FIRST UNITED CORP/MD/
Form 10-Q
November 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For quarterly period ended September 30, 2015

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _______________ to ________________

Commission file number 0-14237

First United Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1380770
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

19 South Second Street, Oakland, Maryland	21550-0009
(Address of principal executive offices)	(Zip Code)

(800) 470-4356

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 þ 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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 6,254,620 shares of common stock, par value $.01 per share, as of October 31, 2015.

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FIRST UNITED CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST UNITED CORPORATION

Consolidated Statement of Financial Condition

(In thousands, except per share and percentage data)

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Cash and due from banks	$61,406	$ 27,554
Interest bearing deposits in banks	3,383	7,897
Cash and cash equivalents	64,789	35,451
Investment securities – available-for-sale (at fair value)	185,519	221,117
Investment securities – held to maturity (fair value $108,759 at September 30, 2015 and $110,771 at December 31, 2014)	106,732	109,449
Restricted investment in bank stock, at cost	5,904	7,524
Loans	843,092	839,991
Allowance for loan losses	(12,211)	(12,065)
Net loans	830,881	827,926
Premises and equipment, net	25,013	25,629
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	39,853	33,504
Deferred tax assets	23,928	25,907
Other real estate owned	7,477	12,932
Accrued interest receivable and other assets	19,215	21,853
Total Assets	$1,320,315	$ 1,332,296
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$214,975	$ 201,188
Interest bearing deposits	781,366	780,135
Total deposits	996,341	981,323
Short-term borrowings	38,460	39,801
Long-term borrowings	147,555	182,606
Accrued interest payable and other liabilities	23,367	19,567
Total Liabilities	1,205,723	1,223,297

Shareholders' Equity:		
Preferred stock – no par value; Authorized 2,000 shares of which 30 shares of Series A, $1,000 per share liquidation preference, 5% cumulative increasing to 9% cumulative on February 15, 2014, were issued and outstanding on September 30, 2015 and December 31, 2014	30,000	30,000
Common Stock – par value $.01 per share; Authorized 25,000 shares; issued and outstanding 6,255 shares at September 30, 2015 and 6,228 at December 31, 2014	63	62
Surplus	21,939	21,795
Retained earnings	79,841	77,375
Accumulated other comprehensive loss	(17,251)	(20,233)
Total Shareholders' Equity	114,592	108,999
Total Liabilities and Shareholders' Equity	$ 1,320,315	$ 1,332,296

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Nine months ended September 30,	
	2015	2014
	(Unaudited)	
Interest income		
Interest and fees on loans	$27,549	$28,144
Interest on investment securities		
Taxable	5,365	5,323
Exempt from federal income tax	970	1,175
Total investment income	6,335	6,498
Other	268	276
Total interest income	34,152	34,918
Interest expense		
Interest on deposits	3,018	3,489
Interest on short-term borrowings	42	46
Interest on long-term borrowings	4,213	4,699
Total interest expense	7,273	8,234
Net interest income	26,879	26,684
Provision for loan losses	626	1,629
Net interest income after provision for loan losses	26,253	25,055
Other operating income		
Net gains – other	100	1,127
Total net gains	100	1,127
Service charges	2,177	2,213
Trust department	4,225	3,922
Debit card income	1,586	1,516
Bank owned life insurance	849	737
Brokerage commissions	706	607
Other	308	309
Total other income	9,851	9,304
Total other operating income	9,951	10,431
Other operating expenses		
Salaries and employee benefits	15,703	14,613
FDIC premiums	1,404	1,360
Equipment	1,905	1,931
Occupancy	1,867	1,868
Data processing	2,580	2,379
Professional Services	1,145	1,092
Other real estate owned	976	2,128
Other	4,782	5,202

Total other operating expenses	30,362	30,573
Income before income tax expense	5,842	4,913
Provision for income tax expense	1,351	975
Net Income	4,491	3,938
Accumulated preferred stock dividends and discount accretion	(2,025)	(1,925)
Net Income Available to Common Shareholders	$ 2,466	$ 2,013
Basic and diluted net income per common share	$ 0.39	$ 0.32
Weighted average number of basic and diluted shares outstanding	6,247	6,220

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Three Months Ended September 30,	
	2015	2014
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 9,311	$ 9,447
Interest on investment securities		
Taxable	1,755	1,579
Exempt from federal income tax	302	371
Total investment income	2,057	1,950
Other	93	100
Total interest income	11,461	11,497
Interest expense		
Interest on deposits	960	1,154
Interest on short-term borrowings	14	16
Interest on long-term borrowings	1,277	1,502
Total interest expense	2,251	2,672
Net interest income	9,210	8,825
Provision for loan losses	500	688
Net interest income after provision for loan losses	8,710	8,137
Other operating income		
Net gains– other	95	166
Total net gains	95	166
Service charges	792	747
Trust department	1,455	1,354
Debit card income	578	529
Bank owned life insurance	294	249
Brokerage commissions	238	201
Other	90	88
Total other income	3,447	3,168
Total other operating income	3,542	3,334
Other operating expenses		
Salaries and employee benefits	5,445	4,910
FDIC premiums	474	478
Equipment	634	625
Occupancy	617	592
Data processing	871	803
Professional Services	240	239
Other real estate owned	(71)	514
Other	1,500	1,747

Total other operating expenses	9,710	9,908
Income before income tax expense	2,542	1,563
Provision for income tax expense	594	223
Net Income	1,948	1,340
Accumulated preferred stock dividends and discount accretion	(675)	(675)
Net Income Available to Common Shareholders	$ 1,273	$ 665
Basic and diluted net income per common share	$ 0.20	$ 0.10
Weighted average number of basic and diluted shares outstanding	6,255	6,228

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

	Nine months ended September 30,	
	2015	2014
Comprehensive Income (in thousands)	(Unaudited)	
Net Income	$ 4,491	$ 3,938
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	3,729	3,388
Net unrealized gains on all other AFS securities	1,394	8,255
Net unrealized gains/(losses) on HTM securities	225	(2,315)
Net unrealized gains on cash flow hedges	55	137
Net unrealized losses on pension	(2,452)	(650)
Net unrealized gains on SERP	31	1
Other comprehensive income, net of tax	2,982	8,816
Comprehensive income	$ 7,473	$ 12,754

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

	Three months ended September 30,	
	2015	2014
Comprehensive Income (in thousands)	(Unaudited)	

Net Income	$ 1,948	$ 1,340
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	913	346
Net unrealized gains/(losses) on all other AFS securities	727	(87)
Net unrealized gains on HTM securities	64	57
Net unrealized gains on cash flow hedges	20	26
Net unrealized losses on pension	(1,616)	(687)
Net unrealized gains on SERP	10	0
Other comprehensive income/(loss), net of tax	118	(345)
Comprehensive income	$ 2,066	$ 995

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
	(Unaudited)					
Balance at January 1, 2014	$29,994	$ 62	$21,661	$74,379	$ (24,213)	$ 101,883
Net income				5,597		5,597
Other comprehensive income					3,980	3,980
Stock based compensation			134			134
Preferred stock discount accretion	6			(6)		0
Preferred stock dividends paid				(2,595)		(2,595)
Balance at December 31, 2014	30,000	62	21,795	77,375	(20,233)	108,999
Net income				4,491		4,491
Other comprehensive income					2,982	2,982
Stock based compensation		1	144			145
Preferred stock dividends paid				(2,025)		(2,025)
Balance at September 30, 2015	$30,000	$ 63	$21,939	$79,841	$ (17,251)	$ 114,592

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Cash Flows

(In thousands)

	Nine months ended September 30,	
	2015	2014
	(Unaudited)	
Operating activities		
Net income	$4,491	$3,938
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	626	1,629
Depreciation	1,307	1,471
Stock compensation	144	95
(Gain)/loss on sales of other real estate owned	(718)	921
Write-downs of other real estate owned	1,202	885
Gain on loan sales	(40)	(37)
Loss on disposal of fixed assets	2	3
Net amortization of investment securities discounts and premiums- AFS	436	152
Net amortization of investment securities discounts and premiums- HTM	78	19
(Gains)/losses on sales of investment securities – available-for-sale	(62)	7
Gain on sales of investment securities – held for trading	0	(1,100)
Amortization of deferred loan fees	(408)	(363)
Decrease in accrued interest receivable and other assets	2,638	2,229
Decrease/(increase) in deferred tax benefit	377	(4)
Decrease in accrued interest payable and other liabilities	(137)	(5,685)
Earnings on bank owned life insurance	(849)	(737)
Net cash provided by operating activities	9,087	3,423
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	38,713	122,291
Proceeds from maturities/calls of investment securities held-to-maturity	6,348	3,275
Proceeds from sales of investment securities available-for-sale	52,672	56,838
Proceeds from sales of investment securities held for trading	0	1,100
Purchases of investment securities available-for-sale	(47,640)	(153,924)
Purchases of investment securities held-to-maturity	(3,709)	(2,421)
Proceeds from sales of other real estate owned	5,870	5,667
Proceeds from loan sales	4,935	4,312
Proceeds from disposal of fixed assets	6	0
Purchase of BOLI policy	(5,500)	0
Net decrease in FHLB stock	1,620	389
Net increase in loans	(8,967)	(23,782)
Purchases of premises and equipment	(699)	(570)
Net cash provided by investing activities	43,649	13,175

Financing activities		
Net increase/(decrease) in deposits	15,018	(4,370)
Preferred stock dividends paid	(2,025)	(8,420)
Common stock grants	1	0
Net (decrease)/increase in short-term borrowings	(1,341)	4,318
Payments on long-term borrowings	(35,051)	(49)
Net cash used in financing activities	(23,398)	(8,521)
Increase in cash and cash equivalents	29,338	8,077
Cash and cash equivalents at beginning of the year	35,451	43,063
Cash and cash equivalents at end of period	$64,789	$51,140
Supplemental information		
Interest paid	$7,533	$14,995
Non-cash investing activities:		
Transfers from loans to other real estate owned	$899	$2,030
Security sold September 30, settled in October	$0	$618
Transfers from securities available for sale to held-to-maturity	$0	$103,934

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

NoteS to Consolidated Financial Statements (UNAUDITED)

Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of First United Corporation and its consolidated subsidiaries, including First United Bank & Trust (the "Bank"), have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information, as required by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 270, *Interim Reporting*, and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all the information and footnotes required for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring items, have been included. Operating results for the nine- and three-month periods ended September 30, 2015 are not necessarily indicative of the results that may be expected for the full year or for any future interim period. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2014. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2015 presentation. Such reclassifications had no impact on net income or equity.

Subsequent Events –

On October 30, 2015, First United Corporation and its bank subsidiary, First United Bank & Trust (collectively, "First United"), were notified by the Financial Industry Regulatory Authority ("FINRA") that a FINRA arbitration panel had awarded $11.5 million in compensatory damages to First United in a proceeding that First United brought against FTN Financial Securities Corp. ("FTN") and two of its representatives. First United alleged, among other things, that, in recommending and selling certain trust preferred securities to First United, FTN committed fraud, breached its fiduciary duty to First United, breached its contract with First United and violated rules concerning suitability and other regulatory standards. FTN paid the $11.5 million award amount to First United on November 5, 2015.

First United Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of September 30, 2015 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, *Subsequent Events*.

As used in these notes to consolidated financial statements, First United Corporation and its consolidated subsidiaries are sometimes collectively referred to as the "Corporation".

Note 2 – Earnings Per Common Share

Basic earnings per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is derived by dividing net income available to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents.

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The following tables set forth the calculation of basic and diluted earnings per common share for the nine- and three-month periods ended September 30, 2015 and 2014:

	Nine months ended September 30,					
	2015			2014		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$4,491			$3,938		
Preferred stock dividends	(2,025)			(1,919)		
Discount accretion on preferred stock	0			(6)		
Net income available to common shareholders	$2,466	6,247	$ 0.39	$2,013	6,220	$ 0.32

	Three months ended September 30,					
	2015			2014		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$1,948			$1,340		
Preferred stock dividends deferred	(675)			(675)		
Discount accretion on preferred stock	0			0		
Net income available to common shareholders	$1,273	6,255	$ 0.20	$665	6,228	$ 0.10

Note 3 – Net Gains

The following table summarizes the gain/(loss) activity for the nine- and three-month periods ended September 30, 2015 and 2014:

	Nine months ended September 30,		Three months ended September 30,	
(in thousands)	2015	2014	2015	2014
Net gains – other:				
Available-for-sale securities:				
Realized gains	$ 373	$ 427	$ 217	$ 222
Realized losses	(311)	(434)	(138)	(75)
Held-for-trading:				
Realized gains	0	1,100	0	0
Gain on sale of consumer loans	40	37	16	19

Loss on disposal of fixed assets	(2)	(3)	0	0
Net gains – other	$ 100	$ 1,127	$ 95	$ 166

Note 4 – Cash and Cash Equivalents

Cash and due from banks, which represents vault cash in the retail offices and invested cash balances at the Federal Reserve and other correspondent banks, is carried at cost which approximates fair value.

(in thousands)	September 30, 2015	December 31, 2014
Cash and due from banks, weighted average interest rate of 0.10% (at September 30, 2015)	$ 61,406	$ 27,554

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Interest bearing deposits in banks, which represent funds invested at a correspondent bank, are carried at cost which approximates fair value and, as of September 30, 2015 and December 31, 2014, consisted of daily funds invested at the Federal Home Loan Bank ("FHLB") of Atlanta, First Tennessee Bank ("FTN"), and Merchants and Traders ("M&T").

(in thousands)	September 30, 2015	December 31, 2014
FHLB daily investments, interest rate of 0.005% (at September 30, 2015)	$ 1,521	$ 983
FTN daily investments, interest rate of 0.07% (at September 30, 2015)	850	850
M&T daily investments, interest rate of 0.15% (at September 30, 2015)	1,012	6,064
	$ 3,383	$ 7,897

Note 5 – Investments

The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The amortized cost of debt securities classified as available-for-sale is adjusted for the amortization of premiums to the first call date, if applicable, or to maturity, and for the accretion of discounts to maturity, or, in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from investments. Interest and dividends are included in interest income from investments. Gains and losses on the sale of securities are recorded using the specific identification method.

