>	<b>171,704</b>	<b>205,396</b>
<b>Net interest revenue</b>	<b>58,220</b>	<b>71,209</b>	<b>185,123</b>	<b>203,355</b>
Provision for loan losses	76,000	3,700	99,000	26,100
<b>Net interest (loss) revenue after provision for loan losses</b>	<b>(17,780)</b>	<b>67,509</b>	<b>86,123</b>	<b>177,255</b>
<b>Fee revenue:</b>				
Service charges and fees	8,171	7,855	23,941	23,083
Mortgage loan and other related fees	1,410	2,118	5,575	6,817
Consulting fees	1,727	2,381	5,786	6,369
Brokerage fees	905	895	2,812	3,031
Securities gains, net	120	225	477	1,818
Losses on prepayment of borrowings				(1,164)
Other	788	2,141	3,832	6,597

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Total fee revenue	13,121	15,615	42,423	46,551
<b>Total revenue</b>	(4,659)	83,124	128,546	223,806
<b>Operating expenses:</b>				
Salaries and employee benefits	28,626	29,698	86,133	88,037
Communications and equipment	3,909	3,936	11,593	11,593
Occupancy	3,905	3,617	11,325	10,124
Advertising and public relations	1,399	1,537	4,759	5,651
Postage, printing and supplies	1,493	1,479	4,533	4,819
Professional fees	1,596	1,920	5,196	5,409
Amortization of intangibles	752	771	2,264	1,968
Other	15,290	5,224	28,457	13,124
Total operating expenses	56,970	48,182	154,260	140,725
(Loss) income before income taxes	(61,629)	34,942	(25,714)	83,081
Income tax (benefit) expense	(21,755)	12,406	(9,011)	29,289
<b>Net (loss) income</b>	\$ (39,874)	\$ 22,536	\$ (16,703)	\$ 53,792
Net (loss) income available to common shareholders	\$ (39,878)	\$ 22,532	\$ (16,715)	\$ 53,778
(Loss) earnings per common share:				
Basic	\$ (.84)	\$ .47	\$ (.35)	\$ 1.18
Diluted	(.84)	.46	(.35)	1.16
Cash dividends per common share	.00	.09	.18	.27
Stock dividends per common share	.09	.00	.09	.00
Weighted average common shares outstanding:				
Basic	47,304	48,348	47,111	45,452
Diluted	47,304	48,977	47,111	46,235

See notes to Consolidated Financial Statements

**Table of Contents****UNITED COMMUNITY BANKS, INC.  
Consolidated Balance Sheet**

<i>(in thousands, except share and per share data)</i>	<b>September 30, 2008 <i>(unaudited)</i></b>	<b>December 31, 2007 <i>(audited)</i></b>	<b>September 30, 2007 <i>(unaudited)</i></b>
<b>ASSETS</b>			
Cash and due from banks	\$ 126,033	\$ 157,549	\$ 162,710
Interest-bearing deposits in banks	40,707	62,074	75,745
Cash and cash equivalents	166,740	219,623	238,455
Securities available for sale	1,400,827	1,356,846	1,296,826
Mortgage loans held for sale	17,763	28,004	23,717
Loans, net of unearned income	5,829,937	5,929,263	5,952,749
Less allowance for loan losses	111,299	89,423	90,935
Loans, net	5,718,638	5,839,840	5,861,814
Premises and equipment, net	179,727	180,088	174,918
Accrued interest receivable	47,920	62,828	67,385
Goodwill and other intangible assets	322,544	325,305	326,080
Other assets	218,384	194,768	191,405
<b>Total assets</b>	<b>\$ 8,072,543</b>	<b>\$ 8,207,302</b>	<b>\$ 8,180,600</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
Liabilities:			
Deposits:			
Demand	\$ 680,196	\$ 700,941	\$ 737,357
NOW	1,393,928	1,474,818	1,464,956
Money market	394,358	452,917	495,092
Savings	179,274	186,392	195,132
Time:			
Less than \$100,000	1,814,926	1,573,604	1,595,515
Greater than \$100,000	1,481,512	1,364,763	1,358,302
Brokered	745,141	322,516	307,954
Total deposits	6,689,335	6,075,951	6,154,308
Federal funds purchased, repurchase agreements, and other short-term borrowings	119,699	638,462	502,081
Federal Home Loan Bank advances	285,362	519,782	519,381
Long-term debt	137,996	107,996	107,996
Accrued expenses and other liabilities	23,271	33,209	63,073



Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

<b>Total liabilities</b>	7,255,663	7,375,400	7,346,839
Shareholders' equity:			
Preferred stock, \$1 par value; \$10 stated value; 10,000,000 shares authorized; 25,800, 25,800 and 25,800 shares issued and outstanding	258	258	258
Common stock, \$1 par value; 100,000,000 shares authorized; 48,809,301, 48,809,301 and 48,809,301 shares issued	48,809	48,809	48,809
Common stock issuable; 116,567, 73,250 and 66,366 shares	2,762	2,100	1,954
Capital surplus	457,779	462,881	462,499
Retained earnings	317,544	347,391	347,478
Treasury stock; 1,213,182, 1,905,921 and 1,266,935 shares, at cost	(27,024)	(43,798)	(30,969)
Accumulated other comprehensive income	16,752	14,261	3,732
<b>Total shareholders' equity</b>	816,880	831,902	833,761
<b>Total liabilities and shareholders' equity</b>	\$ 8,072,543	\$ 8,207,302	\$ 8,180,600

See notes to Consolidated Financial Statements

**Table of Contents****UNITED COMMUNITY BANKS, INC.****Consolidated Statement of Changes in Shareholders' Equity (Unaudited)****For the Nine Months Ended September 30,**

	Preferred	Common	Common	Capital	Retained	Treasury	Accumulated Other Comprehensive Income	Total
(in thousands, except share and per share data)	Stock	Stock	Stock Issuable	Surplus	Earnings	Stock	(Loss)	
<b>Balance, December 31, 2006</b>	\$ 322	\$ 42,891	\$ 862	\$ 270,383	\$ 306,261	\$	\$ (3,952)	\$ 616,767
Comprehensive income:								
Net income					53,792			53,792
Other comprehensive income:								
Unrealized holding gains on available for sale securities, net of deferred tax expense and reclassification adjustment							3,282	3,282
Unrealized gains on derivative financial instruments qualifying as cash flow hedges, net of deferred tax expense							4,402	4,402
Comprehensive income					53,792		7,684	61,476
Retirement of preferred stock (6,400 shares)	(64)							(64)
Cash dividends declared on common stock (\$.27 per share)					(12,561)			(12,561)
Common stock issued for acquisitions (5,691,948 shares)		5,692		185,649				191,341
Exercise of stock options (110,328 shares)		78		457		767		1,302
Common stock issued to Dividend Reinvestment Plan and employee benefit plans (123,692 shares)		118		3,360		139		3,617
Amortization of stock option and restricted stock awards				2,611				2,611
Vesting of restricted stock (30,310 shares issued, 3,125 shares deferred)		30	93	(123)				
Purchases of treasury stock (1,304,775 shares)						(31,875)		(31,875)
Deferred compensation plan, net, including dividend equivalents			999					999
Tax benefit from options exercised				162				162
Dividends declared on preferred stock (\$.45 per share)					(14)			(14)
<b>Balance, September 30, 2007</b>	\$ 258	\$ 48,809	\$ 1,954	\$ 462,499	\$ 347,478	\$ (30,969)	\$ 3,732	\$ 833,761
<b>Balance, December 31, 2007</b>	\$ 258	\$ 48,809	\$ 2,100	\$ 462,881	\$ 347,391	\$ (43,798)	\$ 14,261	\$ 831,902

Comprehensive income:								
Net loss				(16,703)				(16,703)
Other comprehensive (loss) income:								
Unrealized holding losses on available for sale securities, net of deferred tax benefit and reclassification adjustment						(3,009)		(3,009)
Unrealized gains on derivative financial instruments qualifying as cash flow hedges, net of deferred tax expense and reclassification adjustment						5,500		5,500
Comprehensive (loss) income				(16,703)		2,491		(14,212)
Cash dividends declared on common stock (\$.18 per share)				(8,465)				(8,465)
Stock dividends declared on common stock (360,155 shares, 1 for 130 shares)			(4,279)	(4,667)	8,906			(40)
Exercise of stock options (79,935 shares)			(927)		1,947			1,020
Common stock issued to Dividend Reinvestment Plan and employee benefit plans (233,276 shares)			(2,689)		5,460			2,771
Amortization of stock options and restricted stock			2,928					2,928
Vesting of restricted stock (15,159 shares issued, 8,700 shares deferred)	264		(626)		362			
Deferred compensation plan, net, including dividend equivalents	512							512
Shares issued from deferred compensation plan (4,214 shares)			(114)	15		99		
Tax benefit from options exercised			476					476
Dividends declared on preferred stock (\$.45 per share)					(12)			(12)
<b>Balance, September 30, 2008</b>	\$ 258	\$ 48,809	\$ 2,762	\$ 457,779	\$ 317,544	\$ (27,024)	\$ 16,752	\$ 816,880

\* Comprehensive loss for the third quarter of 2008 was \$23,443,000 and comprehensive income for the third quarter of 2007 was \$38,911,000.

See notes to Consolidated Financial Statements

**Table of Contents****UNITED COMMUNITY BANKS, INC.**  
**Consolidated Statement of Cash Flows (Unaudited)**

<i>(in thousands)</i>	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities, net of effect of business combinations:</b>		
Net (loss) income	\$ (16,703)	\$ 53,792
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation, amortization and accretion	11,134	10,553
Provision for loan losses	99,000	26,100
Stock based compensation	2,928	2,611
Gain on sale of securities available for sale	(477)	(1,818)
Loss (gain) on sale of other assets	16	(208)
Loss (gain) on sale of other real estate	10,391	(412)
Loss on prepayment of borrowings		1,164
Changes in assets and liabilities:		
Other assets and accrued interest receivable	1,792	(8,737)
Accrued expenses and other liabilities	86	(8,464)
Mortgage loans held for sale	10,241	11,608
<b>Net cash provided by operating activities</b>	<b>118,408</b>	<b>86,189</b>
<b>Investing activities, net of effect of business combinations:</b>		
Proceeds from sales of securities available for sale	84,955	106,709
Proceeds from maturities and calls of securities available for sale	396,673	248,991
Purchases of securities available for sale	(519,421)	(484,229)
Net increase in loans	(58,709)	(81,394)
Purchase of Bank Owned Life Insurance		(50,000)
Proceeds from sales of premises and equipment	514	720
Purchases of premises and equipment	(8,960)	(26,768)
Net cash paid for acquisitions		(4,346)
Proceeds from sale of other real estate	51,970	9,787
<b>Net cash used by investing activities</b>	<b>(52,978)</b>	<b>(280,530)</b>
<b>Financing activities, net of effect of business combinations:</b>		
Net change in deposits	613,384	(186,423)
Net change in federal funds purchased, repurchase agreements, and other short-term borrowings	(518,763)	472,852
Repayments of other borrowings		(5,000)
Proceeds from FHLB advances	400,000	950,000
Repayments of FHLB advances	(634,000)	(931,164)
Proceeds from issuance of subordinated debt	30,000	
Proceeds from exercise of stock options	1,020	1,302

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Proceeds from issuance of common stock for dividend reinvestment and employee benefit plans	2,771	3,617
Retirement of preferred stock		(64)
Purchase of treasury stock		(31,875)
Cash dividends on common stock	(12,713)	(11,719)
Cash dividends on preferred stock	(12)	(14)
<b>Net cash (used) provided by financing activities</b>	<b>(118,313)</b>	<b>261,512</b>
<b>Net change in cash and cash equivalents</b>	<b>(52,883)</b>	<b>67,171</b>
Cash and cash equivalents at beginning of period	219,623	171,284
<b>Cash and cash equivalents at end of period</b>	<b>\$ 166,740</b>	<b>\$ 238,455</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the period for:		
Interest	\$ 173,976	\$ 203,519
Income taxes	20,124	37,661

See notes to Consolidated Financial Statements

**Table of Contents****United Community Banks, Inc.**

Notes to Consolidated Financial Statements

**Note 1 Accounting Policies**

The accounting and financial reporting policies of United Community Banks, Inc. ( United ) and its subsidiaries conform to accounting principles generally accepted in the United States of America and general banking industry practices. The accompanying interim consolidated financial statements have not been audited. All material intercompany balances and transactions have been eliminated. A more detailed description of United s accounting policies is included in the 2007 annual report filed on Form 10-K.

In management s opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments are normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim periods.

