FIRST UNITED CORP/MD/
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For quarterly period ended September 30, 2018

¨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 every Interactive Data File required to be submitted 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 such files). Yes þ No ¨

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

Large accelerated filer ¨	Accelerated filer þ
Non-accelerated filer ¨	Smaller reporting company þ
Emerging growth company ¨	

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 7,084,478 shares of common stock, par value $.01 per share, as of October 31, 2018.

INDEX TO QUARTERLY REPORT

FIRST UNITED CORPORATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST UNITED CORPORATION

Consolidated Statement of Financial Condition

(In thousands, except per share data)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and due from banks	$21,725	$ 82,273
Interest bearing deposits in banks	1,832	1,479
Cash and cash equivalents	23,557	83,752
Investment securities – available-for-sale (at fair value)	138,645	146,470
Investment securities – held to maturity (fair value $91,896 at September 30, 2018 and $95,346 at December 31, 2017)	93,726	93,632
Restricted investment in bank stock, at cost	5,394	5,204
Loans	964,060	892,518
Allowance for loan losses	(10,323)	(9,972)
Net loans	953,737	882,546
Premises and equipment, net	36,894	30,881
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	43,027	42,155
Deferred tax assets	9,029	9,252
Other real estate owned	7,482	10,141
Accrued interest receivable and other assets	25,411	21,433
Total Assets	$1,347,906	$ 1,336,470
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$264,317	$ 252,049
Interest bearing deposits	760,258	787,341
Total deposits	1,024,575	1,039,390
Short-term borrowings	86,805	48,845
Long-term borrowings	100,929	120,929
Accrued interest payable and other liabilities	20,016	18,916
Total Liabilities	1,232,325	1,228,080

Shareholders' Equity:		
Common Stock – par value $.01 per share;Authorized 25,000 shares; issued and outstanding 7,084 shares at September 30, 2018 and 7,067 at December 31, 2017	71	71
Surplus	31,815	31,553
Retained earnings	107,733	101,359
Accumulated other comprehensive loss	(24,038)	(24,593)
Total Shareholders' Equity	115,581	108,390
Total Liabilities and Shareholders' Equity	$1,347,906	$ 1,336,470

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,	
	2018	2017
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 32,895	$ 29,504
Interest on investment securities		
Taxable	4,380	4,153
Exempt from federal income tax	706	691
Total investment income	5,086	4,844
Other	369	578
Total interest income	38,350	34,926
Interest expense		
Interest on deposits	2,856	2,418
Interest on short-term borrowings	253	51
Interest on long-term borrowings	2,535	3,057
Total interest expense	5,644	5,526
Net interest income	32,706	29,400
Provision for loan losses	1,187	1,809
Net interest income after provision for loan losses	31,519	27,591
Other operating income		
Net gains	190	3
Service charges	2,374	2,310
Trust department	5,010	4,629
Debit card income	1,818	1,805
Bank owned life insurance	872	894
Brokerage commissions	828	662
Other	306	331
Total other income	11,208	10,631
Total other operating income	11,398	10,634
Other operating expenses		
Salaries and employee benefits	18,308	16,478
FDIC premiums	474	451
Equipment	2,246	1,855
Occupancy	1,909	1,862
Data processing	2,844	2,644
Marketing	386	407
Professional Services	947	844
Contract Labor	522	534

Telephony Expense	637	601
Other real estate owned	682	305
Other	3,450	3,387
Total other operating expenses	32,405	29,368
Income before income tax expense	10,512	8,857
Provision for income tax expense	2,227	2,556
Net Income	8,285	6,301
Accumulated preferred stock dividends	0	(990)
Net Income Available to Common Shareholders	$8,285	$5,311
Basic and diluted net income per common share	$1.17	$0.77
Weighted average number of basic and diluted shares outstanding	7,076	6,887
Dividends declared per common share	$0.27	$0.00

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,	
	2018	2017
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 11,487	$ 9,987
Interest on investment securities		
Taxable	1,459	1,410
Exempt from federal income tax	233	237
Total investment income	1,692	1,647
Other	85	274
Total interest income	13,264	11,908
Interest expense		
Interest on deposits	1,072	841
Interest on short-term borrowings	129	17
Interest on long-term borrowings	807	948
Total interest expense	2,008	1,806
Net interest income	11,256	10,102
Provision for loan losses	471	901
Net interest income after provision for loan losses	10,785	9,201
Other operating income		
Net gains/(losses)	9	(11)
Service charges	814	802
Trust department	1,705	1,579
Debit card income	617	661
Bank owned life insurance	288	294
Brokerage commissions	277	236
Other	96	100
Total other income	3,797	3,672
Total other operating income	3,806	3,661
Other operating expenses		
Salaries and employee benefits	6,270	5,686
FDIC premiums	171	183
Equipment	810	619
Occupancy	657	643
Data processing	1,001	919
Marketing	153	137
Professional Services	304	307
Contract Labor	185	128