The following table shows a comparison of amortized cost and fair values of investment securities at September 30, 2015 and December 31, 2014:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCI
September 30, 2015					
Available for Sale:					
U.S. government agencies	$ 34,096	$ 125	$ 0	$ 34,221	$ 0
Residential mortgage-backed agencies	14,495	162	163	14,494	0
Commercial mortgage-backed agencies	45,162	669	26	45,805	0
Collateralized mortgage obligations	10,172	92	47	10,217	0
Obligations of states and political subdivisions	48,065	1,081	292	48,854	0
Collateralized debt obligations	35,636	3,631	7,339	31,928	(60)
Total available for sale	$ 187,626	$ 5,760	$ 7,867	$ 185,519	$ (60)
Held to Maturity:					
U.S. government agencies	$ 24,658	$ 784	$ 0	$ 25,442	$ 0
Residential mortgage-backed agencies	54,869	689	83	55,475	0
Commercial mortgage-backed agencies	18,148	565	0	18,713	0
Collateralized mortgage obligations	6,432	0	34	6,398	0
Obligations of states and political subdivisions	2,625	106	0	2,731	0
Total held to maturity	$ 106,732	$ 2,144	$ 117	$ 108,759	$ 0
December 31, 2014					
Available for Sale:					
U.S. treasuries	$ 29,607	$ 0	$ 11	$ 29,596	$ 0
U.S. government agencies	39,077	117	253	38,941	0
Residential mortgage-backed agencies	45,175	510	412	45,273	0
Commercial mortgage-backed agencies	26,007	53	103	25,957	0
Collateralized mortgage obligations	8,611	96	0	8,707	0
Obligations of states and political subdivisions	46,151	1,413	260	47,304	0
Collateralized debt obligations	37,117	1,155	12,933	25,339	6,143
Total available for sale	$ 231,745	$ 3,344	$ 13,972	$ 221,117	$ 6,143
Held to Maturity:					
U.S. government agencies	$ 24,520	$ 514	$ 0	$ 25,034	$ 0
Residential mortgage-backed agencies	58,400	613	5	59,008	0
Commercial mortgage-backed agencies	16,425	312	0	16,737	0
Collateralized mortgage obligations	7,379	5	0	7,384	0
Obligations of states and political subdivisions	2,725	0	117	2,608	0
Total held to maturity	$ 109,449	$ 1,444	$ 122	$ 110,771	$ 0

Proceeds from sales of available for sale securities and the realized gains and losses are as follows:

	Nine months ended September 30,		Three months ended September 30,	
(in thousands)	2015	2014	2015	2014
Proceeds	$ 52,672	$ 56,838	$ 28,005	$ 616
Realized gains	373	1,527	217	222
Realized losses	311	434	138	75

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The following table shows the Corporation's investment securities with gross unrealized losses and fair values at September 30, 2015 and December 31, 2014, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months		12 months or more	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2015				
Available for Sale:				
Residential mortgage-backed agencies	$ 0	$ 0	$ 8,110	$ 163
Commercial mortgage-backed agencies	5,733	26	0	0
Collateralized mortgage obligations	5,560	47	0	0
Obligations of states and political subdivisions	18,168	151	4,320	141
Collateralized debt obligations	0	0	22,976	7,339
Total available for sale	$ 29,461	$ 224	$ 35,406	$ 7,643
Held to Maturity:				
Residential mortgage-backed agencies	$ 7,838	$ 83	$ 0	$ 0
Collateralized mortgage obligations	6,398	34	0	0
Total held to maturity	$ 14,236	$ 117	$ 0	$ 0
December 31, 2014				
Available for Sale:				
U.S. treasuries	$ 27,096	$ 11	$ 0	$ 0
U.S. government agencies	0	$ 0	$ 18,819	$ 253
Residential mortgage-backed agencies	0	0	17,918	412
Commercial mortgage-backed agencies	12,298	97	973	6
Obligations of states and political subdivisions	0	0	8,981	260
Collateralized debt obligations	0	0	20,290	12,933
Total available for sale	$ 39,394	$ 108	$ 66,981	$ 13,864
Held to Maturity:				
Residential mortgage-backed agencies	3,850	5	0	0
Obligations of states and political subdivisions	0	0	2,608	117
Total held to maturity	$ 3,850	$ 5	$ 2,608	$ 117

Management systematically evaluates securities for impairment on a quarterly basis. Management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other-than-temporary impairment ("OTTI") losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets,*(ASC Section 325-40-35). Further discussion about the evaluation of securities for impairment can be found in Item 2 of Part I of this report under the heading "*Investment Securities*".

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of the Corporation's consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for the Corporation's collateralized debt obligation ("CDO") portfolio consisting of pooled trust preferred securities. Based on management's review of the assumptions and results of the third-party review, it believes that the valuations are adequate at September 30, 2015.

U.S. Government Agencies – Available for Sale – There were no U.S. government agencies in an unrealized loss position as of September 30, 2015.

Residential Mortgage-Backed Agencies – Available for Sale - There were no residential mortgage-backed agencies in an unrealized loss position for less than 12 months as of September 30, 2015. There was one residential mortgage-backed agency security in an unrealized loss position for 12 months or more. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2015.

Commercial Mortgage-Backed Agencies – Available for Sale – There were two commercial mortgage-backed agencies in an unrealized loss position for less than 12 months as of September 30, 2015. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2015. There were no commercial mortgage-backed agency securities in an unrealized loss position for 12 months or more.

Collateralized Mortgage Obligations – Available for Sale – There was one collateralized mortgage obligation in an unrealized loss position for less than 12 months as of September 30, 2015. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell it before recovery of its amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2015. There were no collateralized mortgage obligations in an unrealized loss position for 12 months or more.

Obligations of State and Political Subdivisions – Available for Sale – There were 10 obligations of state and political subdivisions that have been in an unrealized loss position for less than 12 months at September 30, 2015. There was one security that has been in an unrealized loss position for 12 months or more. These investments are of investment grade as determined by the major rating agencies and management reviews the ratings of the underlying issuers and performs an in-depth credit analysis on the securities. Management believes that this portfolio is well-diversified throughout the United States, and all bonds continue to perform according to their contractual terms. The Corporation does not intend to sell these investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2015.

Collateralized Debt Obligations – Available for Sale - The $7.3 million in unrealized losses greater than 12 months at September 30, 2015 relates to 12 pooled trust preferred securities that are included in the CDO portfolio. See Note 9 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during the first nine months of 2015. The unrealized losses on the remaining securities in the portfolio are primarily attributable to continued depression in market interest rates, marketability, liquidity and the current economic environment.

U.S. Government Agencies – Held to Maturity – There were no U.S. government agencies in an unrealized loss position as of September 30, 2015.

Residential Mortgage-Backed Agencies – Held to Maturity - Five residential mortgage-backed agencies have been in an unrealized loss position for less than 12 months as of September 30, 2015. The securities are of the highest investment grade and the Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at September 30, 2015. There were no residential mortgage-backed agencies in an unrealized loss position for 12 months or more.

Commercial Mortgage-Backed Agencies – Held to Maturity - There were no commercial mortgage-backed agencies in the Held to Maturity portfolio as of September 30, 2015 in a loss position.

Collateralized Mortgage Obligations – Held to Maturity – There was one collateralized mortgage obligations in an unrealized loss position for less than 12 months as of September 30, 2015. The security is of the highest investment grade and the Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at September 30, 2015. There were no collateralized mortgage obligations in an unrealized loss position for 12 months or more.

Obligations of State and Political Subdivisions – Held to Maturity – There were no obligations of state and political subdivisions in the Held to Maturity portfolio as of September 30, 2015 in a loss position.

The following tables present a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the nine- and three-month periods ended September 30, 2015 and 2014:

	Nine months ended September 30,	
(in thousands)	2015	2014
Balance of credit-related OTTI at January 1	$ 12,583	$ 13,422
Reduction for increases in cash flows expected to be collected	(479)	(501)
Balance of credit-related OTTI at September 30	$ 12,104	$ 12,921

	Three months ended September 30,	
(in thousands)	2015	2014
Balance of credit-related OTTI at July 1	$ 12,243	$ 13,091
Reduction for increases in cash flows expected to be collected	(139)	(170)
Balance of credit-related OTTI at September 30	$ 12,104	$ 12,921

The amortized cost and estimated fair value of securities by contractual maturity at September 30, 2015 are shown in the following table. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2015	
(in thousands)	Amortized Cost	Fair Value
Contractual Maturity		
Available for sale:		
Due after one year through five years	$ 37,604	$ 37,899
Due after five years through ten years	14,765	15,355
Due after ten years	65,428	61,749
	117,797	115,003
Residential mortgage-backed agencies	$ 14,495	$ 14,494
Commercial mortgage-backed agencies	45,162	45,805
Collateralized mortgage obligations	10,172	10,217
	$ 187,626	$ 185,519
Held to Maturity:		
Due after five years through ten years	$ 15,571	$ 16,100
Due after ten years	11,712	12,073
	27,283	28,173
Residential mortgage-backed agencies	$ 54,869	$ 55,475
Commercial mortgage-backed agencies	18,148	18,713
Collateralized mortgage obligations	6,432	6,398

$106,732	$108,759

Note 6 - Restricted Investment in Bank Stock

Restricted stock, which represents required investments in the common stock of the FHLB of Atlanta, Atlantic Community Bankers Bank (“ACBB”) and Community Bankers Bank (“CBB”), is carried at cost and is considered a long-term investment.

Management evaluates the restricted stock for impairment in accordance with ASC Industry Topic 942, *Financial Services – Depository and Lending*-(ASC Section 942-325-35). Management's evaluation of potential impairment is based on management's assessment of the ultimate recoverability of the cost of the restricted stock rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (a) the significance of the decline in net assets of the issuing bank as compared to the capital stock amount for that bank and the length of time this situation has persisted, (b) commitments by the issuing bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of that bank, and (c) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuing bank. Management has evaluated the restricted stock for impairment and believes that no impairment charge is necessary as of September 30, 2015.

The Corporation recognizes dividends received on its restricted stock investments on a cash basis. For the nine months ended September 30, 2015, dividends of $234,445 were recognized in earnings. For the comparable period of 2014, dividends of $212,665 were recognized in earnings. For the three months ended September 30, 2015 and 2014, dividends of $78,777 and $68,329, respectively, were recognized in earnings.

Note 7 – Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio as of September 30, 2015 and December 31, 2014:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
September 30, 2015						
Individually evaluated for impairment	$ 12,484	$ 5,690	$ 1,031	$ 4,820	$ 0	$ 24,025
Collectively evaluated for impairment	$ 253,449	$ 93,066	$ 73,749	$ 374,127	$ 24,676	$ 819,067
Total loans	$ 265,933	$ 98,756	$ 74,780	$ 378,947	$ 24,676	$ 843,092
December 31, 2014						
Individually evaluated for impairment	$ 11,949	$ 6,553	$ 1,861	$ 4,418	$ 0	$ 24,781
Collectively evaluated for impairment	$ 244,115	$ 92,748	$ 91,394	$ 363,223	$ 23,730	$ 815,210
Total loans	$ 256,064	$ 99,301	$ 93,255	$ 367,641	$ 23,730	$ 839,991

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate ("CRE") loan segment is then segregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied, non-farm, and nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The acquisition and development ("A&D") loan segment is segregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. A&D loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan is made. The commercial and industrial ("C&I") loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is segregated into two classes. Amortizing term loans are primarily first lien loans. Home equity lines of credit are generally second lien loans. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

Management uses a 10-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a substandard classification. Loans in the substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of a specific allocation of the allowance for loan losses that management believes is associated with a pending event that could trigger loss in the short-term will be classified in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in the commercial segments at origination and on an ongoing basis. The Bank's experienced Credit Quality and Loan Review Department performs an annual review of all commercial relationships of $500,000 or greater. Confirmation of the appropriate risk grade is included as part of the review process on an ongoing basis. The Credit Quality and Loan Review Department continually reviews and assesses loans within the portfolio. In addition, the Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than $1,000,000 and/or criticized non-consumer loans greater than $500,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard within the internal risk rating system as of September 30, 2015 and December 31, 2014:

(in thousands)	Pass	Special Mention	Substandard	Total
September 30, 2015				
Commercial real estate				
Non owner-occupied	$125,412	$ 11,669	$ 10,462	$147,543
All other CRE	99,712	565	18,113	118,390
Acquisition and development				
1-4 family residential construction	15,752	0	700	16,452
All other A&D	75,595	76	6,633	82,304
Commercial and industrial	71,292	252	3,236	74,780
Residential mortgage				
Residential mortgage - term	291,679	238	10,350	302,267
Residential mortgage - home equity	74,901	49	1,730	76,680
Consumer	24,659	0	17	24,676
Total	$779,002	$ 12,849	$ 51,241	$843,092
December 31, 2014				
Commercial real estate				
Non owner-occupied	$115,276	$ 10,884	$ 11,273	$137,433
All other CRE	90,740	8,618	19,273	118,631
Acquisition and development				
1-4 family residential construction	12,920	0	790	13,710
All other A&D	72,323	1,356	11,912	85,591
Commercial and industrial	88,579	884	3,792	93,255
Residential mortgage				
Residential mortgage - term	280,113	379	10,934	291,426

Residential mortgage - home equity	74,698	90	1,427	76,215
Consumer	23,658	0	72	23,730
Total	$758,307	$ 22,211	$ 59,473	$839,991

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Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment remains unpaid 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans as of September 30, 2015 and December 31, 2014:

(in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and Accruing	Non-Accrual	Total Loans
September 30, 2015							
Commercial real estate							
Non owner-occupied	$145,975	$ 69	$ 0	$ 0	$ 69	$ 1,499	$ 147,543
All other CRE	112,969	179	187	148	514	4,907	118,390
Acquisition and development							
1-4 family residential construction	16,452	0	0	0	0	0	16,452
All other A&D	79,110	0	252	0	252	2,942	82,304
Commercial and industrial	74,532	79	0	0	79	169	74,780
Residential mortgage							
Residential mortgage - term	297,653	438	1,638	509	2,585	2,029	302,267
Residential mortgage - home equity	75,374	798	278	0	1,076	230	76,680
Consumer	24,446	178	52	0	230	0	24,676
Total	$826,511	$ 1,741	$ 2,407	$ 657	$ 4,805	$ 11,776	$ 843,092
December 31, 2014							
Commercial real estate							
Non owner-occupied	$135,994	$ 104	$ 183	$ 0	$ 287	$ 1,152	$ 137,433
All other CRE	112,825	1,196	0	0	1,196	4,610	118,631
Acquisition and development							
1-4 family residential construction	13,710	0	0	0	0	0	13,710
All other A&D	81,702	239	40	1	280	3,609	85,591
Commercial and industrial	93,060	0	20	4	24	171	93,255
Residential mortgage							
Residential mortgage - term	279,340	8,654	1,350	416	10,420	1,666	291,426

Residential mortgage - home equity	74,913	577	313	69	959	343	76,215
Consumer	23,316	287	88	39	414	0	23,730
Total	$814,860	$ 11,057	$ 1,994	$ 529	$ 13,580	$ 11,551	$ 839,991

Non-accrual loans which have been subject to a partial charge-off totaled $5.1 million at September 30, 2015, compared to $4.6 million at December 31, 2014. Loans secured by 1-4 family residential real estate properties in the process of foreclosure were $2.4 million at September 30, 2015 and $1.9 million at December 31, 2014.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the allocated portion of the Bank's ALL. In the second quarter of 2015, management determined that it would be prudent to establish an unallocated portion of the ALL to protect the Bank from other risks associated with the loan portfolio that may not be specifically identifiable.

The following table summarizes the primary segments of the ALL, as of September 30, 2015 and December 31, 2014 segregated by the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
September 30, 2015							
Individually evaluated for impairment	$ 29	$ 1,607	$ 0	$ 84	$ 0	$ 0	$1,720
Collectively evaluated for impairment	$ 2,552	$ 2,881	$ 734	$ 3,608	$ 216	$ 500	$10,491
Total ALL	$ 2,581	$ 4,488	$ 734	$ 3,692	$ 216	$ 500	$12,211
December 31, 2014							
Individually evaluated for impairment	$ 36	$ 1,141	$ 0	$ 59	$ 0	$ 0	$1,236
Collectively evaluated for impairment	$ 2,388	$ 2,771	$ 1,680	$ 3,803	$ 187	$ 0	$10,829
Total ALL	$ 2,424	$ 3,912	$ 1,680	$ 3,862	$ 187	$ 0	$12,065

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan (a) is greater than $500,000 or (b) is part of a relationship that is greater than $750,000 and is either (i) in nonaccrual status or (ii) risk-rated Substandard and greater than 60 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Bank does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired; otherwise, loans in these segments are considered impaired when they are classified as non-accrual.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. If the fair value of the collateral less selling costs method is utilized for collateral securing loans in the commercial segments, then an updated external appraisal is ordered on the collateral supporting the loan if the loan balance is greater than $500,000 and the existing appraisal is greater than 18 months old. If an updated appraisal has not been received and reviewed in time for the determination of estimated fair value at quarter (or year) end, or if the appraisal is found to be deficient following the Corporation's internal appraisal review process and re-ordered, then the estimated fair value of the collateral is determined by adjusting the existing appraisal by the appropriate percentage from an internally prepared appraisal discount grid. This grid considers the age of a third party appraisal and the geographic region where the collateral is located. The discount rates in the appraisal discount grid are updated periodically to reflect the most current knowledge that management has available, including the results of current appraisals. A specific allocation of the ALL is recorded if there is any deficiency in collateral value determined by comparing the estimated fair value to the recorded investment of the loan. When updated appraisals are received and reviewed, adjustments are made to the specific allocation as needed.

