SOUTHERN FIRST BANCSHARES INC
Form 10-Q
July 31, 2017

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the Quarterly Period Ended June 30, 2017**
**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the Transition Period from to**
**Commission file number 000-27719**

## Southern First Bancshares, Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **South Carolina** | **58-2459561** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|---|---|
| **100 Verdae Boulevard, Suite 100 Greenville, S.C.** | **29606** |
| (Address of principal executive offices) | (Zip Code) |

**864-679-9000**
(Registrant s telephone number, including area code)
**Not Applicable**
(Former name, former address, and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 | (Do not check if a smaller reporting company) | Smaller Reporting Company |
| | | Emerging growth company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 7,314,181 shares of common stock, par value $0.01 per share, were issued and outstanding as of July 25, 2017.

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
**June 30, 2017 Form 10-Q**

**INDEX**

**PART I. CONSOLIDATED FINANCIAL INFORMATION**
**Item 1. CONSOLIDATED FINANCIAL STATEMENTS**

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
***CONSOLIDATED BALANCE SHEETS***

| (dollars in thousands, except share data) | **June 30, 2017** (Unaudited) | **December 31, 2016** (Audited) |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | $ 7,412 | 11,574 |
| Federal funds sold | 52,097 | 24,039 |
| Interest-bearing deposits with banks | 27,303 | 10,939 |
| Total cash and cash equivalents | 86,812 | 46,552 |
| Investment securities: | | |
| Investment securities available for sale | 81,379 | 64,480 |
| Other investments | 4,031 | 5,742 |
| Total investment securities | 85,410 | 70,222 |
| Mortgage loans held for sale | 11,480 | 7,801 |
| Loans | 1,299,829 | 1,163,644 |
| Less allowance for loan losses | (15,444) | (14,855) |
| Loans, net | 1,284,385 | 1,148,789 |
| Bank owned life insurance | 25,837 | 25,471 |
| Property and equipment, net | 31,686 | 28,362 |
| Deferred income taxes | 7,050 | 6,825 |
| Other assets | 6,566 | 6,886 |
| Total assets | $ 1,539,226 | 1,340,908 |
| **LIABILITIES** | | |
| Deposits | $ 1,297,911 | 1,091,151 |
| Federal Home Loan Bank advances and other borrowings | 73,200 | 115,200 |
| Junior subordinated debentures | 13,403 | 13,403 |
| Other liabilities | 11,976 | 11,282 |
| Total liabilities | 1,396,490 | 1,231,036 |
| **SHAREHOLDERS EQUITY** | | |
| Preferred stock, par value $.01 per share, 10,000,000 shares authorized, no shares issued and outstanding | - | - |
| Common stock, par value $.01 per share, 10,000,000 shares authorized, 7,314,181 and 6,463,789 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively | 73 | 65 |
| Nonvested restricted stock | (587) | (600) |
| Additional paid-in capital | 99,174 | 73,371 |
| Accumulated other comprehensive income (loss) | (180) | (504) |
| Retained earnings | 44,256 | 37,540 |
| Total shareholders equity | 142,736 | 109,872 |
| Total liabilities and shareholders equity | $ 1,539,226 | 1,340,908 |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
***CONSOLIDATED STATEMENTS OF INCOME***
**(Unaudited)**

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands, except share data) | **2017** | **2016** | **2017** | **2016** |
| **Interest income** | | | | |
| Loans | $ 14,280 | 11,999 | 27,806 | 23,794 |
| Investment securities | 390 | 458 | 766 | 947 |
| Federal funds sold | 261 | 46 | 318 | 91 |
| Total interest income | 14,931 | 12,503 | 28,890 | 24,832 |
| **Interest expense** | | | | |
| Deposits | 1,739 | 946 | 2,989 | 1,934 |
| Borrowings | 840 | 1,044 | 1,942 | 2,078 |
| Total interest expense | 2,579 | 1,990 | 4,931 | 4,012 |
| Net interest income | 12,352 | 10,513 | 23,959 | 20,820 |
| Provision for loan losses | 500 | 575 | 1,000 | 1,200 |
| Net interest income after provision for loan losses | 11,852 | 9,938 | 22,959 | 19,620 |
| **Noninterest income** | | | | |
| Mortgage banking income | 1,603 | 2,235 | 2,660 | 3,682 |
| Service fees on deposit accounts | 284 | 244 | 561 | 463 |
| Income from bank owned life insurance | 183 | 180 | 366 | 366 |
| Gain on sale of investment securities | 2 | 19 | 2 | 325 |
| Loss on disposal of fixed assets | (50) | - | (50) | - |
| Other income | 540 | 468 | 1,075 | 868 |
| Total noninterest income | 2,562 | 3,146 | 4,614 | 5,704 |
| **Noninterest expenses** | | | | |
| Compensation and benefits | 5,524 | 4,855 | 10,798 | 9,405 |
| Occupancy | 1,033 | 892 | 1,999 | 1,762 |
| Real estate owned expenses | (3) | 359 | 10 | 644 |
| Outside service and data processing costs | 823 | 628 | 1,568 | 1,226 |
| Insurance | 297 | 217 | 587 | 450 |
| Professional fees | 382 | 284 | 695 | 538 |
| Marketing | 196 | 199 | 407 | 430 |
| Other | 510 | 419 | 1,059 | 914 |
| Total noninterest expenses | 8,762 | 7,853 | 17,123 | 15,369 |
| Income before income tax expense | 5,652 | 5,231 | 10,450 | 9,955 |
| **Income tax expense** | 2,048 | 1,925 | 3,734 | 3,643 |
| **Net income available to common shareholders** | $ 3,604 | 3,306 | 6,716 | 6,312 |
| **Earnings per common share** | | | | |
| Basic | $ 0.52 | 0.52 | 1.00 | 1.00 |
| Diluted | $ 0.49 | 0.49 | 0.95 | 0.94 |
| **Weighted average common shares outstanding** | | | | |
| Basic | 6,986,948 | 6,301,853 | 6,713,608 | 6,287,350 |
| Diluted | 7,366,208 | 6,702,820 | 7,099,381 | 6,683,126 |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
***CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME***
**(Unaudited)**

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands) | **2017** | **2016** | **2017** | **2016** |
| Net income | $ 3,604 | 3,306 | 6,716 | 6,312 |
| Other comprehensive income (loss): | | | | |
| Unrealized gain (loss) on securities available for sale: | | | | |
| Unrealized holding gain (loss) arising during the period, pretax | 258 | 682 | 496 | 1,774 |
| Tax (expense) benefit | (89) | (232) | (170) | (603) |
| Reclassification of realized gain | (2) | (19) | (2) | (325) |
| Tax expense | - | 7 | - | 110 |
| Other comprehensive income (loss) | 167 | 438 | 324 | 956 |
| Comprehensive income | $ 3,771 | 3,744 | 7,040 | 7,268 |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
***CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY***
***FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2016***
**(Unaudited)**