**Note 2 Stock-Based Compensation**

United has an equity compensation plan that allows for grants of incentive stock options, nonqualified stock options, restricted stock awards (also referred to as nonvested stock awards), stock awards, performance share awards or stock appreciation rights. Options granted under the plan can have an exercise price no less than the fair market value of the underlying stock at the date of grant. The general terms of the plan include a vesting period (usually four years) with an exercisable period not to exceed ten years. Certain option and restricted stock awards provide for accelerated vesting if there is a change in control (as defined in the plan). As of September 30, 2008, approximately 1,385,000 additional awards could be granted under the plan. Through September 30, 2008, only incentive stock options, nonqualified stock options and restricted stock awards and units had been granted under the plan.

The following table shows stock option activity for the first nine months of 2008.

<b>Options</b>	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted-Average Remaining Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value (\$000)</b>
Outstanding at December 31, 2007	2,912,557	\$ 21.57		
Stock dividend adjustment	25,770			
Granted	594,750	13.76		
Exercised	(87,941)	13.41		
Forfeited	(53,175)	28.50		
Expired	(34,370)	24.08		
Outstanding at September 30, 2008	3,357,591	20.10	6.3	\$ 995
Exercisable at September 30, 2008	2,027,290	\$ 18.81	4.7	\$ 950

The weighted average fair value of stock options granted in the first nine months of 2008 and 2007 was \$2.90 and \$8.29, respectively. The fair value of each option granted was estimated on the date of grant using the Black-Scholes model. Because United s option plan has not been in place long enough to gather sufficient information about exercise patterns to establish an expected life, United uses the formula provided by the Securities and Exchange Commission in Staff Accounting Bulletin No. 107 to determine the expected life of options. The weighted average assumptions used to determine the fair value of stock options are presented in the table below.

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
Expected volatility	23.42%	20.00%
Expected dividend yield	2.62%	1.17%
Expected life (in years)	6.25	6.27
Risk-free rate	3.44%	4.60%

**Table of Contents**

United's stock trading history began in March of 2002 when United listed on the Nasdaq National Market. For 2008 and 2007, expected volatility was determined using United's historical monthly volatility over the period beginning in March of 2002 through the end of the last completed year. Compensation expense for stock options was \$1,578,000 and \$1,564,000 for the nine months ended September 30, 2008 and 2007, respectively, which was net of deferred tax benefits of \$692,000 and \$492,000, respectively. The amount of compensation expense for both periods was determined based on the fair value of the options at the time of grant, multiplied by the number of options granted that were expected to vest, which was then amortized, net of any applicable tax benefit, over the vesting period. The forfeiture rate for options is estimated to be approximately 3% per year. The total intrinsic value of options exercised during the nine months ended September 30, 2008 and 2007 was \$391,000 and \$2,163,000, respectively.

The table below presents the activity in restricted stock awards for the first nine months of 2008.

<b>Restricted Stock</b>	<b>Shares</b>		<b>Weighted-Average Grant-Date Fair Value</b>
Outstanding at December 31, 2007	84,413	\$	29.26
Stock dividend adjustment	669		
Granted	31,097		14.19
Vested	(23,859)		26.95
Cancelled	(3,000)		30.10
Outstanding at September 30, 2008	89,320	\$	24.38

Compensation expense for restricted stock is based on the fair value of restricted stock awards at the time of grant, which is equal to the value of United's common stock on the date of grant. The value of restricted stock grants that are expected to vest is amortized into expense over the vesting period. For the nine months ended September 30, 2008 and 2007, compensation expense of \$659,000 and \$555,000, respectively, was recognized related to restricted stock awards. The total intrinsic value of the restricted stock was \$1,184,000 at September 30, 2008.

As of September 30, 2008, there was \$7.9 million of unrecognized compensation cost related to nonvested stock options and restricted stock awards granted under the plan. That cost is expected to be recognized over a weighted-average period of 1.4 years. The aggregate grant date fair value of options and restricted stock awards that vested during the nine months ended September 30, 2008, was \$3.6 million.

**Note 3 Common Stock Issued / Common Stock Issuable**

United provides a Dividend Reinvestment and Share Purchase Plan (DRIP) to its shareholders. Under the DRIP, shareholders of record can voluntarily reinvest all or a portion of their cash dividends into shares of United's common stock, as well as purchase additional stock through the plan with cash. United's 401(k) retirement plan regularly purchases shares of United's common stock directly from United. In addition, United has an Employee Stock Purchase Program (ESPP) that allows eligible employees to purchase shares of common stock at a 5% discount, with no commission charges. For the nine months ended September 30, 2008 and 2007, United issued 233,276 and 123,692 shares, respectively, and increased capital by \$2.8 million and \$3.6 million, respectively, through these programs.

United offers its common stock as an investment option in its deferred compensation plan. The common stock component of the deferred compensation plan is accounted for as an equity instrument and is reflected in the consolidated financial statements as common stock issuable. At September 30, 2008 and 2007, 116,567 and 66,366 shares, respectively, were issuable under the deferred compensation plan.



**Table of Contents****Note 4 Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share for the three months and nine months ended September 30, 2008 and 2007.

(in thousands, except per share data)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net income available to common shareholders	\$ (39,878)	\$ 22,532	\$ (16,715)	\$ 53,778
<b>Weighted average shares outstanding:</b>				
Basic	47,304	48,348	47,111	45,452
Effect of dilutive securities <sup>(1)</sup>				
Stock options and restricted stock		565		733
Common stock issuable under deferred compensation plan		64		50
Diluted	47,304	48,977	47,111	46,235
<b>Earnings per common share:</b>				
Basic	\$ (.84)	\$ .47	\$ (.35)	\$ 1.18
Diluted	\$ (.84)	\$ .46	\$ (.35)	\$ 1.16

(1) Due to a net loss for the three months and nine months ended September 30, 2008, stock options, restricted stock, and common stock issuable are considered anti-dilutive and thus are not included in this calculation.

**Note 5 Assets and Liabilities Measured at Fair Value**

On January 1, 2008, United adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, SFAS No. 157 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

**Fair Value Hierarchy**

Level 1 Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that United has the ability to access.

Level 2 Valuation is based upon quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption based on unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. United's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

**Securities Available for Sale**

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

## **Table of Contents**

### **Deferred Compensation Plan Assets and Liabilities**

Included in other assets in the consolidated balance sheet are assets related to employee deferred compensation plans. The assets associated with these plans are invested in mutual funds and classified as Level 1. Deferred compensation liabilities, also classified as Level 1, are carried at the fair value of the obligation to the employee, which mirrors the fair value of the invested assets and is included in other liabilities in the consolidated balance sheet.

### **Loans Held for Sale**

Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, United classifies loans subjected to nonrecurring fair value adjustments as Level 2.

### **Loans**

United does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, United records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, United records the impaired loan as nonrecurring Level 3.

### **Foreclosed Assets**

Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, United records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, United records the foreclosed asset as nonrecurring Level 3.

### **Goodwill and Other Intangible Assets**

Goodwill and identified intangible assets are subject to impairment testing. United's approach to testing goodwill for impairment is to compare the business unit's carrying value to the implied fair value based on multiples of earnings and tangible book value for recently completed merger transactions. In the event the fair value is determined to be less than the carrying value, the asset is recorded at fair value as determined by the valuation model. As such, United classifies goodwill and other intangible assets subjected to nonrecurring fair value adjustments as Level 3.

### **Derivative Financial Instruments**

Currently, United uses interest rate swaps and interest rate floors to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

The fair values of interest rate options are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fell below the strike rate of the floors. The variable interest rates used in the calculation of projected receipts on the floor are based on an expectation of future

interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of SFAS No. 157, United incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, United has considered the effect of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

**Table of Contents**

Although United has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2008, United has assessed the significance of the effect of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, United has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

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

The table below presents United's assets and liabilities measured at fair value on a recurring basis as of September 30, 2008, aggregated by the level in the fair value hierarchy within which those measurements fall.

(in thousands)

Description	Level 1	Level 2	Level 3	Balance at September 30, 2008
<b>Assets</b>				
Securities available for sale	\$	\$ 1,400,827	\$	\$ 1,400,827
Deferred compensation plan assets	4,435			4,435
Derivative financial instruments		38,100		38,100
Total	\$ 4,435	\$ 1,438,927	\$	\$ 1,443,362
<b>Liabilities</b>				
Deferred compensation plan liability	\$ 4,435	\$	\$	\$ 4,435
Total liabilities	\$ 4,435	\$	\$	\$ 4,435

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

United may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. Generally Accepted Accounting Principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. The table below presents United's assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2008, aggregated by the level in the fair value hierarchy within which those measurements fall.

(in thousands)

Description	Level 1	Level 2	Level 3	Balance at September 30, 2008
<b>Assets</b>				
Loans	\$	\$	\$ 58,741	\$ 58,741
Foreclosed assets			33,746	33,746
Total	\$	\$	\$ 92,487	\$ 92,487

**Note 6 Stock Dividend**

During the third quarter of 2008, United replaced its regular cash dividend with a stock dividend at a rate of 1 new share for every 130 shares owned. The stock dividend has been reflected in the financial statements as an issuance of stock with no proceeds rather than a stock split and therefore previously numbers of shares outstanding have not been adjusted. The amount of \$40,000 shown in the equity statement as a reduction of capital related to the stock dividend is the amount of cash paid to shareholders for fractional shares.

**Note 7 Issuance of Subordinated Debt**

On August 29, 2008, United Community Bank, United's wholly-owned banking subsidiary, issued \$30 million in subordinated debt which qualifies as Tier II capital under Risk-Based Capital rules. The unsecured subordinated debt accrues interest at three-month LIBOR plus 4.00% and matures on August 29, 2015. The subordinated debt is pre-payable at any time without penalty.

**Note 8 Recent Accounting Pronouncements**

In February 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) FAS 140-3 *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. This statement provides guidance regarding the accounting for a transfer of a financial asset and repurchase financing where the counterparties for both transactions are the same. In these circumstances, certain criteria must be met in order to not account for the transactions as a linked transaction. This FSP becomes effective for fiscal years and interim periods within those fiscal years, beginning on or after November 15, 2008. United does not anticipate that this FSP will have a material effect on United's financial position, results of operations, or disclosures.

**Table of Contents**

In February 2008, the FASB issued FSP FAS 157-1 *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP 157-2 *Effective Date of FASB Statement No. 157*. FSP FAS 157-1 excludes leases from the provisions of SFAS No. 157, unless the lease is valued under a transaction covered by Statement of Financial Accounting Standards No. 141(R) (SFAS No. 141). FSP FAS 157-2 delays implementation of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities measured at fair value on a non-recurring basis until fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. Because United does not have any leases which are subject to fair value accounting, and because United already discloses nonfinancial assets measured at fair value on a nonrecurring basis in the financial statements, United does not anticipate that these FSPs will have a material effect on United's financial position, results of operations, or disclosures.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161 (SFAS No. 161), *Disclosures about Derivative Instruments and Hedging Activities*. This statement requires an entity to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related items are accounted for under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This statement is intended to enhance the current disclosure framework in SFAS 133, by requiring the objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. This statement becomes effective for fiscal years and interim periods beginning within those years after November 15, 2008. As this statement is related to disclosures only, United does not anticipate that adoption of this standard will have a material effect on United's financial position or results of operations.

In September 2008, the FASB issued FASB Staff Positions FAS 133-1 (FSP FAS 133-1) and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45*; and *Clarification of the Effective Date of FASB Statement No. 161*. This staff position details the proper disclosure and reporting for credit derivatives for both the party that assumes credit risk (seller) and the party that is protected by the credit derivative (buyer). The disclosures should include the nature, term, reasoning, and events and circumstances that would require the seller to perform under the derivative contract. This FSP is effective for reporting periods ending after November 15, 2008. United is not the buyer or seller on any credit derivatives at this time, and thus United does not anticipate that adoption of this staff position will have a material effect on United's financial position or results of operations.