The evaluation of the need and amount of a specific allocation of the ALL and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of September 30, 2015 and December 31, 2014:

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
(in thousands)	Recorded Investment	Related Allowances	Recorded Investment	Recorded Investment	Unpaid Principal Balance
September 30, 2015					
Commercial real estate					
Non owner-occupied	$ 137	$ 29	$ 4,445	$ 4,582	$ 4,592
All other CRE	0	0	7,902	7,902	8,401
Acquisition and development					
1-4 family residential construction	700	68	0	700	746
All other A&D	4,419	1,539	571	4,990	8,756
Commercial and industrial	0	0	1,031	1,031	3,298
Residential mortgage					
Residential mortgage - term	298	84	4,245	4,543	4,967
Residential mortgage – home equity	0	0	277	277	298
Consumer	0	0	0	0	0
Total impaired loans	$ 5,554	$ 1,720	$ 18,471	$ 24,025	$ 31,058
December 31, 2014					
Commercial real estate					
Non owner-occupied	$ 143	$ 35	$ 4,353	$ 4,496	$ 4,543
All other CRE	0	0	7,453	7,453	7,944
Acquisition and development					
1-4 family residential construction	790	105	0	790	836
All other A&D	3,615	1,037	2,148	5,763	9,590
Commercial and industrial	0	0	1,861	1,861	2,723
Residential mortgage					
Residential mortgage - term	296	59	3,779	4,075	4,485
Residential mortgage – home equity	0	0	343	343	363
Consumer	0	0	0	0	0
Total impaired loans	$ 4,844	$ 1,236	$ 19,937	$ 24,781	$ 30,484

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity (full and partial charge-offs, net of full and partial recoveries) at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. Consumer pools currently utilize a rolling 12 quarters, while Commercial pools currently utilize a rolling eight quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. “Pass” pools for commercial and residential real estate are further segmented based upon the geographic location of the underlying collateral. There are seven geographic regions utilized – six that represent the Bank’s lending footprint and a seventh for all out-of-market credits. Different economic environments and resultant credit risks exist in each region that are acknowledged in the assignment of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Management supplements the historical charge-off factor with a number of additional qualitative factors that are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors, which are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources, are: (a) national and local economic trends and conditions; (b) levels of and trends in delinquency rates and non-accrual loans; (c) trends in volumes and terms of loans; (d) effects of changes in lending policies; (e) experience, ability, and depth of lending staff; (f) value of underlying collateral; and (g) concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Residential mortgage and consumer loans are charged off after they are 120 days contractually past due. All other loans are charged off based on an evaluation of the facts and circumstances of each individual loan. When the Bank believes that its ability to collect is solely dependent on the liquidation of the collateral, a full or partial charge-off is recorded promptly to bring the recorded investment to an amount that the Bank believes is supported by an ability to collect on the collateral. The circumstances that may impact the Bank’s decision to charge-off all or a portion of a loan include default or non-payment by the borrower, scheduled foreclosure actions, and/or prioritization of the Bank’s claim in bankruptcy. There may be circumstances where, due to pending events, the Bank will place a specific allocation of the ALL on a loan for which a partial charge-off has been previously recognized. This specific allocation may be either charged off or removed depending upon the outcome of the pending event. Full or partial charge-offs are not recovered until full principal and interest on the loan have been collected, even if a subsequent appraisal supports a higher value. Loans with partial charge-offs generally remain in non-accrual status. Both full and partial charge-offs reduce the recorded investment of the loan and the ALL and are considered to be charge-offs for purposes of all credit loss metrics and trends, including the historical rolling charge-off rates used in the determination of the ALL. At September 30, 2015, $.5 million of the ALL was considered to be unallocated.

The following tables present the activity in the ALL for the nine- and three-month periods ended September 30, 2015 and 2014:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at January 1, 2015	$ 2,424	$ 3,912	$ 1,680	$ 3,862	$ 187	$ 0	$ 12,065
Charge-offs	(295)	(256)	0	(200)	(247)	0	(998)
Recoveries	66	100	24	162	166	0	518
Provision	386	732	(970)	(132)	110	500	626
ALL balance at September 30, 2015	$ 2,581	$ 4,488	$ 734	$ 3,692	$ 216	$ 500	$ 12,211
ALL balance at January 1, 2014	$ 4,052	$ 4,172	$ 766	$ 4,320	$ 284	$ 0	$ 13,594
Charge-offs	(85)	(2,423)	(213)	(682)	(380)	0	(3,783)
Recoveries	11	104	22	183	308	0	628
Provision	(1,386)	1,857	1,016	158	(16)	0	1,629
ALL balance at September 30, 2014	$ 2,592	$ 3,710	$ 1,591	$ 3,979	$ 196	$ 0	$ 12,068

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at July 1, 2015	$ 2,566	$ 3,806	$ 1,007	$ 3,707	$ 223	$ 500	$ 11,809
Charge-offs	(8)	0	0	(164)	(73)	0	(245)
Recoveries	1	59	4	29	54	0	147
Provision	22	623	(277)	120	12	0	500
ALL balance at September 30, 2015	$ 2,581	$ 4,488	$ 734	$ 3,692	$ 216	$ 500	$ 12,211
ALL balance at July 1, 2014	$ 2,839	$ 3,642	$ 1,553	$ 4,178	$ 251	$ 0	$ 12,463
Charge-offs	(64)	(903)	(5)	(116)	(117)	0	(1,205)
Recoveries	1	33	15	27	46	0	122
Provision	(184)	938	28	(110)	16	0	688
ALL balance at September 30, 2014	$ 2,592	$ 3,710	$ 1,591	$ 3,979	$ 196	$ 0	$ 12,068

The ALL is based on estimates, and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following tables present the average recorded investment in impaired loans by class and related interest income recognized for the periods indicated:

(in thousands)	Nine months ended September 30, 2015 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Nine months ended September 30, 2014 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$4,314	$ 117	$ 0	$1,890	$ 28	$ 0
All other CRE	7,626	89	8	9,497	116	67
Acquisition and development						
1-4 family residential construction	745	26	0	1,690	34	0
All other A&D	5,311	94	0	8,108	129	0
Commercial and industrial	1,471	60	18	2,065	70	2
Residential mortgage						
Residential mortgage - term	4,245	124	4	6,552	154	55
Residential mortgage – home equity	349	0	2	640	4	4
Consumer	7	0	0	11	0	0
Total	$24,068	$ 510	$ 32	$30,453	$ 535	$ 128

(in thousands)	Three months ended September 30, 2015 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Three months ended September 30, 2014 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$4,607	$ 39	$ 0	$2,591	$ 17	$ 0
All other CRE	7,935	34	0	8,506	35	23
Acquisition and development						
1-4 family residential construction	701	8	0	1,016	9	0
All other A&D	5,091	31	0	7,540	33	0
Commercial and industrial	1,253	13	0	1,905	21	0
Residential mortgage						
Residential mortgage - term	4,400	42	2	6,225	47	3
Residential mortgage – home equity	321	0	0	597	0	3
Consumer	0	0	0	0	0	0
Total	$24,308	$ 167	$ 2	$28,380	$ 162	$ 29

In the normal course of business, the Bank modifies loan terms for various reasons. These reasons may include as a retention strategy, remaining competitive in the current interest rate environment, and re-amortizing or extending a loan term to better match the loan's payment stream with the borrower's cash flows. A modified loan is considered to be a troubled debt restructuring ("TDR") when the Bank has determined that the borrower is troubled (i.e., experiencing financial difficulties). The Bank evaluates the probability that the borrower will be in payment default on any of its debt obligations in the foreseeable future without modification. To make this determination, the Bank performs a global financial review of the borrower and loan guarantors to assess their current ability to meet their financial obligations.

When the Bank restructures a loan to a troubled borrower, the loan terms (i.e., interest rate, payment amount, amortization period, and/or maturity date) are modified in such a way as to enable the borrower to cover the modified debt service payments based on current financials and cash flow adequacy. If a borrower's hardship is thought to be temporary, then modified terms are only offered for that time period. Where possible, the Bank obtains additional collateral and/or secondary payment sources at the time of the restructure in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. To date, the Bank has not forgiven any principal as a restructuring concession. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default.

All loans designated as TDRs are considered impaired loans and may be in either accruing or non-accruing status. The Bank's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition. Accordingly, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. If the loan was accruing at the time of the modification, then it continues to be in accruing status subsequent to the modification. Non-accrual TDRs may return to accruing status when there has been sufficient payment performance for a period of at least six months. TDRs are considered to be in payment default if, subsequent to modification, the loans are transferred to non-accrual status or to foreclosure. Loans may be removed from being reported as a TDR in the calendar year following the modification if the interest rate at the time of modification was consistent with the interest rate for a loan with comparable credit risk and the loan has performed according to its modified terms for at least six months.

The volume and type of TDR activity is considered in the assessment of the local economic trends' qualitative factor used in the determination of the ALL for loans that are evaluated collectively for impairment.

The following tables present the volume and recorded investment at the time of modification of TDRs by class and type of modification that occurred during the periods indicated:

(in thousands)	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Nine months ended September 30, 2015						
Commercial real estate						
Non owner-occupied	0	$ 0	1	$ 3,097	1	$ 136
All other CRE	0	0	1	237	5	3,847
Acquisition and development						
1-4 family residential construction	0	0	0	0	1	700
All other A&D	0	0	3	372	1	1,746
Commercial and industrial	0	0	1	930	0	0
Residential mortgage						
Residential mortgage – term	1	156	2	599	1	116
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	1	$ 156	8	$ 5,235	9	$ 6,545

(in thousands)	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Three months ended September 30, 2015						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	0	$ 0
All other CRE	0	0	0	0	0	0
Acquisition and development						
1-4 family residential construction	0	0	0	0	1	700
All other A&D	0	0	0	0	1	1,746
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	1	156	0	0	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	1	$ 156	0	$ 0	2	$ 2,446

During the nine months ended September 30, 2015, there were eight new TDRs. In addition, 10 existing TDRs which had reached their original modification maturity were re-modified. A $5,744 reduction of the ALL resulted from a change to the impairment evaluation of two loans from evaluated collectively to being evaluated individually. The remaining six new TDRs were impaired at the time of modification, resulting in no impact to the ALL as a result of the modifications and there was no impact to the recorded investment relating to the transfer of these loans.

During the quarter ended June 30, 2015, one residential mortgage loan totaling $70,000 that was modified as a TDR within the previous 12 months was transferred to non-accrual, and is considered a payment default. There were no payment defaults in the quarters ended September 30, 2015 or March 31, 2015.

(in thousands)	Temporary Rate Modification Number of Contracts	Temporary Rate Modification Recorded Investment	Extension of Maturity Number of Contracts	Extension of Maturity Recorded Investment	Modification of Payment and Other Terms Number of Contracts	Modification of Payment and Other Terms Recorded Investment
Nine Months Ended September 30,						
2014						
Commercial real estate						
Non owner-occupied	0	$ 0	2	$ 277	0	$ 0
All other CRE	0	0	0	0	4	2,627
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	0	0	0	0
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	1	90	0	0	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	1	$ 90	2	$ 277	4	$ 2,627

(in thousands)	Temporary Rate Modification Number of Contracts	Temporary Rate Modification Recorded Investment	Extension of Maturity Number of Contracts	Extension of Maturity Recorded Investment	Modification of Payment and Other Terms Number of Contracts	Modification of Payment and Other Terms Recorded Investment
Three Months Ended September 30, 2014						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	0	$ 0
All other CRE	0	0	0	0	0	0
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	0	0	0	0
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	0	0	0	0	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	0	$ 0	0	$ 0

During the nine months ended September 30, 2014, there were two new TDRs. In addition, five existing TDRs which had reached their original modification maturity were re-modified. A $1,055 reduction of the ALL resulted from a change to the impairment evaluation of one loan, from evaluated collectively to being evaluated individually. The remaining new TDR was impaired at the time of modification, resulting in no impact to the ALL as a result of the modifications and there was no impact to the recorded investment relating to the transfer of these loans.

During the nine months ended September 30, 2014, three A&D loans totaling $1.7 million, a $.2 million C&I loan and a $.4 million owner-occupied CRE loan that were modified as TDRs within the previous 12 months were transferred to non-accrual, and are considered payment defaults.

Note 8 - Other Real Estate Owned

The following table presents the components of Other Real Estate Owned (“OREO”) at September 30, 2015 and December 31, 2014:

(in thousands)	September 30, 2015	December 31, 2014
Commercial real estate	$ 1,728	$ 1,772
Acquisition and development	4,746	9,263
Residential mortgage	1,003	1,897
Total OREO	$ 7,477	$ 12,932

The following table presents the activity in the OREO valuation allowance for the nine- and three-month periods ended September 30, 2015 and 2014:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Balance beginning of period	$ 3,440	$ 4,047	$ 3,843	$ 3,742
Fair value write-down	1,202	885	350	442
Sales of OREO	(831)	(1,155)	(382)	(407)
Balance at end of period	$ 3,811	$ 3,777	$ 3,811	$ 3,777

The following table presents the components of OREO expenses, net, for the nine- and three-month periods ended September 30, 2015 and 2014:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
(Gains)/losses on real estate, net	$ (718)	$ 921	$ (640)	$ (49)
Fair value write-down, net	1,202	885	350	442
Expenses, net	704	594	248	237
Rental and other income	(212)	(272)	(29)	(116)
Total OREO expense/(income), net	$ 976	$ 2,128	$ (71)	$ 514

Note 9 – Fair Value of Financial Instruments

The Corporation complies with the guidance of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. The Corporation also follows the guidance on matters relating to all financial instruments found in ASC Subtopic 825-10, *Financial Instruments – Overall*.

Fair value is defined as the price to sell an asset or to transfer a liability in an orderly transaction between willing market participants as of the measurement date. Fair value is best determined by values quoted through active trading markets. Active trading markets are characterized by numerous transactions of similar financial instruments between willing buyers and willing sellers. Because no active trading market exists for various types of financial instruments, many of the fair values disclosed were derived using present value discounted cash flows or other valuation techniques described below. As a result, the Corporation's ability to actually realize these derived values cannot be assumed.

The Corporation measures fair values based on the fair value hierarchy established in ASC Paragraph 820-10-35-37. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of inputs that may be used to measure fair value under the hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities. This level is the most reliable source of valuation.

Level 2: Quoted prices that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability. Level 2 inputs include inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates). It also includes inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs). Several sources are utilized for valuing these assets, including a contracted valuation service, Standard & Poor's ("S&P") evaluations and pricing services, and other valuation matrices.

Level 3: Prices or valuation techniques that require inputs that are both significant to the valuation assumptions and not readily observable in the market (i.e. supported with little or no market activity). Level 3 instruments are valued based on the best available data, some of which is internally developed, and consider risk premiums that a market participant would require.

The level established within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Transfers in and out of Level 1, 2 or 3 are recorded at fair value at the beginning of the reporting period.

Management believes that the Corporation's valuation techniques are appropriate and consistent with the techniques used by other market participants. However, the use of different methodologies and assumptions could result in a different estimate of fair values at the reporting date. The valuation techniques used by the Corporation to measure, on a recurring and non-recurring basis, the fair value of assets as of September 30, 2015 are discussed in the paragraphs that follow.

Investments – The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The fair value of investments is determined using a market approach. As of September 30, 2015, the U.S. Government agencies, residential and commercial mortgage-backed securities, collateralized mortgage obligations, and state and political subdivisions bonds segments are classified as Level 2 within the valuation hierarchy. Their fair values were determined based upon market-corroborated inputs and valuation matrices, which were obtained through third party data service providers or securities brokers through which the Corporation has historically transacted both purchases and sales of investment securities.