| (dollars in thousands, except share data) | Common stock Shares | Common stock Amount | Preferred stock Shares | Preferred stock Amount | Nonvested restricted stock | Additional paid-in capital | Accumulated other comprehensive income (loss) |
|---|---|---|---|---|---|---|---|
| **December 31, 2015** | **6,289,038** | **$ 63** | **-** | **-** | **$ (360)** | **$ 70,037** | **$ (4)** |
| Net income | - | - | - | - | - | - | - |
| Proceeds from exercise of stock options | 49,374 | 1 | - | - | - | 368 | - |
| Issuance of restricted stock | 17,000 | - | - | - | (391) | 391 | - |
| Amortization of deferred compensation on restricted stock | - | - | - | - | 144 | - | - |
| Compensation expense related to stock options, net of tax | - | - | - | - | - | 382 | - |
| Other comprehensive income | - | - | - | - | - | - | 956 |
| **June 30, 2016** | **6,355,412** | **$ 64** | **-** | **$ -** | **$ (607)** | **$ 71,178** | **$ 952** |
| **December 31, 2016** | **6,463,789** | **65** | **-** | **-** | **(600)** | **73,371** | **(504)** |
| Net income | - | - | - | - | - | - | - |
| Net issuance of common stock | 805,000 | 8 | - | - | - | 24,750 | - |
| Proceeds from exercise of stock options | 42,267 | - | - | - | - | 416 | - |
| Issuance of restricted stock | 3,125 | - | - | - | (146) | 146 | - |
| Amortization of deferred compensation on restricted stock | - | - | - | - | 159 | - | - |
| Compensation expense related to stock options, net of tax | - | - | - | - | - | 491 | - |
| Other comprehensive income | - | - | - | - | - | - | 324 |
| **June 30, 2017** | **7,314,181** | **$ 73** | **-** | **$ -** | **$ (587)** | **$ 99,174** | **$ (180)** |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
***CONSOLIDATED STATEMENTS OF CASH FLOWS***
(Unaudited)

| (dollars in thousands) | For the six months ended June 30, 2017 | 2016 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 6,716 | $ 6,312 |
| Adjustments to reconcile net income to cash provided by (used for) operating activities: | | |
| Provision for loan losses | 1,000 | 1,200 |
| Depreciation and other amortization | 669 | 633 |
| Accretion and amortization of securities discounts and premium, net | 267 | 268 |
| Gain on sale of investment securities available for sale | (2) | (325) |
| (Gain) loss on sale of real estate owned | (12) | 51 |
| Loss on disposal of fixed assets | 50 | - |
| Write-down of real estate owned | 7 | 389 |
| Compensation expense related to stock options and grants | 650 | 526 |
| Gain on sale of loans held for sale | (2,854) | (3,424) |
| Loans originated and held for sale | (94,159) | (122,495) |
| Proceeds from sale of loans held for sale | 93,334 | 116,495 |
| Increase in cash surrender value of bank owned life insurance | (366) | (366) |
| (Increase) decrease in deferred tax asset | (392) | 963 |
| Decrease (increase) in other assets, net | 109 | (432) |
| Increase in other liabilities | 694 | 1,863 |
| Net cash provided by operating activities | 5,711 | 1,658 |
| **Investing activities** | | |
| Increase (decrease) in cash realized from: | | |
| Origination of loans, net | (136,760) | (61,309) |
| Purchase of property and equipment | (4,043) | (2,484) |
| Purchase of investment securities: | | |
| Available for sale | (20,675) | (16,852) |
| Other | (1,811) | (169) |
| Payments and maturities, calls and repayments of investment securities: | | |
| Available for sale | 4,002 | 13,127 |
| Other | 3,522 | - |
| Proceeds from sale of investment securities available for sale | - | 10,602 |
| Proceeds from sale of real estate owned | 380 | 320 |
| Net cash used for investing activities | (155,385) | (56,765) |
| **Financing activities** | | |
| Increase (decrease) in cash realized from: | | |
| Increase in deposits, net | 206,760 | 63,391 |
| Decrease in Federal Home Loan Bank advances and other borrowings, net | (42,000) | - |
| Proceeds from issuance of common stock | 24,758 | - |
| Proceeds from the exercise of stock options and warrants | 416 | 369 |
| Net cash provided by financing activities | 189,934 | 63,760 |
| Net increase in cash and cash equivalents | 40,260 | 8,653 |
| **Cash and cash equivalents at beginning of the period** | 46,552 | 62,866 |
| **Cash and cash equivalents at end of the period** | $ 86,812 | $ 71,519 |
| **Supplemental information** | | |
| **Cash paid for** | | |
| Interest | $ 4,891 | $ 4,012 |
| Income taxes | 3,410 | 2,680 |
| **Schedule of non-cash transactions** | | |
| Real estate acquired in settlement of loans | 164 | 245 |
| Unrealized gain on securities, net of income taxes | 324 | 1,171 |

See notes to consolidated financial statements that are an integral part of these consolidated statements.

***SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY***
***NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***

**NOTE 1 Nature of Business and Basis of Presentation**

*Business Activity*
***Southern First Bancshares, Inc.*** (the "Company") is a South Carolina corporation that owns all of the capital stock of Southern First Bank (the "Bank") and all of the stock of Greenville First Statutory Trust I and II (collectively, the "Trusts"). The Trusts are special purpose non-consolidated entities organized for the sole purpose of issuing trust preferred securities. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions. The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the FDIC, and providing commercial, consumer and mortgage loans to the general public.

*Basis of Presentation*
The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three- and six-month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on March 3, 2017. The consolidated financial statements include the accounts of the Company and the Bank. In accordance with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 810, Consolidation, the financial statements related to the Trusts have not been consolidated.

*Use of Estimates*
The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, real estate acquired in the settlement of loans, fair value of financial instruments, evaluating other-than-temporary-impairment of investment securities and valuation of deferred tax assets.

*Business Segments*
The Company began reporting its activities as three business segments Commercial and Retail Banking, Mortgage Banking and Corporate in 2016. In determining proper segment definition, the Company considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated, relative to a resource allocation and performance assessment. The Company accounts for intersegment revenues and expenses as if the revenue/expense transactions were generated to third parties, that is, at current market prices. Please refer to Note 9 Reportable Segments for further information on the reporting for the Company s three business segments.

*Reclassifications*
Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis and had no effect on shareholders equity or net income.

*Subsequent Events*
Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management performed an evaluation to determine whether there have been any subsequent events since the balance sheet date and determined that no subsequent events occurred requiring accrual or disclosure.

**NOTE 2 Investment Securities**

The amortized costs and fair value of investment securities are as follows:

| | | | | June 30, 2017 |
|---|---|---|---|---|
| | Amortized | Gross Unrealized | | Fair |
| (dollars in thousands) | Cost | Gains | Losses | Value |
| **Available for sale** | | | | |
| US government agencies | $ 9,260 | 12 | 72 | 9,200 |
| SBA securities | 4,438 | - | 21 | 4,417 |
| State and political subdivisions | 20,129 | 321 | 72 | 20,378 |
| Mortgage-backed securities | 47,822 | 9 | 447 | 47,384 |
| Total investment securities available for sale | $ 81,649 | 342 | 612 | 81,379 |

| | | | | December 31, 2016 |
|---|---|---|---|---|
| | Amortized | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | Value |
| **Available for sale** | | | | |
| US government agencies | $ 6,271 | 1 | 113 | 6,159 |
| SBA securities | 1,453 | - | 16 | 1,437 |
| State and political subdivisions | 20,625 | 141 | 292 | 20,474 |
| Mortgage-backed securities | 36,895 | 21 | 506 | 36,410 |
| Total investment securities available for sale | $ 65,244 | 163 | 927 | 64,480 |

During the first six months of 2017, there were $415,000 of investment securities either sold or called, resulting in a gain on sale of $2,000. During the first six months of 2016, approximately $19.8 million of investment securities were either sold or called, subsequently resulting in a gain on sale of $325,000.