On October 10, 2008, the FASB issued FASB Staff Position FAS 157-3 (FSP FAS 157-3), *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. This staff position addressed concerns among financial entities regarding assets trading in markets that were at one time active but have subsequently become inactive. Under FSP FAS 157-3, firms must take into account the facts and circumstances to determine whether the known trades in an inactive market are reflective of orderly transactions that are not forced liquidations or distressed sales. If the firm makes this determination, they can classify the assets as Level 3 of the fair value hierarchy and use an appropriate valuation approach relying to an extent on unobservable inputs, and thus following the appropriate disclosures associated with a recurring Level 3 asset. United's current portfolio does not include any securities for which FSP FAS 157-3 would apply. Thus, FSP FAS 157-3 is not expected to have a material effect on United's financial position, results of operations, or disclosures.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Forward-Looking Statements**

This Form 10-Q contains forward-looking statements regarding United Community Banks, Inc. (United), including, without limitation, statements relating to United's expectations with respect to revenue, credit losses, levels of nonperforming assets, expenses, earnings and other measures of financial performance. Words such as may, could, would, should, believes, expects, anticipates, estimates, intends, plans, targets or similar expressions identify forward-looking statements. These forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties that are subject to change based on various factors (many of which are beyond United's control). The following factors, among others, could cause United's financial performance to differ materially

from the expectations expressed in such forward-looking statements:

our recent operating results may not be indicative of future operating results;

our business is subject to the success of the local economies in which we operate;

our concentration of construction and land development loans is subject to unique risks that could adversely affect our earnings;

we may face risks with respect to future expansion and acquisitions or mergers;

changes in prevailing interest rates may negatively affect our net income and the value of our assets;

if our allowance for loan losses is not sufficient to cover actual loan losses, our earnings would decrease;



**Table of Contents**

we may be subject to losses due to fraudulent and negligent conduct of our loan customers, third party service providers or employees;

competition from financial institutions and other financial service providers may adversely affect our profitability;

business increases, productivity gains and other investments are lower than expected or do not occur as quickly as anticipated;

competitive pressures among financial services companies increase significantly;

the success of our business strategy;

the strength of the United States economy in general changes;

change in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;

inflation or market conditions fluctuate;

conditions in the stock market, the public debt market and other capital markets deteriorate;

financial services laws and regulations change;

technology changes and United fails to adapt to those changes;

consumer spending and saving habits change;

unanticipated regulatory or judicial proceedings occur; and

United is unsuccessful at managing the risks involved in the foregoing.

Additional information with respect to factors that may cause actual results to differ materially from those contemplated by such forward-looking statements may also be included in other reports that United files with the Securities and Exchange Commission. United cautions that the foregoing list of factors is not exclusive and not to place undue reliance on forward-looking statements. United does not intend to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Form 10-Q.

**Overview**

The following discussion is intended to provide insight into the results of operations and financial condition of United and its subsidiaries and should be read in conjunction with the consolidated financial statements and accompanying notes.

United is a bank holding company registered with the Federal Reserve under the Bank Holding Company Act of 1956 that was incorporated under the laws of the state of Georgia in 1987 and commenced operations in 1988. At September 30, 2008, United had total consolidated assets of \$8.1 billion, total loans of \$5.8 billion, total deposits of \$6.7 billion and stockholders' equity of \$816.9 million.

United's activities are primarily conducted by its wholly owned Georgia banking subsidiary (the Bank) and Brintech, Inc., a consulting firm providing professional services to the financial services industry. The Bank operations are conducted under a community bank model that operates 27 community banks with local bank presidents and boards in north Georgia, the Atlanta metropolitan statistical area (MSA), the Gainesville MSA, coastal Georgia, western North Carolina, and east Tennessee.

Several significant events affecting the banking industry occurred during the third quarter of 2008, including the failure or near failure of several large financial institutions and the failure of Fannie Mae and Freddie Mac, two government sponsored enterprises or GSEs. These events led to serious concerns about the safety and soundness of the financial services industry that affected financial markets around the world. In response to the emerging crisis, on October 3, 2008, Congress passed and President Bush signed into law the *Emergency Economic Stabilization Act of 2008* (The Act) which created a \$700 billion *Troubled Assets Relief Program* ( TARP ) to purchase illiquid assets of troubled banks. The Act also raised the limits on FDIC insurance protection from \$100,000 to \$250,000 through the end of 2009. On October 14, the U.S. Treasury Department announced a voluntary capital purchase program that would allow the U.S. Treasury to purchase senior preferred shares in qualified financial institutions in an amount between 1% and 3% of the financial institutions' risk-weighted assets.

United reported a net operating loss of \$39.9 million for the third quarter of 2008, compared with net operating income of \$22.5 million for the third quarter of 2007. Diluted operating loss per common share was \$.84 for the third quarter of 2008, compared with diluted operating earnings per common share of \$.46 for the third quarter of 2007. The loss in the third quarter of 2008 was due to a \$76 million provision for loan losses and \$10 million in writedowns and expenses on foreclosed properties that reflect the effect of further deterioration in credit conditions in United's loan portfolio.

United reported a net operating loss of \$16.7 million for the nine months ended September 30, 2008, compared with net operating income of \$53.8 million for the nine months ended September 30, 2007. Diluted operating loss per common share was \$.35 for the nine months ended September 30, 2008, compared with diluted operating earnings per common share of \$1.36 for the nine months ended September 30, 2007.

**Table of Contents**

Earnings decreased primarily as a result of a higher provision for loan losses related to the increase in charge-offs within the loan portfolio combined with margin compression due to an increase in non-performing assets, competitive deposit pricing and efforts to build liquidity. Housing sales remain at low levels, leaving a surplus of finished housing and lot inventory in our footprint, most notably in the Atlanta MSA. This decline in housing sales negatively affects both the cash flows of our residential construction and land development customers, and the demand for new land development loans.

Nonperforming assets increased to 2.20% of total assets as of September 30, 2008, compared to .77% as of September 30, 2007. This increase is a reflection of the downstream effects of declining home sales in the Atlanta MSA, which itself is indicative of the regional economic slowdown that is occurring in much of the Southeast. To date, the rise in nonperforming assets has been mostly confined to the residential construction and development portfolio and predominantly within the Atlanta MSA.

Fee revenue decreased \$2.5 million, or 16%, from the third quarter of 2007. Although service charges and fees and brokerage fees remained near the same level as the third quarter of 2007, mortgage fees and consulting fees saw declines reflecting the slow housing market and a decline in demand for consulting services in the banking industry associated with earnings pressures. Other fee revenue was down from a year ago, primarily due to weak performance from bank owned life insurance assets and deferred compensation plan assets in the third quarter of 2008.

Operating expenses increased \$8.8 million, or 18%, from the third quarter of 2007, primarily due to higher expenses associated with and writedowns on foreclosed real estate properties and higher FDIC insurance premiums.

**Critical Accounting Policies**

The accounting and reporting policies of United are in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and conform to general practices within the banking industry. The more critical accounting and reporting policies include United s accounting for the allowance for loan losses and accounting for intangible assets. In particular, United s accounting policies related to allowance for loan losses and intangibles involve the use of estimates and require significant judgment to be made by management. Different assumptions in the application of these policies could result in material changes in United s consolidated financial position or consolidated results of operations. See Asset Quality and Risk Elements herein for additional discussion of United s accounting methodologies related to the allowance.

**Non-GAAP Performance Measures**

The presentation of United s financial results herein include references to operating performance measures, which are measures of performance determined by methods other than GAAP. Management included non-GAAP performance measures because it believes they are useful for evaluating United s operations and performance over periods of time. Also, United uses operating performance measures in managing and evaluating United s business and intends to use them in discussions about United s operations and performance.

Operating performance measures exclude the effect of a special \$15 million fraud related provision for loan losses recorded in the second quarter of 2007 and an additional \$3 million provision and \$18 million in related charge-offs in the fourth quarter of 2007 involving lot loans in a failed real estate development near Spruce Pine, North Carolina. Management believes that the circumstances leading to the special provision and subsequent charge-offs were isolated, non-recurring events and do not reflect overall trends in United s performance. Management also believes that these non-GAAP performance measures provide users of United s financial information with a meaningful measure for assessing United s financial results and credit trends and comparing financial results to prior periods.

**Table of Contents**

A reconciliation of operating earnings measures to reported earnings measures using GAAP is presented below:

**Table 1 Operating Earnings to GAAP Earnings Reconciliation**

(in thousands, except per share data)

	Third Quarter	2008 Second Quarter	First Quarter	2007 Fourth Quarter	2007 Third Quarter	For the Nine Months Ended September 30	
						2008	2007
Special provision for fraud related loan losses	\$	\$	\$	\$ 3,000	\$	\$	\$ 15,000
Income tax effect of special provision				1,167			5,835
After-tax effect of special provision	\$	\$	\$	\$ 1,833	\$	\$	\$ 9,165
<b>Net Income (Loss) Reconciliation</b>							
Operating net income (loss)	\$ (39,874)	\$ 7,093	\$ 16,078	\$ 6,034	\$ 22,536	\$ (16,703)	\$ 62,957
After-tax effect of special provision and merger-related charges				(1,833)			(9,165)
Net income (loss) (GAAP)	\$ (39,874)	\$ 7,093	\$ 16,078	\$ 4,201	\$ 22,536	\$ (16,703)	\$ 53,792
<b>Basic Earnings (Loss) Per Share Reconciliation</b>							
Basic operating earnings (loss) per share	\$ (.84)	\$ .15	\$ .34	\$ .13	\$ .47	\$ (.35)	\$ 1.38
Per share effect of special provision and merger-related charges				(.04)			(.20)
Basic earnings (loss) per share (GAAP)	\$ (.84)	\$ .15	\$ .34	\$ .09	\$ .47	\$ (.35)	\$ 1.18

**Diluted Earnings  
(Loss) Per Share  
Reconciliation**

Diluted operating earnings (loss) per share	\$ (.84)	\$ .15	\$ .34	\$ .13	\$ .46	\$ (.35)	\$ 1.36
Per share effect of special provision and merger-related charges				(.04)			(.20)
Diluted earnings (loss) per share (GAAP)	\$ (.84)	\$ .15	\$ .34	\$ .09	\$ .46	\$ (.35)	\$ 1.16

**Provision for Loan  
Losses  
Reconciliation**

Operating provision for loan losses	\$ 76,000	\$ 15,500	\$ 7,500	\$ 26,500	\$ 3,700	\$ 99,000	\$ 11,100
Special provision for fraud related loan losses				3,000			15,000
Provision for loan losses (GAAP)	\$ 76,000	\$ 15,500	\$ 7,500	\$ 29,500	\$ 3,700	\$ 99,000	\$ 26,100

**Nonperforming  
Assets  
Reconciliation**

Nonperforming assets excluding fraud-related assets	\$ 174,227	\$ 148,219	\$ 85,182	\$ 40,956	\$ 39,761	\$ 174,227	\$ 39,761
Fraud-related loans and OREO included in nonperforming assets	3,477	3,945	4,682	5,302	23,576	3,477	23,576
Nonperforming assets (GAAP)	\$ 177,704	\$ 152,164	\$ 89,864	\$ 46,258	\$ 63,337	\$ 177,704	\$ 63,337

**Allowance for Loan  
Losses  
Reconciliation**

Allowance for loan losses excluding special fraud-related	\$ 111,299	\$ 91,035	\$ 89,848	\$ 89,423	\$ 75,935	\$ 111,299	\$ 75,935
---	------------	-----------	-----------	-----------	-----------	------------	-----------

allowance Fraud-related allowance for loan losses								15,000	15,000
--	--	--	--	--	--	--	--	--------	--------

Allowance for loan losses (GAAP)	\$ 111,299	\$ 91,035	\$ 89,848	\$ 89,423	\$ 90,935	\$ 111,299	\$ 90,935		
-------------------------------------	------------	-----------	-----------	-----------	-----------	------------	-----------	--	--

**Net Charge Offs  
Reconciliation**

Net charge offs excluding charge off of fraud-related loans	\$ 55,736	\$ 14,313	\$ 7,075	\$ 13,012	\$ 5,236	\$ 77,124	\$ 8,822		
Fraud-related loans charged off				18,000					

Net charge offs (GAAP)	\$ 55,736	\$ 14,313	\$ 7,075	\$ 31,012	\$ 5,236	\$ 77,124	\$ 8,822		
---------------------------	-----------	-----------	----------	-----------	----------	-----------	----------	--	--

**Allowance for Loan  
Losses to Loans  
Ratio  
Reconciliation**

Allowance for loan losses to loans ratio excluding fraud-related allowance	1.91%	1.53%	1.51%	1.51%	1.28%	1.91%	1.28%		
Portion of allowance assigned to fraud-related loans					.25		.25		

Allowance for loan losses to loans ratio (GAAP)	1.91%	1.53%	1.51%	1.51%	1.53%	1.91%	1.53%		
---	-------	-------	-------	-------	-------	-------	-------	--	--

**Nonperforming  
Assets to Total  
Assets Ratio  
Reconciliation**

Nonperforming assets to total assets ratio excluding fraud-related assets	2.16%	1.79%	1.02%	.50%	.49%	2.16%	.49%		
Fraud-related nonperforming assets	.04	.05	.05	.06	.28	.04	.28		