The CDO segment, which consists of pooled trust preferred securities issued by banks, thrifts and insurance companies, is classified as Level 3 within the valuation hierarchy. At September 30, 2015, the Corporation owned 16 pooled trust preferred securities with an amortized cost of $35.6 million and a fair value of $31.9 million. The market for these securities at September 30, 2015 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as few CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities or any securities other than those issued or guaranteed by the U.S. Department of the Treasury (the “Treasury”) are depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (a) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at September 30, 2015, (b) an income valuation approach technique (i.e. present value) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than a market approach, and (c) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management relies on an independent third party to prepare both the evaluations of OTTI as well as the fair value determinations for its CDO portfolio. Management believes that the valuations are adequately reflected at September 30, 2015.

The approach used by the third party to determine fair value involves several steps, including detailed credit and structural evaluation of each piece of collateral in each bond, default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

Derivative financial instruments (Cash flow hedge) – The Corporation’s open derivative positions are interest rate swaps that are classified as Level 3 within the valuation hierarchy. Open derivative positions are valued using externally developed pricing models based on observable market inputs provided by a third party and validated by management. The Corporation has considered counterparty credit risk in the valuation of its interest rate swap assets.

Impaired loans – Loans included in the table below are those that are considered impaired with a specific allocation or with a partial charge-off, based upon the guidance of the loan impairment subsection of the *Receivables* Topic, ASC Section 310-10-35, under which the Corporation has measured impairment generally based on the fair value of the loan’s collateral. Fair value consists of the loan balance less its valuation allowance and is generally determined based on independent third-party appraisals of the collateral or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values based upon the lowest level of input that is significant to the fair value measurements.

Other real estate owned – OREO included in the table below are considered impaired with specific write-downs. Fair value of other real estate owned is based on independent third-party appraisals of the properties. These values were determined based on the sales prices of similar properties in the approximate geographic area. These assets are included as Level 3 fair values based upon the lowest level of input that is significant to the fair value measurements.

For Level 3 assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2015 and December 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

(in thousands)	**Fair Value at September 30, 2015**	Valuation Technique	**Significant Unobservable Inputs**	**Significant Unobservable Input Value**
Recurring:				
Investment Securities – available for sale	$ 31,928	Discounted Cash Flow	Discount Rate	Range of Libor+ 5.50% to 9.50%
Cash Flow Hedge	$ (107)	Discounted Cash Flow	Reuters Third Party Market Quote	99.9% (weighted avg 99.9%)
Non-recurring:				
Impaired Loans	$ 5,985	Market Comparable Properties	Marketability Discount	3% -15% (1) (weighted avg 11.6%)
Other Real Estate Owned	$ 2,278	Market Comparable Properties	Marketability Discount	10.0% -15.0% (1) (weighted avg 12.3%)

(in thousands)	**Fair Value at December 31, 2014**	Valuation Technique	**Significant Unobservable Inputs**	**Significant Unobservable Input Value**
Recurring:				
Investment Securities – available for sale	$ 25,339	Discounted Cash Flow	Discount Rate	Range of Libor+ 5% to 12%
Cash Flow Hedge	$ (199)	Discounted Cash Flow	Reuters Third Party Market Quote	99.9% (weighted avg 99.9%)
Non-recurring:				
Impaired Loans	$ 9,122	Market Comparable Properties	Marketability Discount	10% (1) (weighted avg 10%)
Other Real Estate Owned	$ 2,511	Market Comparable Properties	Marketability Discount	10% -15% (1) (weighted avg 11%)

NOTE:

(1) Range would include discounts taken since appraisal and estimated values

For assets measured at fair value on a recurring and non-recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2015 and December 31, 2014 are as follows:

		Fair Value Measurements at September 30, 2015 Using		
	Assets Measured at Fair Value	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
(in thousands)	9/30/2015	(Level 1)	(Level 2)	(Level 3)
Recurring:				
Investment securities available-for-sale:				
U.S. government agencies	$ 34,221		$ 34,221	
Residential mortgage-backed agencies	$ 14,494		$ 14,494	
Commercial mortgage-backed agencies	$ 45,805		$ 45,805	
Collateralized mortgage obligations	$ 10,217		$ 10,217	
Obligations of states and political subdivisions	$ 48,854		$ 48,854	
Collateralized debt obligations	$ 31,928			$ 31,928
Financial Derivative	$ (107)			$ (107)
Non-recurring:				
Impaired loans	$ 5,985			$ 5,985
Other real estate owned	$ 2,278			$ 2,278

		Fair Value Measurements at December 31, 2014 Using		
	Assets Measured at Fair Value	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
(in thousands)	12/31/2014	(Level 1)	(Level 2)	(Level 3)
Recurring:				
Investment securities available-for-sale:				
U.S. treasuries	$ 29,596		$ 29,596	
U.S. government agencies	$ 38,941		$ 38,941	
Residential mortgage-backed agencies	$ 45,273		$ 45,273	
Commercial mortgage-backed agencies	$ 25,957		$ 25,957	
Collateralized mortgage obligations	$ 8,707		$ 8,707	
Obligations of states and political subdivisions	$ 47,304		$ 47,304	
Collateralized debt obligations	$ 25,339			$ 25,339

Financial Derivative	$ (199)	$ (199)
Non-recurring:		
Impaired loans	$ 9,122	$ 9,122
Other real estate owned	$ 2,511	$ 2,511

There were no transfers of assets between any of the fair value hierarchy for the nine-month periods ended September 30, 2015 and 2014.

The following tables show a reconciliation of the beginning and ending balances for fair valued assets measured on a recurring basis using Level 3 significant unobservable inputs for the nine- and three-month periods ended September 30, 2015 and 2014:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
(In thousands)	Investment Securities Available for Sale	Cash Flow Hedge
Beginning balance January 1, 2015	$ 25,339	$ (199)
Total gains realized/unrealized:		
Included in other comprehensive income	6,589	92
Ending balance September 30, 2015	$ 31,928	$ (107)

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
(in thousands)	Investment Securities Available for Sale	Cash Flow Hedge
Beginning balance January 1, 2014	$ 17,538	$ (457)
Total gains realized/unrealized:		
Included in other comprehensive income	6,868	229
Ending balance September 30, 2014	$ 24,406	$ (228)

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)	
(in thousands)	Investment Securities Available for Sale	Cash Flow Hedge
Beginning balance July 1, 2015	$ 30,046	$ (140)
Total gains realized/unrealized:		
Included in other comprehensive income	1,882	33
Ending balance September 30, 2015	$ 31,928	$ (107)

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)	
(in thousands)	Investment Securities Available for Sale	Cash Flow Hedge
Beginning balance July 1, 2014	$ 23,921	$ (272)
Total gains realized/unrealized:		
Included in other comprehensive income	485	44
Ending balance September 30, 2014	$ 24,406	$ (228)

Gains (realized and unrealized) included in earnings for the periods identified above are reported in the Consolidated Statement of Operations in Other Operating Income. There were no gains or losses included in earnings attributable to the change in realized/unrealized gains or losses related to the assets for the nine- and three- months ended September 30, 2015 and 2014.

The disclosed fair values may vary significantly between institutions based on the estimates and assumptions used in the various valuation methodologies. The derived fair values are subjective in nature and involve uncertainties and significant judgment. Therefore, they cannot be determined with precision. Changes in the assumptions could significantly impact the derived estimates of fair value. Disclosure of non-financial assets such as buildings as well as certain financial instruments such as leases is not required. Accordingly, the aggregate fair values presented do not represent the underlying value of the Corporation.

The following methods and assumptions were used by the Corporation to estimate its fair value disclosures for financial instruments:

Cash and due from banks: The carrying amounts as reported in the statement of financial condition for cash and due from banks approximate their fair values.

Interest bearing deposits in banks: The carrying amount of interest bearing deposits approximates their fair values.

Securities held to maturity: Investments in debt securities classified as held to maturity are measured subsequently at amortized cost in the statement of financial position.

Restricted investment in bank stock: The carrying value of stock issued by the FHLB of Atlanta, ACBB and CBB approximates fair value based on the redemption provisions of the stock.

Loans (excluding impaired loans with specific loss allowances): For variable-rate loans that re-price frequently or "in one year or less", and with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate loans that do not re-price frequently are estimated using a discounted cash flow calculation that applies current market interest rates being offered on the various loan products.

Deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts, etc.) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on the various certificates of deposit to the cash flow stream.

Borrowed funds: The fair value of the Bank's FHLB borrowings and junior subordinated debt is calculated based on the discounted value of contractual cash flows, using rates currently existing for borrowings with similar remaining maturities. The carrying amounts of federal funds purchased and securities sold under agreements to repurchase approximate their fair values.

Accrued interest: The carrying amount of accrued interest receivable and payable approximates their fair values.

Off-balance-sheet financial instruments: In the normal course of business, the Bank makes commitments to extend credit and issues standby letters of credit. The Bank expects most of these commitments to expire without being drawn upon; therefore, the commitment amounts do not necessarily represent future cash requirements. Due to the uncertainty of cash flows and difficulty in the predicting the timing of such cash flows, fair values were not estimated for these instruments.

The following tables present fair value information about financial instruments, whether or not recognized in the Consolidated Statement of Financial Condition, for which it is practicable to estimate that value. The actual carrying amounts and estimated fair values of the Corporation's financial instruments that are included in the Consolidated Statement of Financial Condition are as follows:

	September 30, 2015		Fair Value Measurements		
	Carrying	Fair	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(in thousands)	Amount	Value	(Level 1)	(Level 2)	(Level 3)
Financial Assets:					
Cash and due from banks	$61,406	$61,406	$61,406		
Interest bearing deposits in banks	3,383	3,383	3,383		
Investment securities - AFS	185,519	185,519		$ 153,591	$ 31,928
Investment securities - HTM	106,732	108,759		106,134	2,625
Restricted bank stock	5,904	5,904		5,904	
Loans, net	830,881	835,132			835,132
Accrued interest receivable	3,709	3,709		3,709	
Financial Liabilities:					
Deposits – non-maturity	730,899	730,899		730,899	
Deposits – time deposits	265,442	269,464		269,464	
Short-term borrowed funds	38,460	38,460		38,460	
Long-term borrowed funds	147,555	150,565		150,565	
Accrued interest payable	622	622		622	
Financial derivative	107	107			107
Off balance sheet financial instruments	0	0	0		

	December 31, 2014		Fair Value Measurements		
	Carrying	Fair	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(in thousands)	Amount	Value	(Level 1)	(Level 2)	(Level 3)
Financial Assets:					
Cash and due from banks	$27,554	$27,554	$27,554		
Interest bearing deposits in banks	7,897	7,897	7,897		
Investment securities - AFS	221,117	221,117		$ 195,778	$ 25,339
Investment securities - HTM	109,449	110,771		108,163	2,608
Restricted bank stock	7,524	7,524		7,524	
Loans, net	827,926	830,904			830,904
Accrued interest receivable	4,152	4,152		4,152	
Financial Liabilities:					
Deposits- non-maturity	689,581	689,581		689,581	
Deposits- time deposits	291,742	296,713		296,713	
Short-term borrowed funds	39,801	39,801		39,801	
Long-term borrowed funds	182,606	187,143		187,143	
Accrued interest payable	882	882		882	
Financial derivative	199	199			199
Off balance sheet financial instruments	0	0	0		

Loans are measured using a discounted cash flow method. The significant unobservable inputs used in the Level 3 fair value measurements of the Corporation's loans included in the tables above are calculated based on the Corporation's internal new volume rate.

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Note 10 – Accumulated Other Comprehensive Loss

The following table presents the changes in each component of accumulated other comprehensive loss for the 12 months ended December 31, 2014 and the three-month periods ended March 31, 2015, June 30, 2015 and September 30, 2015:

(in thousands)	Investment securities- with OTTI AFS	Investment securities- all other AFS	Investment securities- HTM	Cash Flow Hedge	Pension Plan	SERP	Total
Accumulated OCL, net:							
Balance - January 1, 2014	$ (7,623)	$ (11,292)	$ 0	$ (274)	$ (5,088)	$ 64	$ (24,213)
Other comprehensive income/(loss) before reclassifications	4,349	8,712	(2,395)	155	(6,513)	(319)	3,989
Amounts reclassified from accumulated other comprehensive loss	(405)	25	140	0	209	22	(9)
Balance - December 31, 2014	$ (3,679)	$ (2,555)	$ (2,255)	$ (119)	$ (11,392)	$ (233)	$ (20,233)
Other comprehensive income/(loss) before reclassifications	1,670	621	0	21	(202)	0	2,110
Amounts reclassified from accumulated other comprehensive loss	(100)	58	70	0	112	10	150
Balance – March 31, 2015	$ (2,109)	$ (1,876)	$ (2,185)	$ (98)	$ (11,482)	$ (223)	$ (17,973)
Other comprehensive income/(loss) before reclassifications	1,350	36	0	14	(856)	0	544
Amounts reclassified from accumulated other comprehensive loss	(104)	(48)	91	0	110	11	60
Balance – June 30, 2015	$ (863)	$ (1,888)	$ (2,094)	$ (84)	$ (12,228)	$ (212)	$ (17,369)
Other comprehensive income/(loss) before reclassifications	997	700	0	20	(1,737)	0	(20)
Amounts reclassified from accumulated other comprehensive loss	(84)	27	64	0	121	10	138
Balance - September 30,2015	$ 50	$ (1,161)	$ (2,030)	$ (64)	$ (13,844)	$ (202)	$ (17,251)

The following tables present the components of comprehensive income for the nine- and three-month periods ended September 30, 2015 and 2014:

Components of Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the nine months ended September 30, 2015			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 6,682	$ (2,665)	$4,017
Less: accretable yield recognized in income	479	(191)	288
Net unrealized gains on investments with OTTI	6,203	(2,474)	3,729
Available for sale securities – all other:			
Unrealized holding gains	2,380	(949)	1,431
Less: gains recognized in income	62	(25)	37
Net unrealized gains on all other AFS securities	2,318	(924)	1,394
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(374)	149	(225)
Net unrealized gains on HTM securities	374	(149)	225
Cash flow hedges:			
Unrealized holding gains	92	(37)	55
Pension Plan:			
Unrealized net actuarial loss	(4,651)	1,856	(2,795)
Less: amortization of unrecognized loss	(576)	229	(347)
Less: amortization of transition asset	15	(6)	9
Less: amortization of prior service costs	(9)	4	(5)
Net pension plan liability adjustment	(4,081)	1,629	(2,452)
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized loss	(37)	15	(22)
Less: amortization of prior service costs	(15)	6	(9)
Net SERP liability adjustment	52	(21)	31
Other comprehensive income	$ 4,958	$ (1,976)	$2,982

Components of Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the nine months ended September 30, 2014			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 6,149	$ (2,460)	$ 3,689
Less: accretable yield recognized in income	501	(200)	301
Net unrealized gains on investments with OTTI	5,648	(2,260)	3,388
Available for sale securities – all other:			
Unrealized holding gains	13,746	(5,496)	8,250
Less: losses recognized in income	(7)	2	(5)
Net unrealized gains on all other AFS securities	13,753	(5,498)	8,255
Held to maturity securities:			
Unrealized holding losses	(3,984)	1,593	(2,391)
Less: amortization recognized in income	(127)	51	(76)
Net unrealized losses on HTM securities	(3,857)	1,542	(2,315)
Cash flow hedges:			
Unrealized holding gains	229	(92)	137
Pension Plan:			
Unrealized net actuarial loss	(1,345)	539	(806)
Less: amortization of unrecognized loss	(280)	112	(168)
Less: amortization of transition asset	30	(12)	18
Less: amortization of prior service costs	(9)	3	(6)
Net pension plan liability adjustment	(1,086)	436	(650)
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized gain	13	(5)	8
Less: amortization of prior service costs	(15)	6	(9)
Net SERP liability adjustment	2	(1)	1
Other comprehensive income	$ 14,689	$ (5,873)	$ 8,816