Contractual maturities and yields on the Company s investment securities at June 30, 2017 and December 31, 2016 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | | | | | | | | | | June 30, 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| | Less than one year | | One to five years | | Five to ten years | | Over ten years | | | Total |
| (dollars in thousands) | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| **Available for sale** | | | | | | | | | | |
| US government agencies | $ - | - | 3,015 | 1.70% | 6,185 | 2.38% | - | - | 9,200 | 2.16% |
| SBA securities | - | - | - | - | - | - | 4,417 | 2.43% | 4,417 | 2.43% |
| State and political subdivisions | - | - | 2,409 | 1.55% | 12,196 | 2.36% | 5,773 | 2.82% | 20,378 | 2.39% |
| Mortgage-backed securities | - | - | 914 | 1.36% | 9,686 | 1.82% | 36,784 | 2.12% | 47,384 | 2.03% |
| Total | $ - | - | 6,338 | 1.59% | 28,067 | 2.18% | 46,974 | 2.23% | 81,379 | 2.16% |

| | | | | | | | | | | December 31, 2016 |
|---|---|---|---|---|---|---|---|---|---|---|
| | Less than one year | | One to five years | | Five to ten years | | Over ten years | | | Total |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| **Available for sale** | | | | | | | | | | |
| US government agencies | $ - | - | 997 | 1.15% | 5,162 | 2.23% | - | - | 6,159 | 2.06% |
| SBA securities | - | - | - | - | - | - | 1,437 | 1.32% | 1,437 | 1.32% |
| State and political subdivisions | - | - | 2,271 | 1.73% | 12,287 | 2.35% | 5,916 | 2.77% | 20,474 | 2.40% |
| Mortgage-backed securities | - | - | - | - | 8,527 | 1.64% | 27,883 | 1.68% | 36,410 | 1.67% |
| Total | $ - | - | 3,268 | 1.55% | 25,976 | 2.10% | 35,236 | 1.85% | 64,480 | 1.93% |

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities at June 30, 2017 and December 31, 2016, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | June 30, 2017 |
| | Less than 12 months | | | 12 months or longer | | | Total | | | |
| (dollars in thousands) | # | Fair value | Unrealized losses | # | Fair value | Unrealized losses | # | Fair value | Unrealized losses | |
| **Available for sale** | | | | | | | | | | |
| US government agencies | 8 | $ 6,480 | $ 72 | - | $ - | $ - | 8 | $ 6,480 | $ 72 | |
| SBA securities | 1 | 3,002 | 16 | 1 | 1,414 | 5 | 2 | 4,416 | 21 | |
| State and political subdivisions | 14 | 6,492 | 72 | - | - | - | 14 | 6,491 | 72 | |
| Mortgage-backed securities | 34 | 42,865 | 396 | 3 | 4,415 | 51 | 37 | 47,280 | 447 | |
| Total | 57 | $ 58,839 | $ 556 | 4 | $ 5,829 | $ 56 | 61 | $ 64,668 | $ 612 | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | December 31, 2016 |
| | Less than 12 months | | | 12 months or longer | | | Total | | | |
| | # | Fair value | Unrealized losses | # | Fair value | Unrealized losses | # | Fair value | Unrealized losses | |
| **Available for sale** | | | | | | | | | | |
| US government agencies | 5 | $ 5,144 | $ 113 | - | $ - | $ - | 5 | $ 5,144 | $ 113 | |
| SBA securities | 1 | 1,437 | 16 | - | - | - | 1 | 1,437 | 16 | |
| State and political subdivisions | 32 | 13,936 | 292 | - | - | - | 32 | 13,936 | 292 | |
| Mortgage-backed securities | 25 | 27,292 | 476 | 2 | 3,991 | 30 | 27 | 31,283 | 506 | |
| Total | 63 | $ 47,809 | $ 897 | 2 | $ 3,991 | $ 30 | 65 | $ 51,800 | $ 927 | |

At June 30, 2017, the Company had 57 individual investments with a fair market value of $58.8 million that were in an unrealized loss position for less than 12 months and four individual investments with a fair market value of $5.8 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities are not other-than-temporarily impaired. The Company also considers other factors such as the financial condition of the issuer, including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, the Company has concluded that these securities are not impaired on an other-than-temporary basis.

Other investments are comprised of the following and are recorded at cost which approximates fair value.

| (dollars in thousands) | June 30, 2017 | December 31, 2016 |
|---|---|---|
| Federal Home Loan Bank stock | $ 3,499 | 5,173 |
| Investment in Trust Preferred securities | 403 | 403 |
| Other investments | 129 | 166 |
| Total other investments | $ 4,031 | 5,742 |

The Company has evaluated the Federal Home Loan Bank ( FHLB ) stock for impairment and determined that the investment in the FHLB stock is not other than temporarily impaired as of June 30, 2017 and ultimate recoverability of the par value of this investment is probable. All of the FHLB stock is used to collateralize advances with the FHLB.

At June 30, 2017, $20.5 million of securities were pledged as collateral for repurchase agreements from brokers and no securities were pledged to secure client deposits. At December 31, 2016, $21.0 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $21.1 million of securities were pledged to secure client deposits.

**NOTE 3 Mortgage Loans Held for Sale**

Mortgage loans originated and intended for sale in the secondary market are reported as loans held for sale and carried at fair value under the fair value option, which was adopted by the Company on April 1, 2016, with changes in fair value recognized in current period earnings. At the date of funding of the mortgage loan held for sale, the funded amount of the loan, the related derivative asset or liability of the associated interest rate lock commitment, less direct loan costs becomes the initial recorded investment in the loan held for sale. Such amount approximates the fair value of the loan. At June 30, 2017, mortgage loans held for sale totaled $11.5 million compared to $7.8 million at December 31, 2016.

Mortgage loans held for sale are considered de-recognized, or sold, when the Company surrenders control over the financial assets. Control is considered to have been surrendered when the transferred assets have been isolated from the Company, beyond the reach of the Company and its creditors; the purchaser obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and the Company does not maintain effective control over the transferred assets through an agreement that both entitles and obligates the Company to repurchase or redeem the transferred assets before their maturity or the ability to unilaterally cause the holder to return specific assets.

Gains and losses from the sale of mortgage loans are recognized based upon the difference between the sales proceeds and carrying value of the related loans upon sale and are recorded in mortgage banking income in the statement of income. Mortgage banking income also includes the unrealized gains and losses associated with the loans held for sale and the realized and unrealized gains and losses from derivatives.

Mortgage loans sold by the Company to investors and which were believed to have met investor and agency underwriting guidelines at the time of sale may be subject to repurchase or indemnification in the event of specific default by the borrower or subsequent discovery that underwriting standards were not met. The Company may, upon mutual agreement, agree to repurchase the loans or indemnify the investor against future losses on such loans. In such cases, the Company bears any subsequent credit loss on the loans.