Nonperforming assets to total assets ratio (GAAP)	2.20%	1.84%	1.07%	.56%	.77%	2.20%	.77%
<b>Net Charge Offs to Average Loans Ratio Reconciliation</b>							
Net charge offs to average loans ratio excluding fraud-related loans	3.77%	.97%	.48%	.87%	.35%	1.74%	.21%
Charge offs of fraud-related loans				1.20			
Net charge offs to average loans ratio (GAAP)	3.77%	.97%	.48%	2.07%	.35%	1.74%	.21%

**Table of Contents****Table 2 Financial Highlights  
Selected Financial Information**

<i>except per share equivalent)</i>	<b>Third Quarter</b>	<b>2008 Second Quarter</b>	<b>First Quarter</b>	<b>2007 Fourth Quarter</b>	<b>Third Quarter</b>	<b>Third Quarter 2008-2007 Change</b>	<b>For the Nine Months Ended 2008</b>	<b>2007</b>
<b>SUMMARY</b>								
Revenue	\$ 112,510	\$ 116,984	\$ 129,041	\$ 140,768	\$ 144,884		\$ 358,535	\$ 410,150
Expenses	53,719	55,231	62,754	71,038	73,203		171,704	205,390
Net revenue	58,791	61,753	66,287	69,730	71,681	(18)%	186,831	204,760
Provision for loan losses <sup>(1)</sup>	76,000	15,500	7,500	26,500	3,700		99,000	11,100
Net income before taxes	13,121	15,105	14,197	16,100	15,615	(16)	42,423	46,550
Provision for income taxes	(4,088)	61,358	72,984	59,330	83,596	(105)	130,254	240,200
Net income (loss) before taxes	56,970	49,761	47,529	49,336	48,182	18	154,260	140,720
Provision for income taxes	(61,058)	11,597	25,455	9,994	35,414	(272)	(24,006)	99,480
Net income (loss) after taxes	(21,184)	4,504	9,377	3,960	12,878		(7,303)	36,520
Provision for income taxes	(39,874)	7,093	16,078	6,034	22,536	(277)	(16,703)	62,990
Net income (loss) after taxes and provision, net of tax <sup>(1)</sup>				1,833				9,160
Net income (loss)	\$ (39,874)	\$ 7,093	\$ 16,078	\$ 4,201	\$ 22,536	(277)	\$ (16,703)	\$ 53,790
<b>ROA PERFORMANCE <sup>(1)</sup></b>								
Return on assets (ROA) per common share:								
Net income (loss)	\$ (.84)	\$ .15	\$ .34	\$ .13	\$ .47	(279)	\$ (.35)	\$ 1.33
Equity	(.84)	.15	.34	.13	.46	(283)	(.35)	1.33
Return on tangible equity <sup>(2)(3)(4)</sup>	(30.43)	5.86	13.16	5.06	17.54		(3.99)	17.43
Return on assets <sup>(4)</sup>	(1.95)	.34	.78	.29	1.11		(.27)	1.11
Return on book value ratio	(10.71)	60.00	26.47	69.23	19.15		(77.14)	19.50
<b>ROE PERFORMANCE</b>								
Return on equity (ROE) per share:								
Net income (loss)	\$ (.84)	\$ .15	\$ .34	\$ .09	\$ .47	(279)	\$ (.35)	\$ 1.11
Equity	(.84)	.15	.34	.09	.46	(283)	(.35)	1.11
Dividends declared	.09	.09	.09	.09	.09	0	.27	.27
Return on book value <sup>(3)</sup>	17.12	17.75	18.50	17.70	17.51	(2)	17.12	17.50
Return on book value <sup>(3)</sup>	10.48	11.03	11.76	10.92	10.81	(3)	10.48	10.81
Return on assets ratios:								
Return on assets <sup>(2)(4)</sup>	(19.07)%	3.41%	7.85%	2.01%	10.66%		(2.69)%	10.00%
Return on tangible equity <sup>(4)</sup>	(1.95)	.34	.78	.20	1.11		(.27)	.90
Return on assets <sup>(4)</sup>	3.17	3.32	3.55	3.73	3.89		3.35	3.90
Return on book value ratio	79.35	65.05	59.05	57.67	55.34		67.43	56.10
Return on book value ratio	(10.71)	60.00	26.47	100.00	19.15		(77.14)	22.80



Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

ts	10.28	10.33	10.30	10.20	10.32		10.30	9.3
ty to assets <sup>(3)</sup>	6.65	6.77	6.73	6.58	6.65		6.72	6.6

**LIABILITY**

r loan losses	\$ 111,299	\$ 91,035	\$ 89,848	\$ 89,423	\$ 90,935		\$ 111,299	\$ 90,935
fs <sup>(1)</sup>	55,736	14,313	7,075	13,012	5,236		77,124	8,822
ng loans	139,266	123,786	67,728	28,219	46,783		139,266	46,783
	38,438	28,378	22,136	18,039	16,554		38,438	16,554
forming assets	177,704	152,164	89,864	46,258	63,337		177,704	63,337
r loan losses to loans <sup>(1)</sup>	1.91%	1.53%	1.51%	1.51%	1.28%		1.91%	1.28%
fs to average	3.77	.97	.48	.87	.35		1.74	.2
ng assets to loans and	3.03	2.55	1.50	.78	1.06		3.03	1.0
ng assets to total assets	2.20	1.84	1.07	.56	.77		2.20	.7

**BALANCES**

	\$ 5,889,168	\$ 5,933,143	\$ 5,958,296	\$ 5,940,230	\$ 5,966,933	(1)	\$ 5,926,731	\$ 5,665,311
curities	1,454,740	1,507,240	1,485,515	1,404,796	1,308,192	11	1,482,397	1,235,188
s	7,384,287	7,478,018	7,491,480	7,424,992	7,332,492	1	7,451,017	6,951,575
	8,146,880	8,295,748	8,305,621	8,210,120	8,083,739	1	8,249,042	7,568,912
	6,597,339	6,461,361	6,051,069	6,151,476	6,246,319	6	6,370,753	5,987,222
equity	837,487	856,727	855,659	837,195	834,094	0	849,912	710,951
es basic	47,304	47,060	46,966	47,203	48,348		47,111	45,451
es diluted	47,304	47,249	47,272	47,652	48,977		47,111	46,232

**END**

	\$ 5,829,937	\$ 5,933,141	\$ 5,967,839	\$ 5,929,263	\$ 5,952,749	(2)	\$ 5,829,937	\$ 5,952,749
curities	1,400,827	1,430,588	1,508,402	1,356,846	1,296,826	8	1,400,827	1,296,826
	8,072,543	8,264,051	8,386,255	8,207,302	8,180,600	(1)	8,072,543	8,180,600
	6,689,335	6,696,456	6,175,769	6,075,951	6,154,308	9	6,689,335	6,154,308
equity	816,880	837,890	871,452	831,902	833,761	(2)	816,880	833,761
es outstanding	47,596	47,096	47,004	46,903	47,542		47,596	47,542

(1) Excludes effect of special \$15 million fraud related provision for loan losses recorded in the second quarter of 2007, an additional \$3 million provision in the fourth quarter of 2007, and \$18 million of related loan

charge-offs  
recorded in the  
fourth quarter of  
2007.

- (2) Net income available to common shareholders, which excludes preferred stock dividends, divided by average realized common equity, which excludes accumulated other comprehensive income (loss).
- (3) Excludes effect of acquisition related intangibles and associated amortization.
- (4) Annualized.

**Table of Contents****Results of Operations**

Net operating loss was \$39.9 million for the third quarter of 2008, compared to net operating income of \$22.5 million for the same period in 2007. Diluted operating loss per share was \$.84 for the third quarter of 2008, compared to diluted operating earnings per share of \$.46 for the third quarter of 2007.

Net operating loss was \$16.7 million for the nine months ended September 30, 2008, compared to net operating income of \$63.0 million for the same period in 2007. Diluted operating loss per share was \$.35 for the nine months ended September 30, 2008, compared to diluted operating earnings per share of \$1.36 for the nine months ended September 30, 2007.

**Net Interest Revenue (Taxable Equivalent)**

Net interest revenue (the difference between the interest earned on assets and the interest paid on deposits and borrowed funds) is the single largest component of total revenue. United actively manages this revenue source to provide optimal levels of revenue while balancing interest rate, credit and liquidity risks. Net interest revenue for the three months ended September 30, 2008 was \$58.8 million, down \$12.9 million, or 18%, from last year. Average loans decreased \$77.8 million, or 1%, from the third quarter last year. Overall, United's loan portfolio decreased slightly, which was a result of the slowdown in the housing market, particularly in the Atlanta MSA where period end loans decreased \$256.6 million from September 30, 2007. Much of the decrease was intentional as management sought to rebalance the loan portfolio by reducing the concentration of residential construction loans, particularly in the Atlanta MSA where the housing market has been under considerable stress. In contrast, period-end loans in north Georgia increased \$40.5 million, coastal Georgia increased \$55.8 million, the Gainesville MSA increased \$31.8 million, east Tennessee increased \$23.9 million and western North Carolina decreased \$18.2 million.

Average interest-earning assets for the third quarter 2008 increased \$51.8 million, or 1%, over the same period in 2007. These increases in interest-earning assets were more than funded by interest-bearing sources, resulting in increases in average interest-bearing liabilities of \$125.6 million compared to the same period in 2007. The increase in interest-bearing liabilities was primarily the result of an increase in interest-bearing deposits.

The banking industry uses two ratios to measure relative profitability of net interest revenue. The net interest spread measures the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities. The interest rate spread eliminates the effect of non-interest-bearing deposits and gives a direct perspective on the effect of market interest rate movements. The net interest margin is defined as net interest revenue as a percent of average total interest-earning assets and takes into account the positive effect of investing non-interest-bearing deposits and capital.

For the three months ended September 30, 2008 and 2007, the net interest spread was 2.82% and 3.34%, respectively, while the net interest margin was 3.17% and 3.89%, respectively. The compression of the spread and margin was primarily the result of a rise in non-performing assets and increased deposit pricing resulting from increased competition for deposits due to liquidity pressures affecting the banking industry as a whole. The compression of the spread and margin was also due to the 325 basis point lowering of the prime rate initiated by actions of the Federal Reserve beginning in September 2007 and the resulting repricing of our interest earning assets faster than our interest-bearing liabilities. Also contributing to the lower spread and net interest margin was a shift in earning-asset mix from loans to investment securities. With the additional 100 basis point lowering of the prime rate initiated by the Federal Reserve on October 8, 2008 and October 29, 2008, management expects the spread and margin to further compress.

The average yield on interest-earning assets for the third quarter of 2008 was 6.07%, compared with 7.85% in the third quarter of 2007. Loan yields were down 214 basis points compared with the third quarter of 2007, primarily due to the 325 basis point decrease in the prime rate since September 2007 and an increase in non-performing assets.

The average cost of interest-bearing liabilities for the third quarter was 3.25% compared to 4.51% from the same period of 2007. Even as the cost of borrowed funds decreased 209 basis points compared with the second quarter of 2007, the cost of interest-bearing deposits only decreased 111 basis points in the same timeframe. Deposit pricing decreased less than borrowed funds because at the same time index interest rates were dropping, increasing competition for deposits kept deposit pricing at higher levels in relation to the cost to borrow funds.



**Table of Contents**

The following table shows the relationship between interest revenue and expense, and the average amounts of interest-earning assets and interest-bearing liabilities for the three months ended September 30, 2008 and 2007.