Components of Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the three months ended September 30, 2015			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 1,658	$ (661)	$997
Less: accretable yield recognized in income	139	(55)	84
Net unrealized gains on investments with OTTI	1,519	(606)	913
Available for sale securities – all other:			
Unrealized holding gains	1,288	(515)	773
Less: gains recognized in income	79	(33)	46
Net unrealized gains on all other AFS securities	1,209	(482)	727
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(106)	42	(64)
Net unrealized gains on HTM securities	106	(42)	64
Cash flow hedges:			
Unrealized holding gains	33	(13)	20
Pension Plan:			
Unrealized net actuarial loss	(2,892)	1,153	(1,739)
Less: amortization of unrecognized loss	(204)	80	(124)
Less: amortization of transition asset	5	(2)	3
Less: amortization of prior service costs	(3)	1	(2)
Net pension plan liability adjustment	(2,690)	1,074	(1,616)
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized loss	(13)	5	(8)
Less: amortization of prior service costs	(5)	3	(2)
Net SERP liability adjustment	18	(8)	10
Other comprehensive income	$ 195	$ (77)	$118

Components of Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the three months ended September 30, 2014			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 748	$ (300)	$ 448
Less: accretable yield recognized in income	170	(68)	102
Net unrealized gains on investments with OTTI	578	(232)	346
Available for sale securities – all other:			
Unrealized holding gains	3	(2)	1
Less: gains recognized in income	147	(59)	88
Net unrealized losses on all other AFS securities	(144)	57	(87)
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(95)	38	(57)
Net unrealized gains on HTM securities	95	(38)	57
Cash flow hedges:			
Unrealized holding gains	44	(18)	26
Pension Plan:			
Unrealized net actuarial loss	(1,233)	494	(739)
Less: amortization of unrecognized loss	(93)	37	(56)
Less: amortization of transition asset	10	(4)	6
Less: amortization of prior service costs	(3)	1	(2)
Net pension plan liability adjustment	(1,147)	460	(687)
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized gain	4	(1)	3
Less: amortization of prior service costs	(5)	2	(3)
Net SERP liability adjustment	1	(1)	0
Other comprehensive loss	$ (573)	$ 228	$ (345)

The following table presents the details of amount reclassified from accumulated other comprehensive loss for the nine- and three-month periods ended September 30, 2015 and 2014:

Amounts Reclassified From Accumulated Other Comprehensive Loss (in thousands)	**For the nine months ended September 30, 2015**	**For the Nine months ended September 30, 2014**	**Affected Line Item in the Statement Where Net Income is Presented**
Unrealized gains and losses on investment securities with OTTI:			
Accretable yield	$ 479	$ 501	Interest income on taxable investment securities
Taxes	(191)	(200)	Tax expense
	$ 288	$ 301	Net of tax
Unrealized gains and losses on available for sale investment securities - all others:			
Gains/(losses) on sales	$ 62	$ (7)	Net gains/(losses) - other
Taxes	(25)	2	Tax (expense)/benefit
	$ 37	$ (5)	Net of tax
Unrealized losses on held to maturity securities:			
Amortization	$ (374)	$ (127)	Interest income on taxable investment securities
Taxes	149	51	Tax benefit
	$ (225)	$ (76)	Net of tax
Net pension plan liability adjustment:			
Amortization of unrecognized loss	(576)	(280)	Salaries and employee benefits
Amortization of transition asset	15	30	Salaries and employee benefits
Amortization of prior service costs	(9)	(9)	Salaries and employee benefits
Taxes	227	103	Tax benefit
	$ (343)	$ (156)	Net of tax
Net SERP liability adjustment:			
Amortization of unrecognized (loss)/gain	(37)	13	Salaries and employee benefits
Amortization of prior service costs	(15)	(15)	Salaries and employee benefits
Taxes	21	1	Tax benefit
	$ (31)	$ (1)	Net of tax
Total reclassifications for the period	$ (274)	$ 63	Net of tax

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Amounts Reclassified From Accumulated Other Comprehensive Loss (in thousands)	For the Three months ended September 30, 2015	For the Three months ended September 30, 2014	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on investment securities with OTTI:			
Accretable Yield	$ 139	$ 170	Interest income on taxable investment securities
Taxes	(55)	(68)	Tax expense
	$ 84	$ 102	Net of tax
Unrealized gains and losses on available for sale investment securities - all others:			
Gains on sales	$ 79	$ 147	Net gains - other
Taxes	(33)	(59)	Tax expense
	$ 46	$ 88	Net of tax
Unrealized losses on held to maturity securities:			
Amortization	$ (106)	$ (95)	Interest income on taxable investment securities
Taxes	42	38	Tax benefit
	$ (64)	$ (57)	Net of tax
Net pension plan liability adjustment:			
Amortization of unrecognized loss	(204)	(93)	Salaries and employee benefits
Amortization of transition asset	5	10	Salaries and employee benefits
Amortization of prior service costs	(3)	(3)	Salaries and employee benefits
Taxes	79	34	Tax benefit
	$ (123)	$ (52)	Net of tax
Net SERP liability adjustment:			
Amortization of unrecognized (loss)/gain	(13)	4	Salaries and employee benefits
Amortization of prior service costs	(5)	(5)	Salaries and employee benefits
Taxes	8	1	Tax benefit
	$ (10)	$ 0	Net of tax
Total reclassifications for the period	$ (67)	$ 81	Net of tax

Note 11 – Junior Subordinated Debentures and Restrictions on Dividends

First United Corporation is the parent company to three statutory trust subsidiaries - First United Statutory Trust I and First United Statutory Trust II, both of which are Connecticut statutory trusts ("Trust I" and "Trust II", respectively), and First United Statutory Trust III, a Delaware statutory trust ("Trust III" and, together with Trust I and Trust II, the "Trusts"). The Trusts were formed for the purposes of selling preferred securities to investors and using the proceeds to purchase junior subordinated debentures from First United Corporation ("TPS Debentures") that would qualify as regulatory capital.

In March 2004, Trust I and Trust II issued preferred securities with an aggregate liquidation amount of $30.0 million to third-party investors and issued common equity with an aggregate liquidation amount of $.9 million to First United Corporation. Trust I and Trust II used the proceeds of these offerings to purchase an equal amount of TPS Debentures, as follows:

$20.6 million—floating rate payable quarterly based on three-month LIBOR plus 275 basis points (3.08% at September 30, 2015), maturing in 2034, became redeemable five years after issuance at First United Corporation's option.

$10.3 million—floating rate payable quarterly based on three-month LIBOR plus 275 basis points (3.08% at September 30, 2015) maturing in 2034, became redeemable five years after issuance at First United Corporation's option.

In December 2004, First United Corporation issued $5.0 million of junior subordinated debentures to third-party investors that were not tied to preferred securities. The debentures had a fixed rate of 5.88% for the first five years, payable quarterly, and converted to a floating rate in March 2010 based on the three month LIBOR plus 185 basis points. The debentures matured in March 2015 and were repaid.

In December 2009, Trust III issued 9.875% fixed-rate preferred securities with an aggregate liquidation amount of approximately $7.0 million to private investors and issued common securities to First United Corporation with an aggregate liquidation amount of approximately $.2 million. Trust III used the proceeds of the offering to purchase approximately $7.2 million of 9.875% fixed-rate TPS Debentures. Interest on these TPS Debentures are payable quarterly, and the TPS Debentures mature in 2040 but are redeemable five years after issuance at First United Corporation's option.

In January 2010, Trust III issued an additional $3.5 million of 9.875% fixed-rate preferred securities to private investors and issued common securities to First United Corporation with an aggregate liquidation amount of $.1 million. Trust III used the proceeds of the offering to purchase $3.6 million of 9.875% fixed-rate TPS Debentures. Interest on these TPS Debentures is payable quarterly, and the TPS Debentures mature in 2040 but are redeemable five years after issuance at First United Corporation's option.

The TPS Debentures issued to each of the Trusts represent the sole assets of that Trust, and payments of the TPS Debentures by First United Corporation are the only sources of cash flow for the Trust. First United Corporation has the right, without triggering a default, to defer interest on all of the TPS Debentures for up to 20 quarterly periods, in which case distributions on the preferred securities will also be deferred. Should this occur, First United Corporation may not pay dividends or distributions on, or repurchase, redeem or acquire any shares of its capital stock.

At the request of the Federal Reserve Bank of Richmond (the "Reserve Bank") in December 2010, the Corporation's Board of Directors elected to defer quarterly interest payments under the TPS Debentures beginning with the payments due in March 2011. The terms of the TPS Debentures permit the Corporation to elect to defer payments of interest for up to 20 consecutive quarterly periods, provided that no event of default exists under the TPS Debentures at the time of the election. An election to defer interest payments is not considered a default under the TPS Debentures. In February 2014, First United Corporation received approval from the Reserve Bank to terminate this deferral by making the quarterly interest payments due to the Trusts in March 2014 and paying all deferred interest for prior quarters and has since received approval for interest payments through December 2015.

Until further notice from the Reserve Bank, First United Corporation is required to obtain the Reserve Bank's prior approval before making any future interest payments under the TPS Debentures. In considering a request for approval, the Reserve Bank will consider, among other things, the Corporation's financial condition and its quarterly results of operations. In addition to this pre-approval requirement, First United Corporation's ability to make future quarterly interest payments under the TPS Debentures will depend in large part on its receipt of dividends from the Bank, and the Bank may make dividend payments only with the prior approval of the Federal Deposit Insurance Corporation (the "FDIC") and the Maryland Commissioner of Financial Regulation (the "Maryland Commissioner"). As a result of these limitations, no assurance can be given that First United Corporation will make the quarterly interest payments due under the TPS Debentures in any future quarter. In the event that First United Corporation and/or the Bank do not receive the approvals necessary for First United Corporation to make future quarterly interest payments, First United Corporation will have to again elect to defer interest payments.

The terms of First United Corporation's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") call for the payment, if declared by the Corporation's Board of Directors, of cash dividends on February 15th, May 15th, August 15th and November 15th of each year. On November 15, 2010, at the request of the Reserve Bank, the Corporation's Board of Directors voted to suspend quarterly cash dividends on the Series A Preferred Stock beginning with the dividend payment due November 15, 2010. During the suspension, dividends of $.4 million per dividend period continued to accrue. In April 2014, the Corporation received approval from the Reserve Bank to terminate this deferral by making a $6.5 million payment to the Treasury, representing the quarterly dividend payment due in May 2014 and all unpaid dividends that accrued during the suspension period and has since received approval to make all subsequent dividend payments through November 2015.

Until further notice from the Reserve Bank, First United Corporation is required to obtain the Reserve Bank's prior approval before making any future quarterly dividend payment on the Series A Preferred Stock. In considering a request for approval, the Reserve Bank will consider, among other things, the Corporation's financial condition and its quarterly results of operations. In addition, First United Corporation's ability to make future quarterly dividend payments on the Series A Preferred Stock will depend in large part on its receipt of dividends from the Bank, the declaration and payment of which, as discussed above, are subject to the prior approval of the FDIC and the Maryland Commissioner. If First United Corporation and/or the Bank do not obtain the regulatory approvals required for a particular quarterly dividend, then First United Corporation would have to again suspend quarterly dividend payments, which would result in a prohibition against paying any dividends or other distributions on the outstanding shares of First United Corporation's common stock during the suspension period.

First United Corporation's Board of Directors suspended the payment of dividends on the common stock in December 2010 when it approved the above-mentioned deferral of dividends on the Series A Preferred Stock. That Board of Directors has not resumed the payment of cash dividends on the common stock, and no assurance can be given with respect to if or when such resumption will occur.

Note 12 – Borrowed Funds

The following is a summary of short-term borrowings with original maturities of less than one year:

(Dollars in thousands)	Nine months ended September 30, 2015			Year ended December 31, 2014		
Securities sold under agreements to repurchase:						
Outstanding at end of period	$	38,460		$	39,801	
Weighted average interest rate at end of period		0.15	%		0.15	%
Maximum amount outstanding as of any month end	$	47,131		$	53,819	
Average amount outstanding	$	33,506		$	45,702	
Approximate weighted average rate during the period		0.12	%		0.13	%

At September 30, 2015, the repurchase agreements were secured by $59.7 million in investment securities issued by government related agencies. A minimum of 102% of fair value is pledged against account balances.

The following is a summary of long-term borrowings with original maturities exceeding one year:

(in thousands)	September 30, 2015	December 31, 2014
FHLB advances, bearing fixed interest at rates ranging from 1.00% to 3.69% at September 30, 2015	$ 105,825	$ 135,876
Junior subordinated debt, bearing variable interest rate of 3.03% at September 30, 2015	30,929	35,929
Junior subordinated debt, bearing fixed interest rate of 9.88% at September 30, 2015	10,801	10,801
Total long-term debt	$ 147,555	$ 182,606

At September 30, 2015, the long-term FHLB advances were secured by $216.8 million in loans.

The contractual maturities of all long-term borrowings are as follows:

	September 30, 2015			December 31, 2014
(in thousands)	Fixed Rate	Floating Rate	Total	Total
Due in 2015	0	0	0	35,000
Due in 2016	0	0	0	0
Due in 2017	0	0	0	0
Due in 2018	70,000	0	70,000	70,000
Due in 2019	0	0	0	0
Thereafter	46,626	30,929	77,555	77,606
Total long-term debt	$116,626	$ 30,929	$147,555	$ 182,606

Note 13 – Employee Benefit Plans

The following tables present the components of the net periodic pension plan cost for First United Corporation's Defined Benefit Pension Plan (the "Pension Plan") and the Bank's Supplemental Executive Retirement Plan ("SERP") for the periods indicated:

Pension	For the nine months ended September 30,		For the three months ended September 30,	
(in thousands)	2015	2014	2015	2014

Service cost	$ 242	$ 193	$ 74	$ 64
Interest cost	1,177	1,106	403	369
Expected return on assets	(2,224)	(1,990)	(740)	(662)
Amortization of transition asset	(15)	(30)	(5)	(10)
Amortization of net actuarial loss	576	280	204	93
Amortization of prior service cost	9	9	3	3
Net pension credit included in employee benefits	$ (235)	$ (432)	$ (61)	$ (143)

SERP	For the nine months ended September 30,		For the three months ended September 30,	
(in thousands)	2015	2014	2015	2014
Service cost	$ 87	$ 71	$ 29	$ 23
Interest cost	174	172	58	58
Amortization of recognized loss/(gain)	37	(13)	13	(4)
Amortization of prior service cost	15	15	5	5
Net SERP expense included in employee benefits	$ 313	$ 245	$ 105	$ 82

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The Pension Plan is a noncontributory defined benefit pension plan covers our employees who were hired prior to the freeze and others who were grandfathered into the plan. The benefits are based on years of service and the employees' compensation during the last five years of employment.

Effective April 30, 2010, the Pension Plan was amended, resulting in a "soft freeze", the effect of which prohibits new entrants into the plan and ceases crediting of additional years of service after that date. Effective January 1, 2013, the Pension Plan was amended to unfreeze it for those employees for whom the sum of (a) their ages, at their closest birthday, plus (b) years of service for vesting purposes equals 80 or greater. The "soft freeze" continues to apply to all other plan participants. Pension benefits for these participants are managed through discretionary contributions to the First United Corporation 401(k) Profit Sharing Plan (the "401(k) Plan").

The Bank established the SERP in 2001 as an unfunded supplemental executive retirement plan. The SERP is available only to a select group of management or highly compensated employees to provide supplemental retirement benefits in excess of limits imposed on qualified plans by federal tax law. Concurrent with the establishment of the SERP, the Bank acquired Bank Owned Life Insurance ("BOLI") policies on the senior management personnel and officers of the Bank. The benefits resulting from the favorable tax treatment accorded the earnings on the BOLI policies are intended to provide a source of funds for the future payment of the SERP benefits as well as other employee benefit costs.

The benefit obligation activity for both the Pension Plan and SERP was calculated using an actuarial measurement date of January 1. Plan assets and the benefit obligations were calculated using an actuarial measurement date of December 31.

The Corporation will assess the need for future annual contributions to the pension plan based upon its funded status and an evaluation of the future benefits to be provided thereunder. There have been no contributions made as of September 30, 2015. The Corporation expects to fund the annual projected benefit payments for the SERP from operations.