**NOTE 4 Loans and Allowance for Loan Losses**

The following table summarizes the composition of our loan portfolio. Total gross loans are recorded net of deferred loan fees and costs, which totaled $2.2 million as of June 30, 2017 and $2.0 million as of December 31, 2016.

| | June 30, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| (dollars in thousands) | Amount | % of Total | Amount | % of Total |
| **Commercial** | | | | |
| Owner occupied RE | $ 310,696 | 23.9% | $ 285,938 | 24.6% |
| Non-owner occupied RE | 292,001 | 22.5% | 239,574 | 20.6% |
| Construction | 42,447 | 3.3% | 33,393 | 2.9% |
| Business | 212,703 | 16.3% | 202,552 | 17.4% |
| Total commercial loans | 857,847 | 66.0% | 761,457 | 65.5% |
| **Consumer** | | | | |
| Real estate | 233,401 | 18.0% | 215,588 | 18.5% |
| Home equity | 147,091 | 11.3% | 137,105 | 11.8% |
| Construction | 39,758 | 3.0% | 31,922 | 2.7% |
| Other | 21,732 | 1.7% | 17,572 | 1.5% |
| Total consumer loans | 441,982 | 34.0% | 402,187 | 34.5% |
| Total gross loans, net of deferred fees | 1,299,829 | 100.0% | 1,163,644 | 100.0% |
| Less allowance for loan losses | (15,444) | | (14,855) | |
| Total loans, net | $ 1,284,385 | | $ 1,148,789 | |

*Maturities and Sensitivity of Loans to Changes in Interest Rates*

The information in the following tables summarizes the loan maturity distribution by type and related interest rate characteristics based on the contractual maturities of individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below, because borrowers have the right to prepay obligations with or without prepayment penalties.

| | | | | June 30, 2017 |
|---|---|---|---|---|
| (dollars in thousands) | One year or less | After one but within five years | After five years | Total |
| **Commercial** | | | | |
| Owner occupied RE | $ 27,023 | 163,848 | 119,825 | 310,696 |
| Non-owner occupied RE | 39,353 | 151,447 | 101,201 | 292,001 |
| Construction | 12,303 | 9,210 | 20,934 | 42,447 |
| Business | 70,721 | 101,246 | 40,736 | 212,703 |
| Total commercial loans | 149,400 | 425,751 | 282,696 | 857,847 |
| **Consumer** | | | | |
| Real estate | 26,561 | 54,848 | 151,992 | 233,401 |
| Home equity | 9,382 | 30,130 | 107,579 | 147,091 |
| Construction | 16,602 | 2,614 | 20,542 | 39,758 |
| Other | 7,382 | 9,942 | 4,408 | 21,732 |
| Total consumer loans | 59,927 | 97,534 | 284,521 | 441,982 |
| Total gross loans, net of deferred fees | $ 209,327 | 523,285 | 567,217 | 1,299,829 |
| Loans maturing after one year with: | | | | |
| Fixed interest rates | | | | $ 822,399 |
| Floating interest rates | | | | 268,103 |

| | | | | December 31, 2016 |
|---|---|---|---|---|
| | One year or less | After one but within five years | After five years | Total |
| **Commercial** | | | | |
| Owner occupied RE | $ 26,062 | 145,419 | 114,457 | 285,938 |
| Non-owner occupied RE | 34,685 | 142,261 | 62,628 | 239,574 |
| Construction | 5,881 | 9,558 | 17,954 | 33,393 |
| Business | 66,361 | 99,255 | 36,936 | 202,552 |
| Total commercial loans | 132,989 | 396,493 | 231,975 | 761,457 |
| **Consumer** | | | | |
| Real estate | 26,342 | 49,832 | 139,414 | 215,588 |
| Home equity | 7,142 | 29,041 | 100,922 | 137,105 |
| Construction | 14,103 | 627 | 17,192 | 31,922 |
| Other | 5,049 | 9,305 | 3,218 | 17,572 |
| Total consumer | 52,636 | 88,805 | 260,746 | 402,187 |
| Total gross loan, net of deferred fees | $ 185,625 | 485,298 | 492,721 | 1,163,644 |
| Loans maturing after one year with : | | | | |
| Fixed interest rates | | | | $ 733,892 |
| Floating interest rates | | | | 244,127 |

**Portfolio Segment Methodology**

*Commercial*

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. The Company applies historic grade-specific loss factors to each loan class. In the development of statistically derived loan grade loss factors, the Company observes historical losses over 20 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. The allowance also includes an amount for the estimated impairment on nonaccrual commercial loans and commercial loans modified in a troubled debt restructuring ( TDR ), whether on accrual or nonaccrual status.

*Consumer*
For consumer loans, the Company determines the allowance on a collective basis utilizing historical losses over 20 quarters to represent its best estimate of inherent loss. The Company pools loans, generally by loan class with similar risk characteristics. The allowance also includes an amount for the estimated impairment on nonaccrual consumer loans and consumer loans modified in a TDR, whether on accrual or nonaccrual status.

**Credit Quality Indicators**

*Commercial*
We manage a consistent process for assessing commercial loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. Our risk categories include Pass, Special Mention, Substandard, and Doubtful, each of which is defined by our banking regulatory agencies. Delinquency statistics are also an important indicator of credit quality in the establishment of our allowance for credit losses.

We categorize our loans into risk categories based on relevant information about the ability of the borrower to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. A description of the general characteristics of the risk grades is as follows:

Pass These loans range from minimal credit risk to average however still acceptable credit risk.

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

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

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

The tables below provide a breakdown of outstanding commercial loans by risk category.

| | | | | | June 30, 2017 |
|---|---|---|---|---|---|
| (dollars in thousands) | Owner occupied RE | Non-owner occupied RE | Construction | Business | Total |
| Pass | $ 305,676 | 285,376 | 42,447 | 202,363 | 835,862 |
| Special mention | 2,645 | 3,038 | - | 4,546 | 10,229 |
| Substandard | 2,375 | 3,587 | - | 5,794 | 11,756 |
| Doubtful | - | - | - | - | - |
| | $ 310,696 | 292,001 | 42,447 | 212,703 | 857,847 |

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Owner occupied RE | Non-owner occupied RE | Construction | Business | Total |
| Pass | $ 282,055 | 234,957 | 33,393 | 193,517 | 743,922 |
| Special mention | 1,097 | 975 | - | 2,489 | 4,561 |
| Substandard | 2,786 | 3,642 | - | 6,546 | 12,974 |
| Doubtful | - | - | - | - | - |
| | $ 285,938 | 239,574 | 33,393 | 202,552 | 761,457 |

The following tables provide past due information for outstanding commercial loans and include loans on nonaccrual status as well as accruing TDRs.

| | June 30, 2017 | | | | |
|---|---|---|---|---|---|
| (dollars in thousands) | Owner occupied RE | Non-owner occupied RE | Construction | Business | Total |
| Current | $ 310,451 | 291,236 | 42,447 | 211,280 | 855,414 |
| 30-59 days past due | - | - | - | 266 | 266 |
| 60-89 days past due | - | - | - | - | - |
| Greater than 90 Days | 245 | 765 | - | 1,157 | 2,167 |
| | $ 310,696 | 292,001 | 42,447 | 212,703 | 857,847 |

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Owner occupied RE | Non-owner occupied RE | Construction | Business | Total |
| Current | $ 284,700 | 238,346 | 33,393 | 200,624 | 757,063 |
| 30-59 days past due | 981 | - | - | 1,423 | 2,404 |
| 60-89 days past due | 257 | 56 | - | - | 313 |
| Greater than 90 Days | - | 1,172 | - | 505 | 1,677 |
| | $ 285,938 | 239,574 | 33,393 | 202,552 | 761,457 |

As of June 30, 2017 and December 31, 2016, loans 30 days or more past due represented 0.39% and 0.55% of the Company s total loan portfolio, respectively. Commercial loans 30 days or more past due were 0.19% and 0.38% of the Company s total loan portfolio as of June 30, 2017 and December 31, 2016, respectively.