**Table 3 Average Consolidated Balance Sheets and Net Interest Analysis**

For the Three Months Ended September 30,

<i>(dollars in thousands, taxable equivalent)</i>	<b>2008</b>			<b>2007</b>		
	<b>Average Balance</b>	<b>Interest</b>	<b>Avg. Rate</b>	<b>Average Balance</b>	<b>Interest</b>	<b>Avg. Rate</b>
<b>Assets:</b>						
Interest-earning assets:						
Loans, net of unearned income <sup>(1)(2)</sup>	\$ 5,889,168	\$ 93,270	6.30%	\$ 5,966,933	\$ 126,992	8.44%
Taxable securities <sup>(3)</sup>	1,422,321	18,258	5.13	1,266,609	16,637	5.25
Tax-exempt securities <sup>(1)(3)</sup>	32,419	573	7.07	41,583	704	6.77
Federal funds sold and other interest-earning assets	40,379	409	4.05	57,367	551	3.84
<b>Total interest-earning assets</b>	<b>7,384,287</b>	<b>112,510</b>	<b>6.07</b>	<b>7,332,492</b>	<b>144,884</b>	<b>7.85</b>
Non-interest-earning assets:						
Allowance for loan losses	(93,687)			(93,832)		
Cash and due from banks	111,741			141,536		
Premises and equipment	180,825			173,605		
Other assets <sup>(3)</sup>	563,714			529,938		
<b>Total assets</b>	<b>\$ 8,146,880</b>			<b>\$ 8,083,739</b>		
<b>Liabilities and Shareholders Equity:</b>						
Interest-bearing liabilities:						
Interest-bearing deposits:						
NOW	\$ 1,463,744	\$ 6,778	1.84	\$ 1,431,168	\$ 12,046	3.34
Money market	421,626	2,296	2.17	496,005	5,002	4.00
Savings	182,525	153	.33	201,031	553	1.09
Time less than \$100,000	1,779,550	17,812	3.98	1,624,698	20,151	4.92
Time greater than \$100,000	1,530,719	15,825	4.11	1,391,139	18,192	5.19
Brokered	530,705	5,407	4.05	358,614	4,519	5.00
<b>Total interest-bearing deposits</b>	<b>5,908,869</b>	<b>48,271</b>	<b>3.25</b>	<b>5,502,655</b>	<b>60,463</b>	<b>4.36</b>
Federal funds purchased and other borrowings						
	256,742	1,116	1.73	348,472	4,738	5.39
Federal Home Loan Bank advances	286,540	2,105	2.92	474,555	5,902	4.93
Long-term debt	118,756	2,227	7.46	119,596	2,100	6.97
<b>Total borrowed funds</b>	<b>662,038</b>	<b>5,448</b>	<b>3.27</b>	<b>942,623</b>	<b>12,740</b>	<b>5.36</b>
<b>Total interest-bearing liabilities</b>	<b>6,570,907</b>	<b>53,719</b>	<b>3.25</b>	<b>6,445,278</b>	<b>73,203</b>	<b>4.51</b>

Non-interest-bearing liabilities:			
Non-interest-bearing deposits	688,470	743,664	
Other liabilities	50,016	60,703	
Total liabilities	7,309,393	7,249,645	
Shareholders' equity	837,487	834,094	
<b>Total liabilities and shareholders' equity</b>	<b>\$ 8,146,880</b>	<b>\$ 8,083,739</b>	
<b>Net interest revenue</b>	<b>\$ 58,791</b>	<b>\$ 71,681</b>	
Net interest-rate spread	2.82%	3.34%	
<b>Net interest margin</b> <sup>(4)</sup>	<b>3.17%</b>	<b>3.89%</b>	

(1) Interest revenue on tax-exempt securities and loans has been increased to reflect comparable interest on taxable securities and loans. The rate used was 39%, reflecting the statutory federal income tax rate and the federal tax adjusted state income tax rate.

(2) Included in the average balance of loans outstanding are loans where the accrual of interest has been discontinued.

(3) Securities available for sale are shown at amortized

cost. Pretax  
unrealized  
losses of \$11.7  
million in 2008  
and  
\$13.3 million in  
2007 are  
included in  
other assets for  
purposes of this  
presentation.

- (4) Net interest  
margin is  
taxable  
equivalent  
net-interest  
revenue divided  
by average  
interest-earning  
assets.

**Table of Contents**

The following table shows the relationship between interest revenue and expense, and the average amounts of interest-earning assets and interest-bearing liabilities for the nine months ended September 30, 2008 and 2007.

**Table 4 Average Consolidated Balance Sheets and Net Interest Analysis**

For the Nine Months Ended September 30,

<i>(dollars in thousands, taxable equivalent)</i>	<b>2008</b>			<b>2007</b>		
	<b>Average Balance</b>	<b>Interest</b>	<b>Avg. Rate</b>	<b>Average Balance</b>	<b>Interest</b>	<b>Avg. Rate</b>
<b>Assets:</b>						
Interest-earning assets:						
Loans, net of unearned income <sup>(1)(2)</sup>	\$ 5,926,731	\$ 299,601	6.75%	\$ 5,665,314	\$ 360,430	8.51%
Taxable securities <sup>(3)</sup>	1,447,409	55,765	5.14	1,192,815	46,081	5.15
Tax-exempt securities <sup>(1)(3)</sup>	34,988	1,876	7.15	42,368	2,160	6.80
Federal funds sold and other interest-earning assets	41,889	1,292	4.11	51,076	1,479	3.86
<b>Total interest-earning assets</b>	<b>7,451,017</b>	<b>358,534</b>	<b>6.43</b>	<b>6,951,573</b>	<b>410,150</b>	<b>7.89</b>
Non-interest-earning assets:						
Allowance for loan losses	(93,165)			(78,541)		
Cash and due from banks	136,920			130,816		
Premises and equipment	181,210			159,674		
Other assets <sup>(3)</sup>	573,060			405,388		
<b>Total assets</b>	<b>\$ 8,249,042</b>			<b>\$ 7,568,910</b>		
<b>Liabilities and Shareholders Equity:</b>						
Interest-bearing liabilities:						
Interest-bearing deposits:						
NOW	\$ 1,476,998	\$ 22,581	2.04	\$ 1,378,200	\$ 34,143	3.31
Money market	427,676	7,519	2.35	371,716	11,082	3.99
Savings	184,713	560	.40	187,693	1,236	.88
Time less than \$100,000	1,659,308	53,320	4.29	1,631,243	59,925	4.91
Time greater than \$100,000	1,460,277	48,330	4.42	1,383,004	54,000	5.22
Brokered	480,166	15,106	4.20	342,162	12,541	4.90
<b>Total interest-bearing deposits</b>	<b>5,689,138</b>	<b>147,416</b>	<b>3.46</b>	<b>5,294,018</b>	<b>172,927</b>	<b>4.37</b>
Federal funds purchased and other borrowings						
	396,798	7,254	2.44	255,115	10,226	5.36
Federal Home Loan Bank advances	452,826	10,668	3.15	430,151	15,738	4.89
Long-term debt	111,607	6,366	7.62	115,390	6,505	7.54
<b>Total borrowed funds</b>	<b>961,231</b>	<b>24,288</b>	<b>3.38</b>	<b>800,656</b>	<b>32,469</b>	<b>5.42</b>
<b>Total interest-bearing liabilities</b>	<b>6,650,369</b>	<b>171,704</b>	<b>3.45</b>	<b>6,094,674</b>	<b>205,396</b>	<b>4.51</b>



Non-interest-bearing liabilities:		
Non-interest-bearing deposits	681,615	693,207
Other liabilities	67,146	70,079
Total liabilities	7,399,130	6,857,960
Shareholders' equity	849,912	710,950
<b>Total liabilities and shareholders' equity</b>	<b>\$ 8,249,042</b>	<b>\$ 7,568,910</b>

<b>Net interest revenue</b>	\$ 186,830	\$ 204,754
Net interest-rate spread	2.98%	3.38%
<b>Net interest margin</b> <sup>(4)</sup>	3.35%	3.94%

(1) Interest revenue on tax-exempt securities and loans has been increased to reflect comparable interest on taxable securities and loans. The rate used was 39%, reflecting the statutory federal income tax rate and the federal tax adjusted state income tax rate.

(2) Included in the average balance of loans outstanding are loans where the accrual of interest has been discontinued.

(3) Securities available for sale are shown

at amortized cost. Pretax unrealized gains of \$5.7 million in 2008 and pretax unrealized losses of \$10.4 million in 2007 are included in other assets for purposes of this presentation.

- (4) Net interest margin is taxable equivalent net-interest revenue divided by average interest-earning assets.

**Table of Contents**

The following table shows the relative effect on net interest revenue for changes in the average outstanding amounts (volume) of interest-earning assets and interest-bearing liabilities and the rates earned and paid on such assets and liabilities (rate). Variances resulting from a combination of changes in rate and volume are allocated in proportion to the absolute dollar amounts of the change in each category.

**Table 5 Change in Interest Revenue and Expense on a Taxable Equivalent Basis***(in thousands)*

	Three Months Ended September 30, 2008 Compared to 2007 Increase (decrease) Due to Changes in			Nine Months Ended September 30, 2008 Compared to 2007 Increase (decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
<b>Interest-earning assets:</b>						
Loans	\$ (1,635)	\$ (32,087)	\$ (33,722)	\$ 16,005	\$ (76,834)	\$ (60,829)
Taxable securities	2,006	(385)	1,621	9,891	(207)	9,684
Tax-exempt securities	(161)	30	(131)	(449)	165	(284)
Federal funds sold and other interest-earning assets	(171)	29	(142)	(326)	139	(187)
<b>Total interest-earning assets</b>	39	(32,413)	(32,374)	25,121	(76,737)	(51,616)
<b>Interest-bearing liabilities:</b>						
NOW accounts	268	(5,536)	(5,268)	2,300	(13,862)	(11,562)
Money market accounts	(665)	(2,041)	(2,706)	1,485	(5,048)	(3,563)
Savings deposits	(47)	(353)	(400)	(19)	(657)	(676)
Time deposits less than \$100,000	1,798	(4,137)	(2,339)	1,015	(7,620)	(6,605)
Time deposits greater than \$100,000	1,701	(4,068)	(2,367)	2,894	(8,564)	(5,670)
Brokered deposits	1,871	(983)	888	4,527	(1,962)	2,565
<b>Total interest-bearing deposits</b>	4,926	(17,118)	(12,192)	12,202	(37,713)	(25,511)
Federal funds purchased & other borrowings	(1,010)	(2,612)	(3,622)	4,119	(7,091)	(2,972)
Federal Home Loan Bank advances	(1,867)	(1,930)	(3,797)	792	(5,862)	(5,070)
Long-term debt	(15)	142	127	(215)	76	(139)
<b>Total borrowed funds</b>	(2,892)	(4,400)	(7,292)	4,696	(12,877)	(8,181)
<b>Total interest-bearing liabilities</b>	2,034	(21,518)	(19,484)	16,898	(50,590)	(33,692)

**Increase in net interest revenue**

\$ (1,995)	\$ (10,895)	\$ (12,890)	\$ 8,223	\$ (26,147)	\$ (17,924)
------------	-------------	-------------	----------	-------------	-------------

***Provision for Loan Losses***

The provision for loan losses was \$76.0 million for the third quarter of 2008, compared with \$3.7 million for the same period in 2007. Net loan charge-offs as an annualized percentage of average outstanding loans for the three months ended September 30, 2008 was 3.77%, compared to .35% for the third quarter of 2007. For the first nine months of 2008 net loan charge offs as an annualized percentage of average outstanding loans was 1.74% versus .21% for 2007. As the housing market in general in United's footprint has struggled, most notably in the Atlanta MSA, it has made it difficult for some developers to obtain cash flows from selling lots and houses that were needed to service their debt. This is part of the deterioration of the residential construction and housing markets that has affected the Southeast and resulted in higher credit losses and an increase in non-performing assets.

The provision for loan losses is based on management's evaluation of losses inherent in the loan portfolio and corresponding analysis of the allowance for loan losses at quarter-end. The amount of provision recorded in the third quarter was the amount required such that the total allowance for loan losses reflects, in the estimation of management, the appropriate balance and is adequate to cover inherent losses in the loan portfolio. The substantial increase in the provision was a result of further credit deterioration within United's loan portfolio, mostly in the residential construction and development portion of the portfolio within the Atlanta MSA. Due to management's expectation of continued weakening in the housing market, United disposed of \$66 million of its most troubled assets resulting in a significant increase in charge-offs in the third quarter of 2008. Additional discussion on loan quality and the allowance for loan losses is included in the Asset Quality section of this report.

***Fee Revenue***

Although United continues to focus on increasing fee revenue through new products and services, fee revenue for the three months ended September 30, 2008 was \$13.1 million, a decrease of \$2.5 million, or 16%, from 2007. The following table presents the components of fee revenue for the third quarter and the first nine months of 2008 and 2007.

**Table of Contents****Table 6 Fee Revenue***(dollars in thousands)*

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	Change	2008	2007	Change
Service charges and fees	\$ 8,171	\$ 7,855	4%	\$ 23,941	\$ 23,083	4%
Mortgage loan and other related fees	1,410	2,118	(33)	5,575	6,817	(18)
Consulting fees	1,727	2,381	(27)	5,786	6,369	(9)
Brokerage fees	905	895	1	2,812	3,031	(7)
Securities gains, net	120	225		477	1,818	
Loss on prepayments of borrowings					(1,164)	
Other	788	2,141	(63)	3,832	6,597	(42)
Total	\$ 13,121	\$ 15,615	(16)	\$ 42,423	\$ 46,551	(9)

Mortgage loans and related fees for the first quarter decreased \$708,000, or 33%, from 2007. This decrease was due to decreased demand for new mortgage loans resulting from the slow housing market. In the third quarter of 2008, United closed 492 loans totaling \$83.6 million compared with 549 loans totaling \$100.8 million in the third quarter of 2007. Substantially all originated residential mortgages were sold into the secondary market including the right to service these loans.