On January 9, 2015, the Corporation and members of management who do not participate in the SERP entered into participation agreements under the Deferred Compensation Plan, each styled as a SERP Alternative Participation Agreement (the "Participation Agreement"). Pursuant to each Participation Agreement, the Corporation agreed, for each Plan Year (as defined in the Deferred Compensation Plan) in which it determines that it has been Profitable (as defined in the Participation Agreement), to make a discretionary contribution to the participant's Employer Account in an amount equal to 15% of the participant's base salary level for such Plan Year, with the first Plan Year being the year ending December 31, 2015. The Participation Agreement provides that the participant will become 100% vested in the amount maintained in his or her Employer Account upon the earliest to occur of the following events: (a) Normal Retirement (as defined in the Participation Agreement); (b) Separation from Service (as defined in the Participation Agreement) following a Change of Control (as defined in the Deferred Compensation Plan) and subsequent

Triggering Event (as defined in the Participation Agreement); (c) Separation from Service due to a Disability (as defined in the Participation Agreement); (d) with respect to a particular award of Employer Contribution Credits, the participant's completion of two consecutive Years of Service (as defined in the Participation Agreement) immediately following the Plan Year for which such award was made; or (e) death. Notwithstanding the foregoing, however, a participant will lose entitlement to the amount maintained in his or her Employer Account in the event employment is terminated for Cause (as defined in the Participation Agreement). In addition, the Participation Agreement conditions entitlement to the amounts held in the Employer Account on the participant (1) refraining from engaging in Competitive Employment (as defined in the Participation Agreement) for three years following his or her Separation from Service, (2) refraining from injurious disclosure of confidential information concerning the Corporation, and (3) remaining available, at the Corporation's reasonable request, to provide at least six hours of transition services per month for 12 months following his or her Separation from Service (except in the case of death or Disability), except that only item (2) will apply in the event of a Separation from Service following a Change of Control and subsequent Triggering Event.

Note 14 - Equity Compensation Plan Information

At the 2007 Annual Meeting of Shareholders, First United Corporation's shareholders approved the First United Corporation Omnibus Equity Compensation Plan (the "Omnibus Plan"), which authorizes the issuance of up to 185,000 shares of common stock pursuant to the grant of stock options, stock appreciation rights, stock awards, stock units, performance units, dividend equivalents, and other stock-based awards to employees or directors.

On June 18, 2008, the Board of Directors of First United Corporation adopted a Long-Term Incentive Program (the "LTIP"). This program was adopted as a sub-plan of the Omnibus Plan to reward participants for increasing shareholder value, align executive interests with those of shareholders, and serve as a retention tool for key executives. Under the LTIP, participants are granted shares of restricted common stock of First United Corporation. The amount of an award is based on a specified percentage of the participant's salary as of the date of grant. These shares will vest if the Corporation meets or exceeds certain performance thresholds.

The Corporation complies with the provisions of ASC Topic 718, *Compensation-Stock Compensation*, in measuring and disclosing stock compensation cost. The measurement objective in ASC Paragraph 718-10-30-6 requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. The cost is recognized in expense over the period in which an employee is required to provide service in exchange for the award (the vesting period).

Stock-based awards were made to non-employee directors in May 2015 pursuant to First United Corporation's director compensation policy. Beginning May 2014, each director's annual retainer is paid in 1,000 shares of common stock, with the remainder of $10,000 paid in cash or any portion thereof, in shares of stock. Prior to May 2014, the retainer of the 1,000 shares of stock was paid in shares of stock in the amount of $5,000. A total of 16,022 fully-vested shares of common stock were issued to directors in 2015, which had a fair market value of $8.96 per share. Director stock compensation expense was $111,848 for the nine months ended September 30, 2015 and $95,035 for the nine months ended September 30, 2014. Stock compensation expense was $35,889 and $39,025 for the three months ended September 30, 2015 and 2014, respectively.

In the first quarter of 2015, a one-time stock grant was awarded to two executive officers in the amount of 10,232 shares. These shares do not have any performance restrictions; however, they have a two-year vesting period. Executive stock compensation expense was $32,094 for the nine months ended September 30, 2015 and $11,382 for the three months ended September 30, 2015.

Note 15 – Letters of Credit and Off Balance Sheet Liabilities

The Corporation does not issue any guarantees that would require liability recognition or disclosure other than the standby letters of credit issued by the Bank. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, the Bank's letters of credit are issued with expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral and/or personal guarantees supporting these commitments. The Bank had $1.7 million of outstanding standby letters of credit at September 30, 2015 and $.9 million at December 31, 2014. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required by the letters of credit. Management does not believe that the amount of the liability associated with guarantees under standby letters of credit outstanding at September 30, 2015 and December 31, 2014 is material.

Note 16 – Derivative Financial Instruments

As a part of managing interest rate risk, the Bank entered into interest rate swap agreements to modify the re-pricing characteristics of certain interest-bearing liabilities. The Corporation has designated these interest rate swap agreements as cash flow hedges under the guidance of ASC Subtopic 815-30, *Derivatives and Hedging – Cash Flow Hedges*. Cash flow hedges have the effective portion of changes in the fair value of the derivative, net of taxes, recorded in net accumulated other comprehensive income.

In July 2009, the Corporation entered into three interest rate swap contracts totaling $20.0 million notional amount, hedging future cash flows associated with floating rate trust preferred debt. As of September 30, 2015, swap contracts totaling $5.0 million notional amount remained, as the three-year $5.0 million contract matured on June 15, 2012 and the five-year $10.0 million contract matured on June 17, 2014. The seven-year $5 million contract matures June 17, 2016. The fair value of the interest rate swap contract was ($107) thousand at September 30, 2015 and ($199) thousand at December 31, 2014 and was reported in Other Liabilities on the Consolidated Statement of Financial Condition. Cash in the amount of $.9 million was posted as collateral as of September 30, 2015.

For the nine months ended September 30, 2015, the Corporation recorded an increase in the value of the derivatives of $92 thousand and the related deferred tax benefit of $37 thousand in net accumulated other comprehensive loss to reflect the effective portion of cash flow hedges. ASC Subtopic 815-30 requires this amount to be reclassified to earnings if the hedge becomes ineffective or is terminated. There was no hedge ineffectiveness recorded for the nine months ending September 30, 2015. The Corporation does not expect any losses relating to these hedges to be reclassified into earnings within the next 12 months.

Interest rate swap agreements are entered into with counterparties that meet established credit standards and the Corporation believes that the credit risk inherent in these contracts is not significant as of September 30, 2015.

The table below discloses the impact of derivative financial instruments on the Corporation's Consolidated Financial Statements for the nine- and three-months ended September 30, 2015 and 2014.

Derivative in Cash Flow Hedging Relationships

(in thousands)	Amount of gain recognized in OCI on derivative (effective portion)		Amount of gain or (loss) reclassified from accumulated OCI into income (effective portion) [a]		Amount of gain or (loss) recognized in income or derivative (ineffective portion and amount excluded from effectiveness testing) [b]	
Interest rate contracts:						
Nine months ended:						
September 30, 2015	$	55	$	0	$	0
September 30, 2014		137		0		0
Three months ended:						
September 30, 2015	$	20	$	0	$	0
September 30, 2014		26		0		0

Notes:

(a) Reported as interest expense

(b) Reported as other income

Note 17 – Variable Interest Entities (VIE)

As noted in Note 11, First United Corporation created the Trusts for the purposes of raising regulatory capital through the sale of mandatorily redeemable preferred capital securities to third party investors and common equity interests to First United Corporation. The Trusts are considered Variable Interest Entities ("VIEs"), but are not consolidated because First United Corporation is not the primary beneficiary of the Trusts. At September 30, 2015, the Corporation reported all of the $41.7 million of TPS Debentures issued in connection with these offerings as long-term borrowings and it reported its $1.3 million equity interest in the Trusts as "Other Assets".

In November 2009, the Bank became a 99.99% limited partner in Liberty Mews Limited Partnership ("Liberty Mews"), a Maryland limited partnership formed for the purpose of acquiring, developing and operating low-income housing units in Garrett County, Maryland. The Partnership was financed with a total of $10.6 million of funding, including a $6.1 million equity contribution from the Bank as the limited partner. Liberty Mews used the proceeds from these sources to purchase the land and construct a 36-unit low income housing rental complex at a total cost of $10.6 million. The total assets of Liberty Mews were approximately $9.2 million at September 30, 2015 and $9.4 million at December 31, 2014.

As of December 31, 2011, the Bank had made contributions to Liberty Mews totaling $6.1 million. The project was completed in June 2011, and the Bank is entitled to $8.4 million in federal investment tax credits over a 10-year period as long as certain qualifying hurdles are maintained. The Bank will also receive the benefit of tax operating losses from Liberty Mews to the extent of its capital contribution. The investment in Liberty Mews assists the Bank in achieving its community reinvestment initiatives.

Because Liberty Mews is considered to be a VIE, management performed an analysis to determine whether its involvement with the Partnership would lead it to determine that it must consolidate Liberty Mews. In performing its analysis, management evaluated the risks creating the variability in the Partnership and identified which activities most significantly impact the VIE’s economic performance. Finally, it examined each of the variable interest holders to determine which, if any, of the holders was the primary beneficiary based on their power to direct the most significant activities and their obligation to absorb potentially significant losses of Liberty Mews.

The Bank, as a limited partner, generally has no voting rights. The Bank is not in any way involved in the daily management of Liberty Mews and has no other rights that provide it with the power to direct the activities that most significantly impact Liberty Mews’s economic performance, which are to develop and operate the housing project in such a manner that complies with specific tax credit guidelines. As a limited partner, there is no recourse to the Bank by the creditors of Liberty Mews. The tax credits that result from the Bank’s investment in Liberty Mews are generally subject to recapture should the partnership fail to comply with the applicable government regulations. The Bank has not provided any financial or other support to Liberty Mews beyond its required capital contributions and does not anticipate providing such support in the future. Management currently believes that no material losses are probable as a result of the Bank’s investment in Liberty Mews.

On the basis of management’s analysis, the general partner is deemed to be the primary beneficiary of Liberty Mews. Because the Bank is not the primary beneficiary, Liberty Mews has not been included in the Corporation’s consolidated financial statements.

The Corporation accounts for its investment in Liberty Mews utilizing the effective yield method under guidance that applies specifically to investments in limited partnerships that operate qualified affordable housing projects. Under the effective yield method, the investor recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that tax credits are allocated to the investor. The effective yield is the internal rate of return on the investment, based on the cost of the investment and the guaranteed tax credits allocated to the investor. The tax credit allocated, net of the amortization of the investment in the limited partnership, is recognized in the income statement as a component of income taxes attributable to continuing operations.

The Corporation’s tax expense for the nine months ended September 30, 2015 was approximately $.3 million lower as a result of the impact of the tax credits and the tax losses relating to the partnership.

At September 30, 2015 and December 31, 2014, the Corporation included its total investment in Liberty Mews in "Other Assets" in its Consolidated Statement of Financial Condition. As of September 30, 2015, the Corporation's commitment in Liberty Mews was fully funded. The following table presents details of the Bank's involvement with Liberty Mews at the dates indicated:

(in thousands)	September 30, 2015	December 31, 2014
Investment in LIHTC Partnership		
Carrying amount on Balance Sheet of:		
Investment (Other Assets)	$ 3,994	$ 4,429
Maximum exposure to loss	3,994	4,429

Note 18 – Assets and Liabilities Subject to Enforceable Master Netting Arrangements

Interest Rate Swap Agreements ("Swap Agreements")

The Corporation has entered into interest rate swap agreements to modify the re-pricing characteristics of certain interest-bearing liabilities as a part of managing interest rate risk. The swap agreements have been designated as cash flow hedges, and accordingly, the fair value of the interest rate swap contracts is reported in Other Liabilities on the Consolidated Statement of Financial Condition. The swap agreements were entered into with a third party financial institution. The Corporation is party to master netting arrangements with its financial institution counterparty; however, the Corporation does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, in the form of cash, is pledged by the Corporation as the counterparty with net liability positions in accordance with contract thresholds. See Note 16 to the Consolidated Financial Statements for more information.

Securities Sold Under Agreements to Repurchase ("Repurchase Agreements")

The Bank enters into agreements under which it sells interests in U.S. securities to certain customers subject to an obligation to repurchase, and on the part of the customers to resell, such interests. Under these arrangements, the Bank may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Bank to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e. secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Consolidated Statement of Condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. There is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Bank does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements. The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Bank be in default (i.e. fails to repurchase the U.S. securities on the maturity date of the agreement). The investment security collateral, maintained at 102% of the borrowing, is held by a third party financial institution in the counterparty's custodial account.

The following table presents the liabilities subject to an enforceable master netting arrangement or repurchase agreements as of September 30, 2015 and December 31, 2014.

(In thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Condition	Net Amounts of Liabilities Presented in the Statement of Condition	Gross Amounts Not Offset in the Statement of Condition		
				Financial Instruments	Cash Collateral Pledged	Net Amount
September 30, 2015						
Interest Rate Swap Agreements	$ 107	$ 0	$ 107	$ (107)	$ 0	$ 0
Repurchase Agreements	$ 38,460	$ 0	$ 38,460	$ (38,460)	$ 0	$ 0
December 31, 2014						
Interest Rate Swap Agreements	$ 199	$ 0	$ 199	$ (199)	$ 0	$ 0
Repurchase Agreements	$ 39,801	$ 0	$ 39,801	$ (39,801)	$ 0	$ 0

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Note 19 – Adoption of New Accounting Standards and Effects of New Accounting Pronouncements

In February 2015, the FASB issued Accounting Standards Update ("ASU") 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. ASU 2015-02 changes the consolidation analysis for all reporting entities. The changes primarily affect the consolidation of limited partnerships and their equivalents (e.g., limited liability companies), as well as structured vehicles such as collateralized debt obligations. The ASU simplifies U.S. GAAP by eliminating entity specific consolidation guidance for limited partnerships. It also revises other aspects of the consolidation analysis, including how kick-out rights, fee arrangements and related parties are assessed. The amendments rescind the indefinite deferral of FASB Statement 167 for certain investment funds and replace it with a permanent scope exception for money market funds. The ASU applies to all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. The Corporation is evaluating the provisions of ASU 2015-02, but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In January 2015, the FASB issued ASU 2015-01, *Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. ASU 2015-01 eliminates the requirement in Subtopic 225-20 to consider whether an underlying event or transaction is extraordinary and if so to separately present the item in the income statement net of tax, after income from continuing operations. Items that are either unusual in nature or infrequently occurring will continue to be reported as a separate component of income from continuing operations. Alternatively, these amounts may still be disclosed in the notes to the financial statements. The same requirement has been expanded to include items that are both unusual and infrequent, (i.e., they should be separately presented as a component of income from continuing operations or disclosed in the footnotes). The ASU applies to all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, and the Corporation adopted ASU 2015-01 effective January 1, 2015, which had no material impact on the Corporation's financial condition or results of operations.

In August 2014, the FASB issued ASU 2014-14, *Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure,* an amendment of ASC Subtopic 310-40, *Receivables – Troubled Debt Restructurings by Creditors*. ASU 2014-14 specifies that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the loan has a government guarantee that is not separable from the loan before foreclosure; and at the time of foreclosure, the creditor has the intent to convey the real estate to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under the amount of the claim, which must be a fixed amount determined on the basis of the fair value of the real estate. On January 1, 2015, the Corporation adopted the amendments in ASU 2014-14 using the prospective transition method, with no material impact on the Corporation's financial condition or results of operations.