*Consumer*

The Company manages a consistent process for assessing consumer loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. The Company s categories include Pass, Special Mention, Substandard, and Doubtful, which are defined above. Delinquency statistics are also an important indicator of credit quality in the establishment of the allowance for loan losses.

The tables below provide a breakdown of outstanding consumer loans by risk category.

| | June 30, 2017 | | | | |
|---|---|---|---|---|---|
| (dollars in thousands) | Real estate | Home equity | Construction | Other | Total |
| Pass | $ 229,812 | 143,932 | 39,758 | 21,624 | 435,126 |
| Special mention | 744 | 2,235 | - | 10 | 2,989 |
| Substandard | 2,845 | 924 | - | 98 | 3,867 |
| Doubtful | - | - | - | - | - |
| Loss | - | - | - | - | - |
| | $ 233,401 | 147,091 | 39,758 | 21,732 | 441,982 |

| | Real estate | Home equity | Construction | Other | Total |
|---|---|---|---|---|---|
| | | | | | December 31, 2016 |
| Pass | $ 211,563 | 134,124 | 31,922 | 17,485 | 395,094 |
| Special mention | 1,064 | 2,109 | - | 16 | 3,189 |
| Substandard | 2,961 | 872 | - | 71 | 3,904 |
| Doubtful | - | - | - | - | - |
| Loss | - | - | - | - | - |
| | $ 215,588 | 137,105 | 31,922 | 17,572 | 402,187 |

The following tables provide past due information for outstanding consumer loans and include loans on nonaccrual status as well as accruing TDRs.

| | | | | | June 30, 2017 |
|---|---|---|---|---|---|
| (dollars in thousands) | Real estate | Home equity | Construction | Other | Total |
| Current | $ 231,602 | 146,328 | 39,758 | 21,718 | 439,406 |
| 30-59 days past due | 548 | 566 | - | 14 | 1,128 |
| 60-89 days past due | 977 | - | - | - | 977 |
| Greater than 90 Days | 274 | 197 | - | - | 471 |
| | $ 233,401 | 147,091 | 39,758 | 21,732 | 441,982 |

| | | | | | December 31, 2016 |
|---|---|---|---|---|---|
| | Real estate | Home equity | Construction | Other | Total |
| Current | $ 214,228 | 136,638 | 31,922 | 17,427 | 400,215 |
| 30-59 days past due | 1,041 | 210 | - | 126 | 1,377 |
| 60-89 days past due | 282 | - | - | 6 | 288 |
| Greater than 90 Days | 37 | 257 | - | 13 | 307 |
| | $ 215,588 | 137,105 | 31,922 | 17,572 | 402,187 |

As of June 30, 2017 and December 31, 2016, consumer loans 30 days or more past due were 0.20% and 0.17% of total loans, respectively.

**Nonperforming assets**

The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when the Company believes, after considering economic and business conditions and collection efforts, that the borrower s financial condition is such that collection of the contractual principal or interest on the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

Following is a summary of our nonperforming assets, including nonaccruing TDRs.

| (dollars in thousands) | June 30, 2017 | December 31, 2016 |
|---|---|---|
| **Commercial** | | |
| Owner occupied RE | $ 245 | 276 |
| Non-owner occupied RE | 2,205 | 2,711 |
| Construction | - | - |
| Business | 1,324 | 686 |
| **Consumer** | | |
| Real estate | 534 | 550 |
| Home equity | 197 | 256 |
| Construction | - | - |
| Other | 4 | 13 |
| Nonaccruing troubled debt restructurings | 749 | 990 |
| Total nonaccrual loans, including nonaccruing TDRs | 5,258 | 5,482 |
| Other real estate owned | 428 | 639 |
| Total nonperforming assets | $ 5,686 | 6,121 |
| Nonperforming assets as a percentage of: | | |
| Total assets | 0.37% | 0.46% |
| Gross loans | 0.44% | 0.53% |
| Total loans over 90 days past due | 2,638 | 1,984 |
| Loans over 90 days past due and still accruing | - | - |
| Accruing troubled debt restructurings | $ 6,009 | 5,675 |

**Impaired Loans**

The table below summarizes key information for impaired loans. The Company s impaired loans include loans on nonaccrual status and loans modified in a TDR, whether on accrual or nonaccrual status. These impaired loans may have estimated impairment which is included in the allowance for loan losses. The Company s commercial and consumer impaired loans are evaluated individually to determine the related allowance for loan losses.

| | | | | June 30, 2017 |
|---|---|---|---|---|
| | | Recorded investment | | |
| (dollars in thousands) | Unpaid Principal Balance | Impaired loans | Impaired loans with related allowance for loan losses | Related allowance for loan losses |
| **Commercial** | | | | |
| Owner occupied RE | $ 2,240 | 2,186 | 833 | 401 |
| Non-owner occupied RE | 7,042 | 3,495 | 1,374 | 361 |
| Construction | - | - | - | - |
| Business | 4,308 | 3,581 | 3,087 | 1,305 |
| Total commercial | 13,590 | 9,262 | 5,294 | 2,067 |
| **Consumer** | | | | |
| Real estate | 1,650 | 1,629 | 1,629 | 1,026 |
| Home equity | 203 | 197 | 197 | 135 |
| Construction | - | - | - | - |
| Other | 180 | 179 | 179 | 28 |
| Total consumer | 2,033 | 2,005 | 2,005 | 1,189 |
| Total | $ 15,623 | 11,267 | 7,299 | 3,256 |

| | December 31, 2016 Recorded investment | | | |
|---|---|---|---|---|
| | Unpaid Principal Balance | Impaired loans | Impaired loans with related allowance for loan losses | Related allowance for loan losses |
| **Commercial** | | | | |
| Owner occupied RE | $ 2,284 | 2,243 | 2,224 | 263 |
| Non-owner occupied RE | 7,238 | 4,031 | 1,638 | 457 |
| Construction | - | - | - | - |
| Business | 3,699 | 2,593 | 1,610 | 1,154 |
| Total commercial | 13,221 | 8,867 | 5,472 | 1,874 |
| **Consumer** | | | | |
| Real estate | 1,853 | 1,843 | 1,843 | 682 |
| Home equity | 207 | 257 | - | - |
| Construction | - | - | - | - |
| Other | 261 | 190 | 177 | 88 |
| Total consumer | 2,321 | 2,290 | 2,020 | 770 |
| Total | $ 15,542 | 11,157 | 7,492 | 2,644 |

The following table provides the average recorded investment in impaired loans and the amount of interest income recognized on impaired loans after impairment by portfolio segment and class.