Consulting fees decreased \$654,000, or 27%, compared to 2007. This decrease is a direct result of the current economic stress affecting the financial services industry which has limited sales of new consulting projects.

Other fee revenue decreased \$1.4 million, or 63%, compared to 2007. This decline is due to lower revenue generated by United's bank owned life insurance assets and deferred compensation plan assets.

**Operating Expenses**

For the nine months ended September 30, 2008, total operating expenses were \$57.0 million, an increase of 18% compared with \$48.2 million for the same period in 2007. The following table presents the components of operating expenses for the three months and nine months ended September 30, 2008 and 2007.

**Table 7 Operating Expenses***(dollars in thousands)*

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	Change	2008	2007	Change
Salaries and employee benefits	\$ 28,626	\$ 29,698	(4)%	\$ 86,133	\$ 88,037	(2)%
Communications and equipment	3,909	3,936	(1)	11,593	11,593	
Occupancy	3,905	3,617	8	11,325	10,124	12
Advertising and public relations	1,399	1,537	(9)	4,759	5,651	(16)
Postage, printing and supplies	1,493	1,479	1	4,533	4,819	(6)
Professional fees	1,596	1,920	(17)	5,196	5,409	(4)
Amortization of intangibles	752	771	(2)	2,264	1,968	15
Other	15,290	5,224	193	28,457	13,124	117
Total	\$ 56,970	\$ 48,182	18	\$ 154,260	\$ 140,725	10

Salaries and employee benefits for the third quarter 2008 totaled \$28.8 million, a decrease of \$1.1 million, or 4%, from the same period in 2007. This decrease was primarily due to lower bonus and incentive costs in 2008. At September 30, 2008, total staff was 2,026, an increase of 14 employees from the third quarter 2007, most of which were added in the special assets and credit administration areas.

Professional fees for the third quarter 2008 decreased \$324,000, or 17%, from the same period in 2007. The decrease from a year ago was due to postponement and reduction of lower priority projects at this time.

**Table of Contents**

Other expense of \$15.3 million increased \$10.1 million from 2007. The increase was due to an increase of \$9.5 million in writedowns and expenses on foreclosed properties and an increase in FDIC insurance premiums of approximately \$482,000, which also account for most of the year to date increase over 2007.

***Income Taxes***

Income tax benefit for the third quarter 2008 was \$21.8 million as compared with income tax expense of \$12.4 million for the third quarter of 2007, representing a 35.3% and a 35.5% effective tax rate, respectively. For the first nine months, the income tax benefit was \$9.0 million for the period ending September 30, 2008 and income tax expense was \$29.3 million for the period ending September 30, 2007. The effective tax rate for those periods was 35.0% and 35.3% respectively. The effective tax rates were lower than the statutory tax rates primarily due to interest revenue on certain investment securities and loans that are exempt from income taxes, tax exempt fee revenue and tax credits received on affordable housing investments. Additional information regarding income taxes can be found in Note 14 to the consolidated financial statements filed with United's 2007 Form 10-K.

The effective tax rate for the third quarter of 2008 also reflects a decision by management to surrender certain bank owned life insurance (BOLI) policies with a cash surrender value of approximately \$64 million. The policies were part of a BOLI transaction entered into by the company in April 2007. The underlying assets in which the cash surrender value had been invested had depreciated significantly since their original purchase. United was able to recover its original investment by surrendering the policies, thereby avoiding any loss in value of the underlying assets; however, United will incur a tax charge on the accumulated earnings of the policies. The effective tax rate for the third quarter, absent the tax charge on the surrender, would have been approximately 40%. The 40% effective tax is above United's blended state and federal statutory rate of 38.9%, reflecting the tax benefit of the current pre-tax loss plus the positive effect of tax-exempt earnings and tax credits.

***Balance Sheet Review***

Total assets at September 30, 2008 and 2007 were \$8.1 billion and \$8.2 billion, respectively. Average total assets for the third quarter 2008 were \$8.1 billion, up \$63 million from average assets for the third quarter of 2007.

***Goodwill***

United reviews its goodwill for impairment annually, or more frequently if circumstances indicate that goodwill has been impaired. During the last four quarters, United's stock price has traded below its per-share book value and falling below tangible book value for a short period of time, which we believe reflects uncertainty about the economic cycle rather than the value of the underlying franchise and core business. The current economic environment has resulted in lower earnings with higher credit costs and those costs have been reflected in the income statement as well as valuation adjustments to the loan balances through increases to the level of the allowance for loan losses. Although management believes that goodwill has not been impaired and that the value of United's business remains intact and earnings will return to prior period levels when the credit cycle recovers, a thorough impairment test will be performed during the fourth quarter.

**Table of Contents****Loans**

The following table presents a summary of the loan portfolio.

**Table 8 Loans Outstanding**

(dollars in thousands)

	September 30, 2008	December 31, 2007	September 30, 2007
<b>By Loan Type</b>			
Commercial (secured by real estate)	\$ 1,603,651	\$ 1,475,930	\$ 1,441,192
Commercial construction	508,832	527,123	530,255
Commercial (commercial and industrial)	425,052	417,715	408,466
Total commercial	2,537,535	2,420,768	2,379,913
Residential construction	1,595,981	1,829,506	1,935,249
Residential mortgage	1,528,499	1,501,916	1,459,023
Installment	167,922	177,073	178,564
Total loans	\$ 5,829,937	\$ 5,929,263	\$ 5,952,749
As a percentage of total loans:			
Commercial (secured by real estate)	28%	25%	24%
Commercial construction	9	9	9
Commercial (commercial and industrial)	7	7	7
Total commercial	44	41	40
Residential construction	27	31	32
Residential mortgage	26	25	25
Installment	3	3	3
Total	100%	100%	100%
<b>By Geographic Location</b>			
Atlanta MSA	\$ 1,800,041	\$ 2,002,089	\$ 2,056,656
Gainesville MSA	426,050	399,560	394,251
North Georgia	2,066,163	2,060,224	2,025,619
Western North Carolina	815,280	805,999	833,524
Coastal Georgia	457,710	415,622	401,940
East Tennessee	264,693	245,769	240,759
Total loans	\$ 5,829,937	\$ 5,929,263	\$ 5,952,749

Substantially all of United's loans are to customers located in the immediate market areas of its community banks in Georgia, North Carolina, and Tennessee. At September 30, 2008, total loans were \$5.8 billion, a decrease of \$123 million, or 2%, from September 30, 2007. The rate of loan growth began to decline in the first quarter of 2007 and has continued through 2008. The slowdown in loan growth was due to deterioration in the residential construction and housing markets. This deterioration resulted in part in an oversupply of lot inventory within United's markets,



which further slowed construction activities and acquisition and development projects. To date, the slowdown in the housing market has been most severe in the Atlanta MSA.

***Asset Quality and Risk Elements***

United manages asset quality and controls credit risk through review and oversight of the loan portfolio as well as adherence to policies designed to promote sound underwriting and loan monitoring practices. United's credit administration function is responsible for monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures at all of the Community Banks. Additional information on the credit administration function is included in Item 1 under the heading *Loan Review and Non-performing Assets* in United's Annual Report on Form 10-K.

The provision for loan losses charged to earnings was based upon management's judgment of the amount necessary to maintain the allowance at a level appropriate to absorb losses inherent in the loan portfolio at quarter-end. The amount each period is dependent upon many factors, including growth and changes in the composition of the loan portfolio, net charge-offs, delinquencies, management's assessment of loan portfolio quality, the value of collateral, and other economic factors and trends. The evaluation of these factors is performed quarterly by management through an analysis of the appropriateness of the allowance for loan losses. The increase in the allowance for loan losses during the third quarter of 2008 was due to an increase in classified assets, deterioration in the collateral values leading to an expectation of higher charge-offs upon default and further weakening of the housing market.

**Table of Contents**

Reviews of non-performing loans, past due loans and larger credits, designed to identify potential charges to the allowance for loan losses, as well as determine the adequacy of the allowance, are conducted on a regular basis during the quarter. These reviews are performed by the responsible lending officers, as well as by a separate loan review department, and consider such factors as the financial strength of borrowers, the value of the applicable collateral, past loan loss experience, anticipated loan losses, growth in the loan portfolio, prevailing economic conditions and other factors. United also uses external loan review to supplement the activities of United's loan review department and to ensure the independence of the loan review process.

The following table presents a summary of the changes in the allowance for loan losses for the three and nine month periods ended September 30, 2008 and 2007 on a GAAP basis.

**Table 9 Summary of Loan Loss Experience***(dollars in thousands)*

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Balance beginning of period	\$ 91,035	\$ 92,471	\$ 89,423	\$ 66,566
Allowance from acquisitions				7,091
Charge-offs:				
Commercial (commercial and industrial)	1,025	391	1,759	673
Commercial (secured by real estate)	257	157	1,379	521
Commercial construction	225		350	245
Residential construction	50,305	3,617	65,467	4,537
Residential mortgage	3,359	1,056	7,031	3,007
Installment	801	542	2,138	1,497
Total loans charged-off	55,972	5,763	78,124	10,480
Recoveries				
Commercial (commercial and industrial)	7	6	39	179
Commercial (secured by real estate)		33	68	97
Commercial construction				1
Residential construction	77	106	231	109
Residential mortgage	27	91	112	445
Installment	125	291	550	827
Total recoveries	236	527	1,000	1,658
Net charge-offs	55,736	5,236	77,124	8,822
Provision for loan losses	76,000	3,700	99,000	26,100
Balance end of period	\$ 111,299	\$ 90,935	\$ 111,299	\$ 90,935
Net charge-offs by region				
Atlanta MSA	\$ 48,313	\$ 4,352	\$ 63,642	\$ 6,313
Gainesville MSA	1,470	20	2,153	19
North Georgia	4,567	661	7,676	2,169
Western North Carolina	855	19	1,191	232

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Coastal Georgia	249	11	1,271	12
East Tennessee	282	173	1,191	77
Balance end of period	\$ 55,736	\$ 5,236	\$ 77,124	\$ 8,822
Total loans:				
At period end	\$ 5,829,937	\$ 5,952,749	\$ 5,829,937	\$ 5,952,749
Average	5,889,168	5,966,933	5,926,731	5,665,314
As a percentage of average loans (annualized):				
Net charge-offs	3.77%	.35%	1.74%	.21%
Provision for loan losses	5.13	.25	2.23	.62
Allowance as a percentage of period end loans	1.91	1.53	1.91	1.53
Allowance as a percentage of period end non-performing loans	80	194	80	194

**Table of Contents**

Management believes that the allowance for loan losses at September 30, 2008 reflects the losses inherent in the loan portfolio. This assessment involves uncertainty and judgment; therefore, the adequacy of the allowance for loan losses cannot be determined with precision and may be subject to change in future periods. In addition, bank regulatory authorities, as part of their periodic examination of the Bank, may require adjustments to the provision for loan losses in future periods if, in their opinion, the results of their review warrant such additions.

**Non-performing Assets**

The table below summarizes non-performing assets on a GAAP basis.

**Table 10 Non-Performing Assets**

(dollars in thousands)

	September 30, 2008	December 31, 2007	September 30, 2007
Non-accrual loans	\$ 139,266	\$ 28,219	\$ 46,783
Loans past due 90 days or more and still accruing			
Total non-performing loans	139,266	28,219	46,783
Other real estate owned	38,438	18,039	16,554
Total non-performing assets	\$ 177,704	\$ 46,258	\$ 63,337
Non-performing loans as a percentage of total loans	2.39%	.48%	.79%
Non-performing assets as a percentage of total assets	2.20	.56	.77

Non-performing loans totaled \$139.3 million, compared with \$28.2 million at December 31, 2007 and \$46.8 million at September 30, 2007. The ratio of non-performing loans to total loans increased 160 basis points from September 30, 2007 reflecting a deterioration in United's residential construction and development portfolio primarily in the Atlanta MSA. Non-performing assets, which include non-performing loans and foreclosed real estate, totaled \$177.7 million at September 30, 2008, compared to \$46.3 million at December 31, 2007 and \$63.3 million at September 30, 2007.

United's policy is to classify loans as non-accrual when, in the opinion of management, the principal and interest on a loan is not likely to be repaid in accordance with the loan terms or when the loan becomes 90 days past due and is not well secured and in the process of collection. When a loan is classified on non-accrual status, interest previously accrued but not collected is reversed against current interest revenue. Payments received on a non-accrual loan are applied to reduce outstanding principal.

At September 30, 2008 there were \$94.0 million of loans classified as impaired under the definition outlined in SFAS No. 114 *Accounting By Creditors For Impairment of a Loan*. Of these, \$42.4 million did not have a specific reserve allocated, and \$51.6 million had specific reserves allocated totaling \$17.2 million. The average recorded investment in impaired loans for the quarter ended September 30, 2008 was \$100.6 million. Interest revenue recognized on loans while they were impaired for the first nine months of 2008 was \$598,000.