In June 2014, the FASB issued ASU 2014-11, *Repurchase-to Maturity Transactions, Repurchase Financings, and Disclosures,* an amendment of ASC Topic 860, *Transfers and Servicing*. The amendments in ASU 2014-11 require repurchase-to-maturity transactions to be accounted for as secured borrowing transactions on the balance sheet, rather than sales; and for repurchase financing arrangements, require separate accounting for a transfer of a financial asset executed contemporaneously with (or in contemplation of) a repurchase agreement with the same counterparty, which also will generally result in secured borrowing accounting for the repurchase agreement. The ASU also introduces new disclosures to increase transparency about the types of collateral pledged for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings, and requires a transferor to disclose information about transactions accounted for as a sale in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets through an agreement with the transferee. On January 1, 2015, the Corporation adopted the amendments in ASU 2014-11, with no material impact on the Corporation's financial condition or results of operations. The disclosures required by the ASU are found in Note 12.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers,* which establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. ASU 2014-09 specifies that an entity shall recognize revenue when, or as, the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when, or as, the customer obtains control of the asset. Entities are required to disclose qualitative and quantitative information on the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, with early adoption not permitted. In August 2015, the FASB issued ASU 2015-14 to defer the date of ASU 2014-09 by one year to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application would be permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Corporation is evaluating the provisions of ASU 2014-09, but believes that its adoption will not have a material impact on the Corporation’s financial condition or results of operations.

In January 2014, the FASB issued ASU 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, which provides guidance clarifying when an in substance repossession or foreclosure occurs that would require a loan receivable to be derecognized and the real estate property recognized. ASU 2014-04 specifies the circumstances when a creditor should be considered to have received physical possession of the residential real estate property collateralizing a consumer mortgage loan, and requires interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate that are in the process of foreclosure. On January 1, 2015, the Corporation adopted the amendments in ASU 2014-04 using the prospective transition method. The adoption had no material impact on the Corporation’s financial condition or results of operations.

In January 2014, the FASB issued ASU 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*, which provides amendments and guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. Additional disclosure requirements are applicable to all reporting entities, regardless of whether the election is made. On January 1, 2015, the Corporation adopted the amendments in ASU 2014-01. As of that date, the Corporation had a single investment in a flow-through limited liability entity that invests in an affordable housing project, for which it currently utilizes the effective yield method to account for its investment. As permitted by the ASU, the Corporation did not change its method of accounting. The disclosures required by the ASU are found in Note 17.

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

INTRODUCTION

The following discussion and analysis is intended as a review of material changes in and significant factors affecting the financial condition and results of operations of First United Corporation and its consolidated subsidiaries for the periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and the notes thereto contained in Item 1 of Part I of this report. Unless the context clearly suggests otherwise, references in this report to “us”, “we”, “our”, and “the Corporation” are to First United Corporation and its consolidated subsidiaries.

FORWARD-LOOKING STATEMENTS

This report may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of “forward-looking statements.” Statements that are not historical in nature, including those that include the words “anticipate”, “estimate”, “should”, “expect”, “believe”, “intend”, and similar expressions, are based on current expectations, estimates and projections about, among other things, the industry and the markets in which we operate, and they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this report; general economic, market, or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in our competitive position or competitive actions by other companies; changes in the quality or composition of our loan and investment portfolios; our ability to manage growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond our control. Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on our business or operations. These and other risks are discussed in detail in the periodic reports that First United Corporation files with the Securities and Exchange Commission (the “SEC”) (see Item 1A of Part II of this report for further information). Except as required by applicable laws, we do not intend to publish updates or revisions of any forward-looking statements we make to reflect new information, future events or otherwise.

FIRST UNITED CORPORATION

First United Corporation is a Maryland corporation chartered in 1985 and a bank holding company registered with the Board of Governors of the Federal Reserve System (the “FRB”) under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). Between July 1, 1985 and September 24, 2014, the Corporation was registered with the FRB as a financial holding company under the federal Gramm-Leach-Bliley Act. The Corporation terminated its election to operate as a financial holding company because it is not engaged, and does not anticipate engaging in the foreseeable future, in any activity that requires that election. The termination is not expected to have any material impact on our future financial condition or results of operations. The Corporation's primary business is serving as the parent company of First United Bank & Trust, a Maryland trust company (the "Bank"), First United Statutory Trust I ("Trust I") and First United Statutory Trust II ("Trust II"), both Connecticut statutory business trusts, and First United Statutory Trust III, a Delaware statutory business trust ("Trust III" and together with Trust I and Trust II, the "Trusts"). The Trusts were formed for the purpose of selling trust preferred securities that qualified as Tier 1 capital. The Bank has three wholly-owned subsidiaries: OakFirst Loan Center, Inc., a West Virginia finance company; OakFirst Loan Center, LLC, a Maryland finance company (collectively, the "OakFirst Loan Centers"), and First OREO Trust, a Maryland statutory trust formed for the purposes of servicing and disposing of the real estate that the Bank acquires through foreclosure or by deed in lieu of foreclosure. The Bank also owns 99.9% of the limited partnership interests in Liberty Mews Limited Partnership; a Maryland limited partnership formed for the purpose of acquiring, developing and operating low-income housing units in Garrett County, Maryland.

At September 30, 2015, the Corporation had total assets of $1.3 billion, net loans of $830.9 million, and deposits of $996.3 million. Shareholders' equity at September 30, 2015 was $114.6 million.

The Corporation maintains an Internet site at www.mybank4.com on which it makes available, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the SEC.

RECENT DEVELOPMENTS

On October 30, 2015, First United Corporation and the Bank (collectively, "First United") were notified by the Financial Industry Regulatory Authority ("FINRA") that a FINRA arbitration panel had awarded $11.5 million in compensatory damages to First United in a proceeding that First United brought against FTN Financial Securities Corp. ("FTN") and two of its representatives. First United alleged, among other things, that, in recommending and selling certain trust preferred securities to First United, FTN committed fraud, breached its fiduciary duty to First United, breached its contract with First United and violated rules concerning suitability and other regulatory standards. FTN paid the $11.5 million award amount to First United on November 5, 2015.

ESTIMATES AND CRITICAL ACCOUNTING POLICIES

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. (See Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of Part II of First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2014). On an on-going basis, management evaluates estimates, including those related to loan losses and intangible assets, other-than-temporary impairment ("OTTI") of investment securities, income taxes, fair value of investments and pension plan assumptions. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the consolidated financial statements.

Allowance for Loan Losses

One of our most important accounting policies is that related to the monitoring of the loan portfolio. A variety of estimates impact the carrying value of the loan portfolio, including the calculation of the allowance for loan losses (the "ALL"), the valuation of underlying collateral, the timing of loan charge-offs and the placement of loans on non-accrual status. The ALL is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payment on loans. Estimates for loan losses are arrived at by analyzing risks associated with specific loans and the loan portfolio, current and historical trends in delinquencies and charge-offs, and changes in the size and composition of the loan portfolio. The analysis also requires consideration of the economic climate and outlook, including the economic conditions specific to Western Maryland and Northeastern West Virginia, changes in lending rates, political conditions, and legislation impacting the banking industry. Because the calculation of the ALL relies on management's estimates and judgments relating to inherently uncertain events, actual results may differ from management's estimates.

Goodwill and Other Intangible Assets

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350, *Intangibles - Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. The $11 million recorded as goodwill at September 30, 2015 is primarily related to the Bank's 2003 acquisition of Huntington National Bank branches and is not subject to periodic amortization.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of the Corporation's reporting units be compared to the carrying amount of its net assets, including goodwill. If the estimated current fair value of the reporting unit exceeds its carrying value, no additional testing is required and an impairment loss is not recorded. Otherwise, additional testing is performed, and to the extent such additional testing results in a conclusion that the carrying value of goodwill exceeds its implied fair value, an impairment loss is recognized.

Our goodwill relates to value inherent in the banking business, and that value is dependent upon our ability to provide quality, cost effective services in a highly competitive local market. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of our services. As such, goodwill value is ultimately supported by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill, which could adversely impact earnings in future periods. ASC Topic 350 requires an annual evaluation of goodwill for impairment. The determination of whether or not these assets are impaired involves significant judgments and estimates.

Accounting for Income Taxes

We account for income taxes in accordance with ASC Topic 740, *Income Taxes*. Under this guidance, deferred taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates that will apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

Management regularly reviews the carrying amount of the Corporation's net deferred tax assets to determine if the establishment of a valuation allowance is necessary. If management determines, based on the available evidence, that it is more likely than not that all or a portion of our net deferred tax assets will not be realized in future periods, then a deferred tax valuation allowance will be established. Consideration is given to various positive and negative factors that could affect the realization of the deferred tax assets. In evaluating this available evidence, management considers, among other things, historical performance, expectations of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with utilization of operating loss and tax credit carry forwards not expiring, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earnings trends and the timing of reversals of temporary differences. Management's evaluation is based on current tax laws as well as management's expectations of future performance.

Management expects that our adherence to the required accounting guidance may result in increased volatility in quarterly and annual effective income tax rates because of changes in judgment or measurement including changes in actual and forecasted income before taxes, tax laws and regulations, and tax planning strategies.

Other-Than-Temporary Impairment of Investment Securities

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320, *Investments – Debt and Equity Securities* (Section 320-10-35), management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating OTTI losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). This process is described more fully in the Investment Securities section of the Consolidated Balance Sheet Review.

Fair Value of Investments

We have determined the fair value of our investment securities in accordance with the requirements of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. The Corporation measures the fair market values of its investments based on the fair value hierarchy established in Topic 820. The determination of fair value of investments and other assets is discussed further in Note 9 to the consolidated financial statements presented elsewhere in this report.

Pension Plan Assumptions

Our pension plan costs are calculated using actuarial concepts, as discussed within the requirements of ASC Topic 715, *Compensation – Retirement Benefits.* Pension expense and the determination of our projected pension liability are based upon two critical assumptions: (a) the discount rate; and (b) the expected return on plan assets. We evaluate each of these critical assumptions annually. Other assumptions impact the determination of pension expense and the projected liability including the primary employee demographics, such as retirement patterns, employee turnover, mortality rates, and estimated employer compensation increases. These factors, along with the critical assumptions, are carefully reviewed by management each year in consultation with our pension plan consultants and actuaries. Further information about our pension plan assumptions, the plan's funded status, and other plan information is included in Note 13 to the consolidated financial statements presented elsewhere in this report.

Management does not believe that any material changes in our critical accounting policies have occurred since December 31, 2014.

SELECTED FINANCIAL DATA

The following table sets forth certain selected financial data for the nine-month periods ended September 30, 2015 and 2014 and is qualified in its entirety by the detailed information and unaudited financial statements, including the notes thereto, included elsewhere in this quarterly report.

	As of or For the Nine months ended September 30,			
	2015		2014	
Per Share Data				
Basic and diluted net income per common share	$ 0.39		$ 0.32	
Basic and diluted book value per common share	$ 13.52		$ 13.21	
Significant Ratios				
Return on Average Assets [(a)]	0.45	%	0.39	%
Return on Average Equity [(a)]	5.34	%	4.79	%
Average Equity to Average Assets	9.23	%	8.18	%

Note: [(a)] Annualized

RESULTS OF OPERATIONS

Overview

Consolidated net income available to common shareholders was $2.5 million for the first nine months of 2015, compared to $2.0 million for the same period of 2014. Basic and diluted net income per common share for the first nine months of 2015 was $.39, compared to basic and diluted net income per common share of $.32 for the same period of 2014. The increase in earnings was due to an increase in net interest income of $.2 million, a decrease of $1.0 million in provision expense, and a decline of other operating expenses of $.2 million offset by a decline of $.5 million in other operating income. The net interest margin for the first nine months of 2015, the year ended December 31, 2014 and the first nine months of 2014, on a fully tax equivalent ("FTE") basis, was 3.07%, 3.00% and 3.02%, respectively. Deferred interest income recorded on the investment portfolio contributed to the increase in the net interest margin for the first nine months of 2015 when compared to the margin recorded for the year ended December 31, 2014.

The provision for loan losses decreased to $.6 million for the nine months ended September 30, 2015 from the $1.6 million recorded for the nine months ended September 30, 2014. The decrease was driven by lower net charge-offs and slow loan growth. Specific allocations have been made for impaired loans where management has determined that the collateral supporting the loans is not adequate to cover the loan balance, and the qualitative factors affecting the ALL have been adjusted based on the current economic environment and the characteristics of the loan portfolio.

Interest expense on our interest-bearing liabilities decreased $1.0 million during the nine months ended September 30, 2015 when compared to the same period of 2014 due to a decrease of $4.3 million in average interest-bearing deposits as well as a 20 basis point decrease in the average rate paid. Our management and retail staff continue to focus on shifting the Bank's deposit mix away from higher cost certificates of deposit and towards lower cost core deposit accounts. This strategic focus will continue throughout 2015 as we continue to place an emphasis on the full relationship customer.

Other operating income decreased $.5 million during the first nine months of 2015 when compared to the same period of 2014. This decrease was primarily attributable to a $1.0 million decrease in gains on the sale of investment securities held-for-trading relating to four CDOs that had been written down through impairment charges in prior years. The decrease in gains was offset by increases in trust and brokerage income and earnings on Bank Owned Life Insurance.

Operating expenses decreased $.2 million in the first nine months of 2015 when compared to the same period of 2014. This was due to a $1.2 million decrease in other real estate owned ("OREO") expenses primarily due to a reduction in valuation allowances and a gain booked on the sale of a hotel property in the third quarter of 2015, offset by a $1.1 million increase in salaries and employee benefits due to increased costs related to the administration of the pension plan and health care costs.

Consolidated net income available to common shareholders was $1.3 million, or $.20 per common share, for the third quarter of 2015, compared to $.7 million, or $.10 per common share, for the same period of 2014. The increase in earnings for the third quarter of 2015 when compared to the third quarter of 2014 resulted from an increase in net interest income of $.4 million due to reduced interest expense relating to the payments of long-term debt, reduced provision expense, an increase of $.2 million in other operating income and a reduction in other operating expenses of $.2 million. The net interest margin for the third quarter of 2015, on a FTE basis, increased to 3.13% from 2.96% for the same period of 2014.

Other operating income increased $.2 million during the third quarter of 2015 when compared to the same period of 2014. The increase was attributable to increases in trust department and brokerage income, debit card income and Bank Owned Life Insurance.

Operating expenses decreased $.2 million in the third quarter of 2015 when compared to the same period of 2014. This decrease was due to decreases in OREO expenses relating to a reduction in valuation allowances and a gain booked on the sale of a hotel property and decreases in other miscellaneous expenses. These decreases were offset by a $.5 million increase in salaries and benefits due primarily to increased pension costs and health care costs.

Net Interest Income

Net interest income is the largest source of operating revenue and is the difference between the interest earned on interest-earning assets and the interest expense incurred on interest-bearing liabilities. For analytical and discussion purposes, net interest income is adjusted to an FTE basis to facilitate performance comparisons between taxable and tax-exempt assets. FTE income is determined by increasing tax-exempt income by an amount equal to the federal income taxes that would have been paid if this income were taxable at the statutorily applicable rate.