| | Three months ended June 30, 2017 | | Three months ended June 30, 2016 | |
|---|---|---|---|---|
| (dollars in thousands) | Average recorded investment | Recognized interest income | Average recorded investment | Recognized interest income |
| **Commercial** | | | | |
| Owner occupied RE | $ 2,195 | 26 | 1,994 | 21 |
| Non-owner occupied RE | 3,620 | 48 | 5,582 | 35 |
| Construction | - | - | - | - |
| Business | 3,623 | 54 | 5,272 | 54 |
| Total commercial | 9,438 | 128 | 12,848 | 110 |
| **Consumer** | | | | |
| Real estate | 1,635 | 16 | 1,153 | 12 |
| Home equity | 197 | 1 | 257 | 1 |
| Construction | - | - | - | - |
| Other | 180 | 1 | 294 | 5 |
| Total consumer | 2,012 | 18 | 1,704 | 18 |
| Total | $ 11,450 | 146 | 14,552 | 128 |

| | Six months ended June 30, 2017 | | Six months ended June 30, 2016 | | Year ended December 31, 2016 | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Average recorded investment | Recognized interest income | Average recorded investment | Recognized interest income | Average recorded investment | Recognized interest income |
| **Commercial** | | | | | | |
| Owner occupied RE | $ 2,204 | 53 | 1,999 | 43 | 2,263 | 112 |
| Non-owner occupied RE | 3,721 | 76 | 5,642 | 86 | 4,106 | 200 |
| Construction | - | - | - | - | - | - |
| Business | 3,635 | 98 | 5,315 | 134 | 2,873 | 135 |
| Total commercial | 9,560 | 227 | 12,956 | 263 | 9,242 | 447 |
| **Consumer** | | | | | | |
| Real estate | 1,642 | 33 | 1,155 | 21 | 1,854 | 81 |
| Home equity | 198 | 2 | 257 | 1 | 257 | 2 |
| Construction | - | - | - | - | - | - |
| Other | 181 | 2 | 295 | 6 | 203 | 6 |
| Total consumer | 2,021 | 37 | 1,707 | 28 | 2,314 | 89 |
| Total | $ 11,581 | 264 | 14,663 | 291 | 11,556 | 536 |

**Allowance for Loan Losses**

The allowance for loan loss is management s estimate of credit losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The Company has an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in the portfolio. While the Company attributes portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company s process involves procedures to appropriately consider the unique risk characteristics of the commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. The Company s allowance levels are influenced by loan volume, loan grade or delinquency status, historic loss experience and other economic conditions.

The following table summarizes the activity related to the allowance for loan losses by commercial and consumer portfolio segments:

| | Three months ended June 30, 2 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial | | | | Consu | | | | |
| (dollars in thousands) | Owner occupied RE | Non-owner occupied RE | Construction | Business | Real Estate | Home equity | Construction | Other | T |
| **Balance, beginning of period** | $ 3,052 | 2,967 | 334 | 3,823 | 2,830 | 1,619 | 289 | 373 | 15,28 |
| Provision for loan losses | (88) | 255 | 16 | 139 | 240 | (23) | 39 | (78) | 50 |
| Loan charge-offs | - | (253) | - | (120) | - | - | - | - | (37 |
| Loan recoveries | - | 12 | - | 15 | (9) | 12 | - | - | 3 |
| Net loan charge-offs | - | (241) | - | (105) | (9) | 12 | - | - | (34 |
| **Balance, end of period** | $ 2,964 | 2,981 | 350 | 3,857 | 3,061 | 1,608 | 328 | 295 | 15,44 |
| Net charge-offs to average loans (annualized) | | | | | | | | | 0.1 |
| Allowance for loan losses to gross loans | | | | | | | | | 1.1 |
| Allowance for loan losses to nonperforming loans | | | | | | | | | 293.7 |

| | | | | | | | | | Three months ended June 30, 201 |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial | | | | Consume | | | | |
| (dollars in thousands) | Owner occupied RE | Non-owner occupied RE | Construction | Business | Real Estate | Home equity | Construction | Other | Tot |
| **Balance, beginning of period** | $ 2,493 | 3,236 | 442 | 3,639 | 2,131 | 1,263 | 351 | 343 | 13,898 |
| Provision for loan losses | 304 | (250) | (49) | 488 | 170 | 40 | (139) | 11 | 575 |
| Loan charge-offs | - | - | (42) | (311) | - | (7) | - | (24) | (384) |
| Loan recoveries | - | 25 | - | 203 | - | - | - | - | 228 |
| Net loan charge-offs | - | 25 | (42) | (108) | - | (7) | - | (24) | (156) |
| **Balance, end of period** | $ 2,797 | 3,011 | 351 | 4,019 | 2,301 | 1,296 | 212 | 330 | 14,317 |
| Net charge-offs to average loans (annualized) | | | | | | | | | 0.06 |
| Allowance for loan losses to gross loans | | | | | | | | | 1.34 |
| Allowance for loan losses to nonperforming loans | | | | | | | | | 250.63 |

| | | | | | | | | | Six months ended June 30, 201 |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial | | | | Consume | | | | |
| (dollars in thousands) | Owner occupied RE | Non-owner occupied RE | Construction | Business | Real Estate | Home equity | Construction | Other | Tot |
| **Balance, beginning of period** | $ 2,843 | 2,778 | 295 | 4,123 | 2,780 | 1,475 | 252 | 309 | 14,855 |
| Provision for loan losses | 121 | 623 | 55 | (182) | 200 | 121 | 76 | (14) | 1,000 |
| Loan charge-offs | - | (433) | - | (130) | - | - | - | - | (563) |
| Loan recoveries | - | 13 | - | 46 | 81 | 12 | - | - | 152 |
| Net loan charge-offs | - | (420) | - | (84) | 81 | 12 | - | - | (411) |
| **Balance, end of period** | $ 2,964 | 2,981 | 350 | 3,857 | 3,061 | 1,608 | 328 | 295 | 15,444 |
| Net charge-offs to average loans (annualized) | | | | | | | | | 0.03 |

| | | | | | | | | | Six months ended June 30, 201 |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial | | | | Consume | | | | |
| (dollars in thousands) | Owner occupied RE | Non-owner occupied RE | Construction | Business | Real Estate | Home equity | Construction | Other | Tot |
| **Balance, beginning of period** | $ 2,347 | 3,187 | 338 | 3,800 | 2,070 | 1,202 | 313 | 372 | 13,629 |
| Provision for loan losses | 455 | (128) | 55 | 330 | 418 | 101 | (101) | 70 | 1,200 |
| Loan charge-offs | (5) | (75) | (42) | (348) | (187) | (7) | - | (115) | (779) |
| Loan recoveries | - | 27 | - | 237 | - | - | - | 3 | 267 |
| Net loan charge-offs | (5) | (48) | (42) | (111) | (187) | (7) | - | (112) | (512) |
| **Balance, end of period** | $ 2,797 | 3,011 | 351 | 4,019 | 2,301 | 1,296 | 212 | 330 | 14,317 |
| Net charge-offs to average loans (annualized) | | | | | | | | | 0.10 |

The following table disaggregates the allowance for loan losses and recorded investment in loans by impairment methodology.

| | | | | | | June 30, 2017 |
|---|---|---|---|---|---|---|
| | Allowance for loan losses | | | Recorded investment in loans | | |
| (dollars in thousands) | Commercial | Consumer | Total | Commercial | Consumer | Total |
| Individually evaluated | $ 2,067 | 1,189 | 3,256 | 9,262 | 2,005 | 11,267 |
| Collectively evaluated | 8,085 | 4,103 | 12,188 | 848,585 | 439,977 | 1,288,562 |
| Total | $ 10,152 | 5,292 | 15,444 | 857,847 | 441,982 | 1,299,829 |

| | | | | | | December 31, 2016 |
|---|---|---|---|---|---|---|
| | Allowance for loan losses | | | Recorded investment in loans | | |
| | Commercial | Consumer | Total | Commercial | Consumer | Total |
| Individually evaluated | $ 1,874 | 770 | 2,644 | 8,867 | 2,290 | 11,157 |
| Collectively evaluated | 8,165 | 4,046 | 12,211 | 752,590 | 399,897 | 1,152,487 |
| Total | $ 10,039 | 4,816 | 14,855 | 761,457 | 402,187 | 1,163,644 |

**NOTE 5 Troubled Debt Restructurings**

At June 30, 2017, the Company had 18 loans totaling $6.8 million compared to 17 loans totaling $6.7 million at December 31, 2016, which were considered as TDRs. The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company grants a concession to the debtor that it would not normally consider. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of the workout plan for individual loan relationships, the Company may restructure loan terms to assist borrowers facing financial challenges in the current economic environment. To date, the Company has restored four commercial loans previously classified as TDRs to accrual status.