**Investment Securities**

The composition of the investment securities portfolio reflects United's investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of revenue. The investment securities portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as required collateral for certain deposits.

Total investment securities available for sale at quarter-end increased \$104.0 million from a year ago. The investment portfolio is used as a supplemental tool to stabilize interest rate sensitivity and increase net interest revenue. At September 30, 2008 and September 30, 2007, the securities portfolio represented approximately 17.4% and 15.9% of total assets, respectively.

The investment securities portfolio primarily consists of U.S. Government sponsored agency mortgage-backed securities, non-agency mortgage-backed securities, U.S. Government agency securities, and municipal securities. Mortgage-backed securities rely on the underlying pools of mortgage loans to provide a cash flow of principal and interest. The actual maturities of these securities will differ from contractual maturities because loans underlying the securities can prepay. Decreases in interest rates will generally cause an acceleration of prepayment levels. In a declining interest rate environment, United may not be able to reinvest the proceeds from these prepayments in assets that have comparable yields. In a rising rate environment, the opposite occurs. Prepayments tend to slow and the weighted average life extends. This is referred to as extension risk which can lead to lower levels of liquidity due to the delay of cash receipts and can result in the holding of a below market yielding asset for a longer time period.

**Table of Contents*****Deposits***

Total deposits as of September 30, 2008 were \$6.7 billion, an increase of \$535 million, or 9%, from September 30, 2007. Total non-interest-bearing demand deposit accounts of \$680 million decreased \$57 million, or 8%, and NOW, money market and savings accounts of \$2.0 billion decreased \$188 million, or 9%. Management believes the decreases were primarily caused by seasonal timing, the slowdown in the local economy and the resultant increase in the use of funds by United's customers because average balances have declined over the past year.

Total time deposits, excluding brokered deposits, as of September 30, 2008 were \$3.3 billion, an increase of \$343 million, or 12%, from September 30, 2007. Time deposits less than \$100,000 totaled \$1.8 billion, an increase of \$219 million, or 14%, from a year ago. Time deposits of \$100,000 and greater totaled \$1.5 billion as of September 30, 2008, an increase of \$123 million, or 9%, from September 30, 2007. During the second quarter, United made a decision to actively pursue time deposits by offering a 15 month certificate of deposit at an attractive rate, in order to increase liquidity. The program was very successful and added over \$400 million of customer deposits. United also takes advantage of brokered time deposits, issued in certificates of less than \$100,000, as an alternate source of cost-effective funding. Brokered time deposits as of September 30, 2008 were \$745 million, compared with \$308 million at September 30, 2007.

***Wholesale Funding***

At September 30, 2008, the Bank was a shareholder in a Federal Home Loan Bank ( FHLB ). Through this affiliation, FHLB secured advances totaled \$285 million and \$519 million as of September 30, 2008 and 2007, respectively. This decline was the result of a successful CD program during the second quarter of 2008 and use of brokered deposits in order to keep collateral available for liquidity purposes. United anticipates continued use of this short- and long-term source of funds. FHLB advances outstanding at September 30, 2008 had both fixed and floating interest rates from .81% to 5.06%. Additional information regarding FHLB advances, is provided in Note 10 to the consolidated financial statements included in United's 2007 Form 10-K.

At September 30, 2008, United had \$120 million in Federal funds purchased, repurchase agreements, and other short-term borrowings outstanding, compared to \$502 million outstanding at September 30, 2007. United takes advantage of these additional sources of liquidity when rates are favorable compared to other forms of short-term borrowings, such as FHLB advances and brokered deposits.

***Interest Rate Sensitivity Management***

The absolute level and volatility of interest rates can have a significant effect on United's profitability. The objective of interest rate risk management is to identify and manage the sensitivity of net interest revenue to changing interest rates, in order to achieve United's overall financial goals. Based on economic conditions, asset quality and various other considerations, management establishes tolerance ranges for interest rate sensitivity and manages within these ranges.

Net interest revenue is influenced by changes in the level of interest rates. United manages its exposure to fluctuations in interest rates through policies established by the Asset/Liability Management Committee ( ALCO ). ALCO meets regularly and has responsibility for approving asset/liability management policies, formulating and implementing strategies to improve balance sheet positioning and/or earnings, and reviewing United's interest rate sensitivity.

One of the tools management utilizes to estimate the sensitivity of net interest revenue to changes in interest rates is an interest rate simulation model. Such estimates are based upon a number of assumptions for various scenarios, including the level of balance sheet growth, deposit repricing characteristics and the rate of prepayments. The simulation model measures the potential change in net interest revenue over a twelve-month period under various interest rate scenarios. United's baseline scenario assumes rates remain flat ( flat rate scenario ) over the next twelve months and is the scenario that all others are compared to in order to measure the change in net interest revenue. United runs ramp scenarios that assume gradual increases and decreases of 200 basis points each over the next twelve months. United's policy for net interest revenue simulation is limited to a change from the flat rate scenario of less than 10% for the up or down 200 basis point ramp scenarios over twelve months. At September 30, 2008, United's simulation model indicated that a 200 basis point increase in rates over the next twelve months would cause a 3.2% increase in net interest revenue and a 200 basis point decrease in rates over the next twelve months would cause an approximate 4.0% decrease in net interest revenue. On October 8, 2008 and October 29, 2008, the Federal Open

Markets Committee of the Federal Reserve reduced the targeted federal funds rate by 50 basis points each, thereby reducing the targeted federal funds rate to 1.00%. At September 30, 2008, United's simulation model indicated that a 100 basis point decrease in rates would cause an approximate 2.7% decrease in net interest revenue.

In order to manage its interest rate sensitivity, United uses off-balance sheet contracts that are considered derivative financial instruments. Derivative financial instruments can be a cost and capital effective means of modifying the repricing characteristics of on-balance sheet assets and liabilities. At September 30, 2008, United was a party to interest rate swap contracts under which it pays a variable rate and receives a fixed rate, and interest rate floor contracts in which United pays a premium to a counterparty who agrees to pay United the difference between a variable rate and a strike rate if the variable rate falls below the strike rate.

**Table of Contents**

The following table presents the interest rate derivative contracts outstanding at September 30, 2008.

**Table 11 Derivative Financial Instruments**

(dollars in thousands)

Type/Maturity	Notional Amount	Rate Received / Floor Rate	Rate Paid	Fair Value (10)
<b>Fair Value Hedges:</b>				
<b>LIBOR Swaps (Brokered CDs)</b>				
November 3, 2008 <sup>(1)</sup>	\$ 10,000	5.00%	2.49%	\$ 13
March 24, 2009 <sup>(2)</sup>	60,000	2.85	3.93	
March 30, 2009 <sup>(3)</sup>	20,000	2.85	3.93	
August 27, 2010 <sup>(4)</sup>	50,000	4.30	3.71	(129)
September 22, 2010 <sup>(5)</sup>	50,000	4.25	3.19	(410)
Total:	190,000	3.71	3.60	(526)
<b>LIBOR Swaps (FHLB Advances)</b>				
January 5, 2009 <sup>(6)</sup>	25,000	5.06	2.49	88
March 2, 2009 <sup>(7)</sup>	25,000	4.90	2.49	149
Total:	50,000	4.98	2.49	237
Total Fair Value Hedges	240,000	3.98	3.37	(289)
<b>Cash Flow Hedges:</b>				
<b>Prime Swaps (Prime Loans) <sup>(8)</sup></b>				
November 4, 2008	100,000	8.32	5.00	227
February 1, 2009	25,000	8.31	5.00	224
May 4, 2009	30,000	8.29	5.00	531
June 9, 2010	100,000	5.82	5.00	975
June 11, 2010	25,000	8.26	5.00	1,258
June 13, 2011	25,000	6.72	5.00	648
December 12, 2011	25,000	6.86	5.00	688
January 2, 2012	100,000	6.71	5.00	2,189
March 12, 2012	50,000	6.87	5.00	1,433
March 27, 2012	50,000	6.76	5.00	1,252
March 27, 2012	50,000	6.72	5.00	1,144
January 31, 2013	50,000	6.26	5.00	84
May 6, 2013	50,000	7.21	5.00	1,921
July 22, 2013	100,000	6.88	5.00	2,374
July 25, 2013	50,000	6.92	5.00	1,310
July 25, 2013	25,000	6.91	5.00	631
Total:	855,000	7.00	5.00	16,889



**Prime Floors (Prime Loans) <sup>(9)</sup>**

February 1, 2009	25,000	8.75	257
May 1, 2009	25,000	8.75	485
November 1, 2009	75,000	8.75	2,988
February 4, 2010	100,000	8.75	4,793
August 1, 2010	50,000	8.75	3,007
August 4, 2010	50,000	8.75	3,003
Total:	325,000		14,533
Total Cash Flow Hedges:	1,180,000		31,422
<b>Total Derivative Contracts</b>	<b>\$ 1,420,000</b>		<b>\$ 31,133</b>

(1) Rate Paid equals  
1-Month  
LIBOR minus  
.2725

(2) Rate Paid equals  
1-Month  
LIBOR plus  
1.075

(3) Rate Paid equals  
1-Month  
LIBOR plus  
1.2435

(4) Rate Paid equals  
1-Month  
LIBOR minus  
.655

(5) Rate Paid equals  
1-Month  
LIBOR minus  
.57

(6) Rate Paid equals  
1-Month  
LIBOR minus  
.11

(7) Rate Paid equals  
1-Month  
LIBOR minus  
.128

(8)

Rate Paid equals  
Prime rate as of  
September 30,  
2008

(9) Floor contracts  
receive cash  
payments equal  
to the floor rate  
less the prime  
rate.

(10) Excludes  
accrued interest

**Table of Contents**

United's derivative financial instruments are classified as either cash flow or fair value hedges. The change in fair value of cash flow hedges is recognized in other comprehensive income. Fair value hedges recognize currently in earnings both the effect of the change in the fair value of the derivative financial instrument and the offsetting effect of the change in fair value of the hedged asset or liability associated with the particular risk of that asset or liability being hedged. At September 30, 2008, United had interest rate swap contracts with a total notional amount of \$855 million that were designated as cash flow hedges of prime-based loans. United had interest rate floor contracts with a total notional of \$325 million and a remaining unamortized premium balance of \$3.8 million that were also designated as cash flow hedges of prime-based loans. United also had receive fixed, pay LIBOR swap contracts with a total notional of \$240 million that were accounted for as fair value hedges of brokered deposits and fixed-rate FHLB advances.

United's policy requires all derivative financial instruments be used only for asset/liability management through the hedging of specific transactions or positions, and not for trading or speculative purposes. Management believes that the risk associated with using derivative financial instruments to mitigate interest rate risk sensitivity is minimal and should not have any material unintended effect on the financial condition or results of operations. In order to mitigate potential credit risk, from time to time United may require the counterparties to derivative contracts to pledge securities as collateral to cover the net exposure.

**Liquidity Management**

The objective of liquidity management is to ensure that sufficient funding is available, at reasonable cost, to meet the ongoing operational cash needs and to take advantage of revenue producing opportunities as they arise. While the desired level of liquidity will vary depending upon a variety of factors, it is the primary goal of United to maintain a sufficient level of liquidity in all expected economic environments. Liquidity is defined as the ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining United's ability to meet the daily cash flow requirements of the Banks' customers, both depositors and borrowers.

Two key objectives of asset/liability management are to provide for adequate liquidity in order to meet the needs of customers and to maintain an optimal balance between interest-sensitive assets and interest-sensitive liabilities to optimize net interest revenue. Daily monitoring of the sources and uses of funds is necessary to maintain a position that meets both requirements.

The asset portion of the balance sheet provides liquidity primarily through loan principal repayments and the maturities and sales of securities. Mortgage loans held for sale totaled \$18 million at September 30, 2008, and typically turn over every 45 days as the closed loans are sold to investors in the secondary market.

The liability section of the balance sheet provides liquidity through interest-bearing and noninterest-bearing deposit accounts. Federal funds purchased, Federal Reserve short-term borrowings, FHLB advances and securities sold under agreements to repurchase are additional sources of liquidity and represent United's incremental borrowing capacity. These sources of liquidity are generally short-term in nature and are used as necessary to fund asset growth and meet other short-term liquidity needs.

United had sufficient qualifying collateral to increase FHLB advances by \$813 million at September 30, 2008. United's internal policy limits brokered deposits to 25% of total non-brokered deposits. At September 30, 2008, United had the capacity to increase brokered deposits by \$741 million and still remain within this limit. Also, United had sufficient qualifying assets pledged to the Federal Reserve under the Term Auction Facility, Term Investment Option and Discount Window to increase short-term borrowings by \$414 million.