The following table sets forth the average balances, net interest income and expense, and average yields and rates of our interest-earning assets and interest-bearing liabilities for the nine-month periods ended September 30, 2015 and 2014:

	Nine months ended September 30,					
	2015			2014		
(dollars in thousands)	Average Balance	Interest	**Average Yield/Rate**	Average Balance	Interest	**Average Yield/Rate**
Assets						
Loans	$840,458	$27,576	4.39 %	$816,144	$28,172	4.62 %
Investment Securities:						
Taxable	285,013	5,365	2.52	286,489	5,323	2.48
Non taxable	35,597	1,553	5.83	56,799	1,881	4.43
Total	320,610	6,918	2.88	343,288	7,204	2.81
Federal funds sold	25,219	30	0.16	37,358	62	0.22
Interest-bearing deposits with other banks	4,622	4	0.11	7,856	2	0.03
Other interest earning assets	6,889	234	4.55	7,625	212	3.71
Total earning assets	1,197,798	34,762	3.88 %	1,212,271	35,652	3.93 %
Allowance for loan losses	(11,966)			(12,787)		
Non-earning assets	141,218			143,060		
Total Assets	$1,327,050			$1,342,544		
Liabilities and Shareholders' Equity						
Interest-bearing demand deposits	$151,646	$79	0.07 %	$142,774	$97	0.09 %
Interest-bearing money markets	220,088	359	0.22	213,777	371	0.23
Savings deposits	135,717	177	0.17	122,689	174	0.19
Time deposits:						
Less than $100k	144,394	1,138	1.05	165,380	1,359	1.10
$100k or more	135,400	1,265	1.25	146,914	1,488	1.35
Short-term borrowings	35,922	42	0.16	45,009	46	0.14
Long-term borrowings	170,472	4,213	3.30	182,646	4,699	3.44
Total interest-bearing liabilities	993,639	7,273	0.98 %	1,019,189	8,234	1.08 %
Non-interest-bearing deposits	201,312			195,562		
Other liabilities	19,687			17,963		
Shareholders' Equity	112,412			109,830		
Total Liabilities and Shareholders' Equity	$1,327,050			$1,342,544		
Net interest income and spread		$27,489	2.90 %		$27,418	2.85 %
Net interest margin			3.07 %			3.02 %

Note:

(1) The above table reflects the average rates earned or paid stated on an FTE basis assuming a 35% tax rate. Non-GAAP interest income on a fully taxable equivalent was $610 and $734, respectively.

(2) Net interest margin is calculated as net interest income divided by average earning assets.
(3) The average yields on investments are based on amortized cost.

Net interest income, on an FTE basis, increased $.1 million (.26%) during the first nine months of 2015 over the same period in 2014 due to a $1.0 million (11.67%) decrease in interest expense, which was partially offset by a $.9 million (2.50%) decrease in interest income. The net interest margin in the first nine months of 2015 was 3.07%, compared to 3.02% for the first nine months of 2014.

Comparing the first nine months of 2015 to the same period of 2014, the decline in interest income was due to a $14.5 million decrease in average earning asset balances as well as a five basis point reduction in the rates. The rate decline was due to the loan portfolio repricing and new loans booked at lower rates. The decrease in average earning assets was due to a $22.7 million reduction in investment securities and a $12.1 million decrease in fed funds sold, offset by a $24.3 million increase in loans.

Interest expense decreased during the first nine months of 2015 when compared to the same period of 2014 due to an overall reduction in the average rate paid on interest-bearing liabilities and a decrease of $25.6 million on our average interest-bearing liabilities. The effect on the average rate paid was a 10 basis point decrease from 1.08% for the nine months ended September 30, 2014 to .98% for the same period of 2015.

The following table sets forth the average balances, net interest income and expense, and average yields and rates of our interest-earning assets and interest-bearing liabilities for the three-month periods ended September 30, 2015 and 2014:

(dollars in thousands)	Three months ended September 30, 2015 Average Balance	Interest	**Average Yield/Rate**		2014 Average Balance	Interest	**Average Yield/Rate**	
Assets								
Loans	$842,189	$9,320	4.39	%	$824,268	$9,456	4.55	%
Investment Securities:								
Taxable	271,411	1,755	2.57		278,544	1,580	2.25	
Non taxable	33,689	483	5.69		39,947	595	5.90	
Total	305,100	2,238	2.91		318,491	2,175	2.71	
Federal funds sold	34,330	14	0.16		56,841	30	0.21	
Interest-bearing deposits with other banks	3,692	1	0.11		7,468	1	0.03	
Other interest earning assets	6,080	78	5.12		7,486	68	3.58	
Total earning assets	1,191,391	11,651	3.88	%	1,214,554	11,730	3.83	%
Allowance for loan losses	(11,890)				(12,272)			
Non-earning assets	141,912				137,770			
Total Assets	$1,321,413				$1,340,052			
Liabilities and Shareholders’ Equity								
Interest-bearing demand deposits	$160,616	$23	0.06	%	$140,981	$29	0.08	%
Interest-bearing money markets	218,661	122	0.22		216,502	129	0.24	
Savings deposits	138,837	56	0.16		125,742	60	0.19	
Time deposits:								
Less than $100k	141,711	368	1.03		159,389	441	1.10	
$100k or more	130,328	391	1.19		144,024	495	1.36	
Short-term borrowings	39,010	14	0.14		47,181	16	0.13	
Long-term borrowings	152,452	1,277	3.32		182,631	1,502	3.26	
Total interest-bearing liabilities	981,615	2,251	0.91	%	1,016,450	2,672	1.04	%
Non-interest-bearing deposits	203,971				200,449			
Other liabilities	21,433				10,914			
Shareholders’ Equity	114,394				112,239			
Total Liabilities and Shareholders’ Equity	$1,321,413				$1,340,052			
Net interest income and spread		$9,400	2.97	%		$9,058	2.79	%
Net interest margin			3.13	%			2.96	%

Note:

(1) The above table reflects the average rates earned or paid stated on an FTE basis assuming a 35% tax rate. Non-GAAP interest income on a fully taxable equivalent was $190 and $233, respectively.

(2) Net interest margin is calculated as net interest income divided by average earning assets.

(3) The average yields on investments are based on amortized cost.

Net interest income, on an FTE basis, increased $.3 million during the third quarter of 2015 over the same period in 2014 due to a decrease of $.4 million (15.76%) in interest expense, offset by a $.1 million (.67%) decrease in interest income. The decrease in interest expense was primarily due to the decrease in the average balance of long-term borrowings relating to the payments of sub-debt and a FHLB advance. The net interest margin for the third quarter of 2015 increased to 3.13% from 2.96% for the three months ended September 30, 2014.

Interest expense decreased during the third quarter of 2015 when compared to the same period of 2014 due to the overall reduction in average interest-bearing liabilities of $34.8 million. The overall effect was a 13 basis point decrease in the average rate paid on our average interest-bearing liabilities, from 1.04% for the three months ended September 30, 2014 to .91% for the same period of 2015.

The following table sets forth an analysis of volume and rate changes in interest income and interest expense for our average interest-earning assets and average interest-bearing liabilities for the nine-month periods ending September 30, 2015 and September 30, 2014:

	2015 Compared to 2014		
(in thousands and tax equivalent basis)	Volume	Rate	Net
Interest Income:			
Loans	$1,067	$(1,663)	$(596)
Taxable Investments	(37)	79	42
Non-taxable Investments	(1,237)	909	(328)
Federal funds sold	(19)	(13)	(32)
Other interest earning assets	(185)	209	24
Total interest income	(411)	(479)	(890)
Interest Expense:			
Interest-bearing demand deposits	6	(24)	(18)
Interest-bearing money markets	14	(26)	(12)
Savings deposits	23	(20)	3
Time deposits less than $100	(221)	0	(221)
Time deposits $100 or more	(144)	(79)	(223)
Short-term borrowings	(14)	10	(4)
Long-term borrowings	(402)	(84)	(486)
Total interest expense	(738)	(223)	(961)
Net interest income	$327	$(256)	$71

Note:

(1) The change in interest income/expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

The following table sets forth an analysis of volume and rate changes in interest income and interest expense for our average interest-earning assets and average interest-bearing liabilities for the three-month periods ending September 30, 2015 and September 30, 2014:

	2015 Compared to 2014		
(in thousands and tax equivalent basis)	Volume	Rate	Net
Interest Income:			
Loans	$787	$(923)	$(136)
Taxable Investments	(183)	358	175
Non-taxable Investments	(356)	244	(112)
Federal funds sold	(36)	20	(16)
Other interest earning assets	(271)	281	10
Total interest income	(59)	(20)	(79)
Interest Expense:			
Interest-bearing demand deposits	11	(17)	(6)
Interest-bearing money markets	5	(12)	(7)
Savings deposits	21	(25)	(4)
Time deposits less than $100	(182)	109	(73)
Time deposits $100 or more	(163)	59	(104)
Short-term borrowings	(12)	10	(2)
Long-term borrowings	(1,003)	778	(225)
Total interest expense	(1,323)	902	(421)
Net interest income	$1,264	$(922)	$342

Note:

(1) The change in interest income/expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Provision for Loan Losses

The provision for loan losses was $.6 million for the nine months ended September 30, 2015 compared to $1.6 million for the nine months ended September 30, 2014. The lower net charge-offs as well as continued reductions in the level of classified and impaired assets (discussed below in the section entitled “FINANCIAL CONDITION” under the heading “Allowance and Provision for Loan Losses”), were contributing factors to the lower provision expense. Management strives to ensure that the ALL reflects a level commensurate with the risk inherent in our loan portfolio.

Other Operating Income

Other operating income, exclusive of gains, increased $.5 million during the first nine months of 2015 when compared to the same period of 2014. This increase was attributable to increases in trust and brokerage income and earnings on Bank Owned Life Insurance due to new purchases of general account contracts during the second quarter of 2015.

Net gains of $.1 million were reported in other income in the first nine months of 2015, compared to net gains of $1.1 million during the same period of 2014. The decrease resulted from a reduction in gains on sales of investment securities held-for-trading relating to four CDOs that had been written down through impairment charges in prior years.

Other operating income, exclusive of gains, increased $.3 million during the third quarter of 2015 when compared to the same period of 2014. We saw increases in trust and brokerage income, debit card income and earnings on Bank Owned Life Insurance due to new purchases of general account contracts during the second quarter of 2015.

Net gains of $.1 million were reported in other income in the third quarter of 2015, compared to net gains of $.2 million during the same period of 2014.

The following table shows the major components of other operating income for the nine- and three-month periods ended September 30, 2015 and 2014, exclusive of net gains:

	Income as % of Total Other Operating Income For the nine months ended September 30,				Income as % of Total Other Operating Income For the three months ended September 30,			
	2015		2014		2015		2014	
Service charges	22	%	23	%	23	%	24	%
Trust department	43	%	42	%	42	%	43	%
Debit card Income	16	%	16	%	17	%	17	%
Bank owned life insurance	9	%	8	%	8	%	8	%
Brokerage income	7	%	6	%	7	%	6	%
Other income	3	%	5	%	3	%	2	%
	100	%	100	%	100	%	100	%

Other Operating Expenses

Operating expenses decreased $.2 million in the first nine months of 2015 when compared to the same period of 2014. This was due to a $1.2 million decrease in OREO expenses primarily due to a reduction in valuation allowances and a gain booked on the sale of a hotel property in the third quarter of 2015, offset by a $1.1 million increase in salaries and employee benefits due to increased costs related to the administration of the pension plan and health care costs.

Operating expenses decreased $.2 million in the third quarter of 2015 when compared to the same period of 2014. This decrease was due to decreases in OREO expenses relating to a reduction in valuation allowances and a gain booked on the sale of a hotel property and decreases in other miscellaneous expenses. These decreases were offset by a $.5 million increase in salaries and benefits due primarily to increased pension costs and health care costs.

The composition of other operating expenses for the nine- and three-month periods ended September 30, 2015 and 2014 is illustrated in the following table.

	Expense as % of Total Other Operating Expenses For the nine months ended September 30,				Expense as % of Total Other Operating Expenses For the three months ended September 30,			
	2015		2014		2015		2014	
Salaries and employee benefits	52	%	48	%	56	%	50	%
FDIC premiums	5	%	4	%	5	%	5	%
Occupancy, equipment and data processing	20	%	20	%	22	%	20	%
Professional Services	4	%	4	%	2	%	2	%
Other real estate owned	3	%	7	%	0	%	5	%
Other	16	%	17	%	15	%	18	%
	100	%	100	%	100	%	100	%

Provision for Income Taxes

In reporting interim financial information, income tax provisions should be determined under the procedures set forth in ASC Topic 740, *Income Taxes* (Section 740-270-30). This guidance provides that at the end of each interim period, an entity should make its best estimate of the effective tax rate expected to be applicable for the full fiscal year. The rate so determined should be used in providing for income taxes on a current year-to-date basis. The effective tax rate should reflect anticipated investment tax credits, capital gains rates, and other available tax planning alternatives. In arriving at this effective tax rate, however, no effect should be included for the tax related to significant, unusual or extraordinary items that will be separately reported or reported net of their related tax effect in reports for the interim period or for the fiscal year.

The effective tax rate for the first nine months of 2015 was 23.1%, compared to an effective tax rate of 19.8% for the first nine months of 2014. Our effective income tax rates differed from the 35% federal statutory rate due to the effects of tax-exempt income on loans, securities and bank-owned life insurance, as well as the low income housing tax credits.

FINANCIAL CONDITION

Balance Sheet Overview

When compared to December 31, 2014, total assets at September 30, 2015 remained stable at $1.3 billion. During the first nine months of 2015, cash and interest-bearing deposits in other banks increased $29.3 million, the investment portfolio decreased $38.3 million, Bank Owned Life Insurance increased $6.4 million, due primarily to new general account contracts purchased in the second quarter, and gross loans increased $3.1 million. Total liabilities decreased by $17.6 million during the first nine months of 2015 due primarily to reductions of $1.3 million in short-term borrowings and $35.1 million in long-term borrowings due to the repayment of First United Corporation’s junior subordinated debentures of $5.0 million that matured in March of 2015 and the repayment of an FHLB advance of $30.0 million that matured in July of 2015. This decline was offset by an increase of $15.0 million in total deposits. Comparing September 30, 2015 to December 31, 2014, shareholders’ equity increased $5.6 million as a result of a $3.0 million decrease in accumulated other comprehensive loss and $2.5 million in earnings during the first nine months of 2015.

Loan Portfolio

The following table presents the composition of our loan portfolio at the dates indicated:

(dollars in thousands)	September 30, 2015			December 31, 2014		
Commercial real estate	$ 265,933	31	%	$ 256,064	30	%
Acquisition and development	98,756	12	%	99,301	12	%
Commercial and industrial	74,780	9	%	93,255	11	%
Residential mortgage	378,947	45	%	367,641	44	%
Consumer	24,676	3	%	23,730	3	%
Total Loans	$ 843,092	100	%	$ 839,991	100	%

Comparing September 30, 2015 to December 31, 2014, outstanding loans increased by $3.1 million (.37%). Commercial real estate (“CRE”) loans increased $9.9 million, acquisition and development (“A&D”) loans decreased $.5 million, commercial and industrial (“C&I”) loans decreased $18.5 million, residential mortgages increased by $11.3 million, and the consumer portfolio increased by $.9 million. Approximately 43% of the commercial loan portfolio was collateralized by real estate at September 30, 2015 and 44% at December 31, 2014.

Risk Elements of Loan Portfolio

The following table presents the risk elements of our loan portfolio at the dates indicated. Management is not aware of any potential problem loans other than those listed in this table or discussed below.

(dollars in thousands)	September 30, 2015	% of Applicable Portfolio	December 31, 2014	% of Applicable Portfolio
Non-accrual loans:				
Commercial real estate	$ 6,406	2.41 %	$ 5,762	2.30 %
Acquisition and development	2,942	2.98 %	3,609	3.60 %
Commercial and industrial	169	0.23 %	171	0.20 %
Residential mortgage	2,259	0.60 %	2,009	0.54 %
Consumer	0	0.00 %	0	0.00 %
Total non-accrual loans	$ 11,776	1.40 %	$ 11,551	1.38 %
Accruing Loans Past Due 90 days or more:				
Commercial real estate	$ 148		$ 0	
Acquisition and development	0		1	
Commercial and industrial	0		4	
Residential mortgage	509		485	
Consumer	0		39	
Total loans past due 90 days or more	$ 657		$ 529	
Total non-accrual and accruing loans past due 90 days or more	$ 12,433		$ 12,080	
Restructured Loans (TDRs):				
Performing	$ 11,044		$ 7,621	
Non-accrual (included above)	6,813		6,063	
Total TDRs	$ 17,857		$ 13,684	
Other real estate owned	$ 7,477		$ 12,932	
Impaired loans without a valuation allowance	$ 18,471		$ 19,937	
Impaired loans with a valuation allowance	5,554		4,844	
Total impaired loans	$ 24,025		$ 24,781	
Valuation allowance related to impaired loans	$ 1,720			