During the three months ended June 30, 2017, the Company reduced or deferred payments on one commercial business loan whose modification was considered a TDR. The recorded investment in the loan before modification was $229,000 and the loan s recorded investment following modification was $238,000. The following table summarizes the concession at the time of modification and the recorded investment in the Company s TDRs before and after their modification during the six months ended June 30, 2017 and the three and six months ended 2016, respectively.

| | | | | | For the six months ended June 30, 2017 | | |
|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Renewals deemed a concession | Reduced or deferred payments | Converted to interest only | Maturity date extensions | Total Number of loans | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment |
| **Commercial** | | | | | | | |
| Business | 1 | 1 | - | - | 2 | $ 378 | $ 387 |
| Total loans | 1 | 1 | - | - | 2 | $ 378 | $ 387 |

| | | | | | For the three and six months ended June 30, 2016 | | |
|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Renewals deemed a concession | Reduced or deferred payments | Converted to interest only | Maturity date extensions | Total Number of loans | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment |
| **Commercial** | | | | | | | |
| Business | 1 | - | - | - | 1 | $ 2,381 | $ 2,381 |
| **Consumer** | | | | | | | |
| Other | 2 | - | - | - | 2 | 110 | 114 |
| Total loans | 3 | - | - | - | 3 | $ 2,491 | $ 2,495 |

As of June 30, 2017 and 2016, there were no loans modified as TDRs for which there was a payment default (60 days past due) within 12 months of the restructuring date.

**NOTE 6 Derivative Financial Instruments**

The Company utilizes derivative financial instruments primarily to hedge its exposure to changes in interest rates. All derivative financial instruments are recognized as either assets or liabilities and measured at fair value. The Company accounts for all of its derivatives as free-standing derivatives and does not designate any of these instruments for hedge accounting. Therefore, the gain or loss resulting from the change in the fair value of the derivative is recognized in the Company s statement of income during the period of change.

The Company enters into commitments to originate residential mortgage loans held for sale, at specified interest rates and within a specified period of time, with clients who have applied for a loan and meet certain credit and underwriting criteria (interest rate lock commitments). These interest rate lock commitments ( IRLCs ) meet the definition of a derivative financial instrument and are reflected in the balance sheet at fair value with changes in fair value recognized in current period earnings. Unrealized gains and losses on the IRLCs are recorded as derivative assets and derivative liabilities, respectively, and are measured based on the value of the underlying mortgage loan, quoted mortgage-backed securities ( MBS ) prices and an estimate of the probability that the mortgage loan will fund within the terms of the interest rate lock commitment, net of estimated commission expenses.

The Company manages the interest rate and price risk associated with its outstanding IRLCs and mortgage loans held for sale by entering into derivative instruments such as forward sales of MBS. Management expects these derivatives will experience changes in fair value opposite to changes in fair value of the IRLCs and mortgage loans held for sale, thereby reducing earnings volatility. The Company takes into account various factors and strategies in determining the portion of the mortgage pipeline (IRLCs and mortgage loans held for sale) it wants to economically hedge.

The following table summarizes the Company s outstanding financial derivative instruments at June 30, 2017 and December 31, 2016.

| | | | | | |
|---|---|---|---|---|---|
| | | | | | **June 30, 2017** |
| | | | | | **Fair Value** |
| (dollars in thousands) | | **Notional** | **Balance Sheet Location** | | **Asset/(Liability)** |
| Mortgage loan interest rate lock commitments | $ | 28,457 | Other assets | $ | 357 |
| MBS forward sales commitments | | 20,250 | Other assets | | 72 |
| Total derivative financial instruments | $ | 48,707 | | $ | 429 |

| | | | | | |
|---|---|---|---|---|---|
| | | | | | **December 31, 2016** |
| | | | | | **Fair Value** |
| (dollars in thousands) | | **Notional** | **Balance Sheet Location** | | **Asset/(Liability)** |
| Mortgage loan interest rate lock commitments | $ | 17,986 | Other assets | $ | 256 |
| MBS forward sales commitments | | 14,250 | Other assets | | (3) |
| Total derivative financial instruments | $ | 32,236 | | $ | 253 |

**NOTE 7 Fair Value Accounting**

FASB ASC 820, Fair Value Measurement and Disclosures, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1 Quoted market price in active markets**
Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities that are traded in an active exchange market.

**Level 2 Significant other observable inputs**
Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company s available-for-sale portfolio and valued by a third-party pricing service, as well as certain impaired loans.

**Level 3 Significant unobservable inputs**
Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

Following is a description of valuation methodologies used for assets recorded at fair value.

*Investment Securities*
Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or 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 and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as FHLB stock, approximates fair value based on their redemption provisions.

*Mortgage Loans Held for Sale*
Loans held for sale include mortgage loans which are saleable into the secondary mortgage markets and their fair values are estimated using observable quoted market or contracted prices or market price equivalents, which would be used by other market participants. These saleable loans are considered Level 2.

*Loans*
The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be 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 the impairment in accordance with FASB ASC 310, Receivables. 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 June 30, 2017, a significant portion of the impaired loans were evaluated based on the fair value of the collateral. In accordance with FASB ASC 820, Fair Value Measurement and Disclosures, 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, the Company considers the impaired loan as nonrecurring Level 2. The Company s current loan and appraisal policies require the Bank to obtain updated appraisals on an as is basis at renewal, or in the case of an impaired loan, on an annual basis, either through a new external appraisal or an appraisal evaluation. 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, the Company considers the impaired loan as nonrecurring Level 3. The fair value of impaired loans may also be estimated using the present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

*Other Real Estate Owned ( OREO )*
OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. 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, the Company considers the OREO as nonrecurring Level 3.

*Derivative Financial Instruments*
The Company estimates the fair value of IRLCs based on the value of the underlying mortgage loan, quoted MBS prices and an estimate of the probability that the mortgage loan will fund within the terms of the IRLC, net of commission expenses (Level 2). The Company estimates the fair value of forward sales commitments based on quoted MBS prices (Level 2).