As disclosed in United's consolidated statement of cash flows, net cash provided by operating activities was \$118.4 million for the nine months ended September 30, 2008. The major contributors in this category were non-cash expenses for provision for loan losses of \$99.0 million, decreases in mortgage loans held for sale of \$10.2 million, plus noncash expenses for depreciation, amortization and accretion of \$11.1 million, and noncash writedowns and losses on other real estate of \$10.4 million. These items were offset by a net loss of \$16.7 million. Net cash used by investing activities of \$53.0 million consisted primarily of a net increase in loans totaling \$58.7 million, purchases of premises and equipment of \$9.0 million, and \$519.4 million used to purchase investment securities, partially offset by proceeds from sales of securities of \$85.0 million, maturities and calls of investment securities of \$396.7 million, and sales of other real estate of \$52.0 million. Net cash used by financing activities of \$118.3 million consisted primarily

of a net decrease of \$518.8 million in federal funds purchased, repurchase agreements, and other short-term borrowings, a net decrease in FHLB advances of \$234.0 million and cash dividends paid on common stock of \$12.7 million, offset by a net increase in deposits of \$613.4 million and proceeds from the issuance of subordinated debt of \$30.0 million. In the opinion of management, the liquidity position at September 30, 2008 is sufficient to meet its expected cash flow requirements.

**Table of Contents****Capital Resources and Dividends**

Shareholders' equity at September 30, 2008 was \$816.9 million, a decrease of \$15.0 million from December 31, 2007. Accumulated other comprehensive income is not included in the calculation of regulatory capital adequacy ratios. Excluding the change in the accumulated other comprehensive income, shareholders' equity decreased \$17.5 million from December 31, 2007. Cash dividends of \$8.5 million, or \$.18 per share, were declared on common stock during the first nine months of 2008, a decrease of 33% from the amount declared in the same period in 2007. This was due to United declaring a 1 for 130 stock dividend during the third quarter 2008 in lieu of a cash dividend. Although, United retains a portion of its earnings in order to provide a cost effective source of capital for continued growth and expansion, United recognizes that cash dividends are an important component of shareholder value, and therefore, intends to provide for cash dividends when earnings, capital levels and other factors permit.

United's Board of Directors has authorized the repurchase of United's outstanding common stock for general corporate purposes. At September 30, 2008, 1,000,000 shares remained available to be repurchased under the current 3,000,000 share authorization through December 31, 2008. During the first nine months of 2008, optionees delivered 8,006 shares to exercise stock options.

United's common stock trades on the Nasdaq Global Select Market under the symbol UCBI. Below is a quarterly schedule of high, low and closing stock prices and average daily volume for 2008 and 2007.

**Table 12 Stock Price Information**

	2008				2007			
	High	Low	Close	Avg Daily Volume	High	Low	Close	Avg Daily Volume
First quarter	\$ 20.80	\$ 13.38	\$ 16.98	441,659	\$ 34.98	\$ 30.81	\$ 32.79	232,269
Second quarter	18.51	8.51	8.53	464,566	33.03	25.80	25.89	266,682
Third quarter	19.05	7.64	13.26	359,971	27.50	22.16	24.52	346,596
Fourth quarter					25.73	15.13	15.80	421,910

The following table presents the quarterly cash dividends declared in 2008 and 2007 and the respective payout ratios as a percentage of basic operating earnings per share, which excludes special fraud related provisions for loan losses in the second and fourth quarters of 2007.

**Table 13 Dividend Payout Information**

	2008		2007	
	Dividend	Payout %	Dividend	Payout %
First quarter	\$ .09	26	\$ .09	20
Second quarter	.09	60	.09	19*
Third quarter		**	.09	19
Fourth quarter			.09	69*

\* Based on basic operating earnings per share which excludes the effect of the \$15 million special fraud-related provision for

loan losses in the second quarter of 2007 and \$3 million in the fourth quarter of 2007. Including the special provisions, the dividend payout ratio was 35% and 100%, respectively, for the second and fourth quarters of 2007.

\*\* In the third quarter of 2008, United replaced its regular cash dividend with a stock dividend of one share for every 130 shares owned, which had a value equal to approximately \$.09 per share.

The Board of Governors of the Federal Reserve System has issued guidelines for the implementation of risk-based capital requirements by U.S. banks and bank holding companies. These risk-based capital guidelines take into consideration risk factors, as defined by regulators, associated with various categories of assets, both on and off-balance sheet. Under the guidelines, capital strength is measured in two tiers that are used in conjunction with risk-adjusted assets to determine the risk based capital ratios. The guidelines require an 8% total risk-based capital ratio, of which 4% must be Tier I capital. To be considered well-capitalized under the guidelines, a 10% total risk-based capital ratio is required, of which 6% must be Tier I capital.

A minimum leverage ratio is required in addition to the risk-based capital standards and is defined as Tier I capital divided by average assets adjusted for goodwill and deposit-based intangibles. Although a minimum leverage ratio of 3% is required for the highest-rated bank holding companies which are not undertaking significant expansion programs, the Federal Reserve Board requires a bank holding company to maintain a leverage ratio greater than 3% if it is experiencing or anticipating significant growth or is operating with less than well-diversified risks in the opinion of the Federal Reserve Board. The Federal Reserve Board uses the leverage and risk-based capital ratios to assess capital adequacy of banks and bank holding companies.

**Table of Contents**

The following table shows United's capital ratios, as calculated under regulatory guidelines, at September 30, 2008 and 2007.

**Table 14 Capital Ratios**

(dollars in thousands)

	2008		2007	
	Actual Amount	Regulatory Minimum	Actual Amount	Regulatory Minimum
Tier I Leverage:				
Amount	\$ 523,913	\$ 234,925	\$ 551,265	\$ 232,942
Ratio	6.69%	3.00%	7.10%	3.00%
Tier I Risk-Based:				
Amount	\$ 523,913	\$ 242,082	\$ 551,265	\$ 251,337
Ratio	8.66%	4.00%	8.77%	4.00%
Total Risk-Based:				
Amount	\$ 689,710	\$ 484,164	\$ 696,511	\$ 502,674
Ratio	11.40%	8.00%	11.08%	8.00%

United's Tier I capital excludes other comprehensive income, and consists of stockholders' equity and qualifying capital securities, less goodwill and deposit-based intangibles. Tier II capital components include supplemental capital items such as a qualifying allowance for loan losses and qualifying subordinated debt. Tier I capital plus Tier II capital components is referred to as Total Risk-Based capital.

The capital ratios of United and the Banks currently exceed the minimum ratios as defined by federal regulators. United monitors these ratios to ensure that United and the Banks remain above regulatory minimum guidelines.

**Effect of Inflation and Changing Prices**

A bank's asset and liability structure is substantially different from that of an industrial firm in that primarily all assets and liabilities of a bank are monetary in nature with relatively little investment in fixed assets or inventories. Inflation has an important effect on the growth of total assets and the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity to assets ratio.

United's management believes the effect of inflation on financial results depends on United's ability to react to changes in interest rates, and by such reaction, reduce the inflationary effect on performance. United has an asset/liability management program to manage interest rate sensitivity. In addition, periodic reviews of banking services and products are conducted to adjust pricing in view of current and expected costs.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk**

There have been no material changes in United's quantitative and qualitative disclosures about market risk as of September 30, 2008 from that presented in the Annual Report on Form 10-K for the year ended December 31, 2007. The interest rate sensitivity position at September 30, 2008 is included in management's discussion and analysis on page 25 of this report.

**Item 4. Controls and Procedures**

United's management, including the Chief Executive Officer and Chief Financial Officer, supervised and participated in an evaluation of the company's disclosure controls and procedures as of September 30, 2008. Based on, and as of the date of, that evaluation, United's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective in accumulating and communicating information to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures of that information under the Securities and Exchange Commission's rules and forms and that the disclosure controls and procedures are designed to ensure that the information required to be disclosed in reports that

are filed or submitted by United under the Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no significant changes in the internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.



**Table of Contents**

**Part II. Other Information**

**Item 1. Legal Proceedings**

In the ordinary course of operations, United and the Banks are defendants in various legal proceedings. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the consolidated financial condition or results of operations of United.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors previously disclosed in United's Form 10-K for the year ended December 31, 2007, but United did add the following risk factor:

**Our ability to raise capital could be limited and could affect our liquidity and could be dilutive to existing shareholders.**

Current conditions in the capital markets are such that traditional sources of capital may not be available to us on reasonable terms if we needed to raise capital. In such case, there is no guarantee that we will be able to borrow funds or successfully raise additional capital at all or on terms that are favorable or otherwise not dilutive to existing shareholders.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** None

**Item 3. Defaults upon Senior Securities** None

**Item 4. Submission of Matters to a Vote of Security Holders** None

**Item 5. Other Information** None

**Item 6. Exhibits**

- 3.1 Restated Articles of Incorporation of United Community Banks, Inc., (incorporated herein by reference to Exhibit 3.1 to United Community Banks, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, File No. 0-21656, filed with the Commission on August 14, 2001).
- 3.2 Amendment to the Restated Articles of Incorporation of United Community Banks, Inc. (incorporated herein by reference to Exhibit 3.3 to United Community Banks, Inc.'s Registration Statement on Form S-4, File No. 333-118893, filed with the Commission on September 9, 2004).
- 3.3 Amended and Restated Bylaws of United Community Banks, Inc., dated September 12, 1997 (incorporated herein by reference to Exhibit 3.1 to United Community Banks, Inc.'s Annual Report on Form 10-K, for the year ended December 31, 1997, File No. 0-21656, filed with the Commission on March 27, 1998).
- 4.1 See Exhibits 3.1, 3.2 and 3.3 for provisions of the Restated Articles of Incorporation, as amended, and Amended and Restated Bylaws, which define the rights of the Shareholders.
- 10.1 Subordinated Term Loan Agreement, dated as of August 29, 2008 among United Community Bank, as borrower, the lenders from time to time party thereto, and SunTrust Bank, as administrative agent (incorporated herein by reference to Exhibit 10.1 to United Community Banks, Inc.'s Current Report on Form 8-K dated August 29, 2008, File No. 0-21656, filed with the Commission on August 29, 2008).
- 31.1 Certification by Jimmy C. Tallent, President and Chief Executive Officer of United Community Banks, Inc., as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Certification by Rex S. Schuette, Executive Vice President and Chief Financial Officer of United Community Banks, Inc., as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

**Signatures**

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

**UNITED COMMUNITY BANKS, INC.**

***/s/ Jimmy C. Tallent***

Jimmy C. Tallent  
President and Chief Executive Officer  
(Principal Executive Officer)

***/s/ Rex S. Schuette***

Rex S. Schuette  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

***/s/ Alan H. Kumler***

Alan H. Kumler  
Senior Vice President and Controller  
(Principal Accounting Officer)

Date: November 7, 2008

**Table of Contents**

**Exhibit Index**

<b>Exhibit No.</b>	<b>Description</b>
3.1	Restated Articles of Incorporation of United Community Banks, Inc., (incorporated herein by reference to Exhibit 3.1 to United Community Banks, Inc. s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, File No. 0-21656, filed with the Commission on August 14, 2001).
3.2	Amendment to the Restated Articles of Incorporation of United Community Banks, Inc. (incorporated herein by reference to Exhibit 3.3 to United Community Banks, Inc. s Registration Statement on Form S-4, File No. 333-118893, filed with the Commission on September 9, 2004).
3.3	Amended and Restated Bylaws of United Community Banks, Inc., dated September 12, 1997 (incorporated herein by reference to Exhibit 3.1 to United Community Banks, Inc. s Annual Report on Form 10-K, for the year ended December 31, 1997, File No. 0-21656, filed with the Commission on March 27, 1998).
4.1	See Exhibits 3.1, 3.2 and 3.3 for provisions of the Restated Articles of Incorporation, as amended, and Amended and Restated Bylaws, which define the rights of the Shareholders.
10.1	Subordinated Term Loan Agreement, dated as of August 29, 2008 among United Community Bank, as borrower, the lenders from time to time party thereto, and SunTrust Bank, as administrative agent (incorporated herein by reference to Exhibit 10.1 to United Community Banks, Inc. s Current Report on Form 8-K dated August 29, 2008, File No. 0-21656, filed with the Commission on August 29, 2008).
31.1	Certification by Jimmy C. Tallent, President and Chief Executive Officer of United Community Banks, Inc., as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Rex S. Schuette, Executive Vice President and Chief Financial Officer of United Community Banks, Inc., as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.