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

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016.

| | | | | June 30, 2017 |
|---|---|---|---|---|
| (dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
| **Assets** | | | | |
| Securities available for sale | | | | |
| US government agencies | $ - | 9,200 | - | 9,200 |
| SBA securities | - | 4,417 | - | 4,417 |
| State and political subdivisions | - | 20,378 | - | 20,378 |
| Mortgage-backed securities | - | 47,384 | - | 47,384 |
| Mortgage loans held for sale | - | 11,480 | - | 11,480 |
| Interest rate lock commitments | - | 357 | - | 357 |
| MBS forward sales commitments | - | 72 | - | 72 |
| Total assets measured at fair value on a recurring basis | $ - | 93,288 | - | 93,288 |

| | | | | December 31, 2016 |
|---|---|---|---|---|
| (dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
| **Assets** | | | | |
| Securities available for sale: | | | | |
| US government agencies | $ - | 6,159 | - | 6,159 |
| SBA securities | - | 1,437 | - | 1,437 |
| State and political subdivisions | - | 20,474 | - | 20,474 |
| Mortgage-backed securities | - | 36,410 | - | 36,410 |
| Mortgage loans held for sale | - | 7,801 | - | 7,801 |
| Interest rate lock commitments | - | 256 | - | 256 |
| Total assets measured at fair value on a recurring basis | $ - | 72,537 | - | 72,537 |
| **Liabilities** | | | | |
| MBS forward sales commitments | $ - | 3 | - | 3 |
| Total liabilities measured at fair value on a recurring basis | $ - | 3 | - | 3 |

The Company has no liabilities carried at fair value or measured at fair value on a recurring basis as of June 30, 2017.

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

The Company is predominantly an asset based lender with real estate serving as collateral on more than 80% of loans as of June 30, 2017. Loans which are deemed to be impaired are valued net of the allowance for loan losses, and other real estate owned is valued at the lower of cost or net realizable value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The tables below present the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of June 30, 2017 and December 31, 2016.

| | | | | As of June 30, 2017 |
|---|---|---|---|---|
| (dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Impaired loans | $ - | 2,614 | 5,397 | 8,011 |
| Other real estate owned | - | 315 | 113 | 428 |
| Total assets measured at fair value on a nonrecurring basis | $ - | 2,929 | 5,510 | 8,439 |

| | | | As of December 31, 2016 | | |
|---|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | | |
| Impaired loans | $ | - | 4,075 | 4,438 | 8,513 |
| Other real estate owned | | - | 526 | 113 | 639 |
| Total assets measured at fair value on a nonrecurring basis | $ | - | 4,601 | 4,551 | 9,152 |

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis as of June 30, 2017 and December 31, 2016.

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of June 30, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

| | Valuation Technique | Significant Unobservable Inputs | Range of Inputs |
|---|---|---|---|
| Impaired loans | Appraised Value/ Discounted Cash Flows | Discounts to appraisals or cash flows for estimated holding and/or selling costs or age of appraisal | 0-25% |
| Other real estate owned | Appraised Value/ Comparable Sales | Discounts to appraisals for estimated holding or selling costs | 0-25% |

*Fair Value of Financial Instruments*

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company s common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, federal funds purchased, and securities sold under agreement to repurchase.

*Deposits* Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

*FHLB Advances and Other Borrowings* Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

*Junior subordinated debentures* Fair value for junior subordinated debentures are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management s best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

The estimated fair values of the Company s financial instruments at June 30, 2017 and December 31, 2016 are as follows:

| | | | | | June 30, 2017 |
|---|---|---|---|---|---|
| (dollars in thousands) | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| **Financial Assets:** | | | | | |
| Other investments, at cost | $ 4,031 | 4,031 | - | - | 4,031 |
| Loans, net | 1,284,385 | 1,287,454 | - | 2,614 | 1,284,840 |
| **Financial Liabilities:** | | | | | |
| Deposits | 1,297,911 | 1,201,720 | - | 1,201,720 | - |
| FHLB and other borrowings | 73,200 | 73,606 | - | 73,606 | - |
| Junior subordinated debentures | 13,403 | 12,528 | - | 12,528 | - |

| | | | | | December 31, 2016 |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| **Financial Assets:** | | | | | |
| Other investments, at cost | $ 5,742 | 5,742 | - | - | 5,742 |
| Loans, net | 1,148,789 | 1,149,527 | - | 4,075 | 1,145,452 |
| **Financial Liabilities:** | | | | | |
| Deposits | 1,091,151 | 1,004,923 | - | 1,004,923 | - |
| FHLB and other borrowings | 115,200 | 115,825 | - | 115,825 | - |
| Junior subordinated debentures | 13,403 | 12,026 | - | 12,026 | - |

**NOTE 8 Earnings Per Common Share**

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three and six months ended June 30, 2017 and 2016. Dilutive common shares arise from the potentially dilutive effect of the Company s stock options that were outstanding at June 30, 2017. The assumed conversion of stock options can create a difference between basic and dilutive net income per common share. At June 30, 2017 and 2016, there were 120,681 and 97,500 options, respectively, that were not considered in computing diluted earnings per common share because they were anti-dilutive.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands, except share data) | 2017 | 2016 | 2017 | 2016 |
| Numerator: | | | | |
| Net income available to common shareholders | $ 3,604 | 3,306 | 6,716 | 6,312 |
| Denominator: | | | | |
| Weighted-average common shares outstanding basic | 6,986,948 | 6,301,853 | 6,713,608 | 6,287,350 |
| Common stock equivalents | 379,260 | 400,967 | 385,773 | 395,776 |
| Weighted-average common shares outstanding diluted | 7,366,208 | 6,702,820 | 7,099,381 | 6,683,126 |
| Earnings per common share: | | | | |
| Basic | $ 0.52 | 0.52 | 1.00 | 1.00 |
| Diluted | $ 0.49 | 0.49 | 0.95 | 0.94 |

**NOTE 9 Reportable Segments**

The Company s reportable segments represent the distinct product lines the Company offers and are viewed separately for strategic planning purposes by management. The three segments include Commercial and Retail Banking, Mortgage Banking, and Corporate. The following schedule presents financial information for each reportable segment.

| | Three months ended June 30, 2017 | | | | | Three months ended June 30, 2016 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Commercial and Retail Banking | Mortgage Banking | Corporate | Elimin-ations | Consol-idated | Commercial and Retail Banking | Mortgage Banking | Corporate | Elimin-ation | Cons idate |
| Interest income | $ 14,851 | 80 | 6 | (6) | 14,931 | 12,410 | 93 | - | - | 12,50 |
| Interest expense | 2,442 | - | 143 | (6) | 2,579 | 1,894 | - | 96 | - | 1,990 |
| Net interest income (loss) | 12,409 | 80 | (137) | - | 12,352 | 10,516 | 93 | (96) | - | 10,51 |
| Provision for loan losses | 500 | - | - | - | 500 | 575 | - | - | - | 575 |
| Noninterest income | 959 | 1,603 | - | - | 2,562 | 911 | 2,235 | - | - | 3,14 |
| Noninterest expense | 7,667 | 1,035 | 60 | - | 8,762 | 6,698 | 1,313 | (158) | - | 7,85 |
| Net income (loss) before taxes | 5,201 | 648 | (197) | - | 5,652 | 4,154 | 1,015 | 62 | - | 5,23 |
| Income tax (provision) benefit | (1,877) | (240) | 69 | - | (2,048) | (1,525) | (387) | (13) | - | (1,92 |
| Net income (loss) | $ 3,324 | 408 | (128) | - | 3,604 | 2,629 | 628 | 49 | - | 3,30 |
| Total assets | $ 1,527,837 | 10,958 | 156,145 | (155,714) | 1,539,226 | 1,272,894 | 15,011 | 115,810 | (113,005) | 1,29 |

| | Six months ended June 30, 2017 | | Six months ended June 30, 2016 |
|---|---|---|---|
| | Commercial and Retail | Mortgage | Commercial |