Telephony Expense	207	199
Other real estate owned	189	93
Other	1,142	1,125
Total other operating expenses	11,089	10,039
Income before income tax expense	3,502	2,823
Provision for income tax expense	739	811
Net Income	2,763	2,012
Accumulated preferred stock dividends	0	(225)
Net Income Available to Common Shareholders	$ 2,763	$ 1,787
Basic and diluted net income per common share	$ 0.39	$ 0.25
Weighted average number of basic and diluted shares outstanding	7,084	7,067
Dividends declared per common share	$ 0.09	$ 0.00

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

Comprehensive Income (in thousands)	Nine months ended September 30, 2018 (Unaudited)	2017
Net Income	$ 8,285	$ 6,301
Other comprehensive income, net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	1,851	244
Net unrealized (losses)/gains on all other AFS securities	(1,973)	1,747
Net unrealized gains on HTM securities	146	158
Net unrealized gains/(losses) on cash flow hedges	663	(94)
Net unrealized (losses)/gains on pension	(219)	380
Net unrealized gains on SERP	87	65
Other comprehensive income, net of tax	555	2,500
Comprehensive income	$ 8,840	$ 8,801

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

	Three months ended September 30,	
	2018	2017
Comprehensive Income (in thousands)	(Unaudited)	
Net Income	$ 2,763	$ 2,012
Other comprehensive income, net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	261	212
Net unrealized losses on all other AFS securities	(665)	(39)
Net unrealized gains on HTM securities	63	54
Net unrealized gains on cash flow hedges	112	4
Net unrealized gains on pension	575	184
Net unrealized gains on SERP	29	22
Other comprehensive income, net of tax	375	437
Comprehensive income	$ 3,138	$ 2,449

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	(Unaudited)					
Balance at January 1, 2018	$0	$ 71	$31,553	$101,359	$ (24,593)	$ 108,390
Net income				2,506		2,506
Other comprehensive income					820	820
Common stock issued						-
Common stock dividend declared - $.09 per share				(635)		(635)
Stock based compensation			53			53
Balance at March 31, 2018	0	71	31,606	103,230	(23,773)	111,134
Net income				3,016		3,016
Other comprehensive loss					(640)	(640)
Common stock issued			40			40
Common stock dividend declared - $.09 per share				(639)		(639)
Stock based compensation			63			63
Balance at June 30, 2018	0	71	31,709	105,607	(24,413)	112,974
Net income				2,763		2,763
Other comprehensive income					375	375
Common stock issued			39			39
Common stock dividend declared - $.09 per share				(637)		(637)
Stock based compensation			67			67
Balance at September 30, 2018	$0	$ 71	$31,815	$107,733	$ (24,038)	$ 115,581

See accompanying notes to the consolidated financial statements

8

FIRST UNITED CORPORATION

Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	(Unaudited)					
Balance at January 1, 2017	$20,000	$ 63	$22,178	$92,922	$ (21,465)	$ 113,698
Net income				1,980		1,980
Other comprehensive income					505	505
Stock based compensation			37			37
Common stock issued		8	9,196			9,204
Preferred stock redemption	(10,000)					(10,000)
Preferred stock dividends paid				(540)		(540)
Balance at March 31, 2017	10,000	71	31,411	94,362	(20,960)	114,884
Net income				2,309		2,309
Other comprehensive income					1,558	1,558
Stock based compensation			48			48
Common stock issued			(13)			(13)
Preferred stock dividends paid				(225)		(225)
Balance at June 30, 2017	10,000	71	31,446	96,446	(19,402)	118,561
Net income				2,012		2,012
Other comprehensive income					437	437
Stock based compensation			53			53
Preferred stock dividends paid				(225)		(225)
Balance at September 30, 2017	10,000	71	31,499	98,233	(18,965)	120,838
Net loss				(1,032)		(1,032)
Other comprehensive loss					(1,245)	(1,245)
Stock based compensation			54			54
Preferred stock redemption	(10,000)					(10,000)
Reclassification of certain tax effects				4,383	(4,383)	-
Preferred stock dividends paid				(225)		(225)

Balance at December 31, 2017	$0	$ 71	$31,553	$101,359	$ (24,593)	$ 108,390

See accompanying notes to the consolidated financial statements

9

FIRST UNITED CORPORATION

Consolidated Statement of Cash Flows

(In thousands)

	Nine months ended September 30,	
	2018	2017
	(Unaudited)	
Operating activities		
Net income	$8,285	$6,301
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,187	1,809
Depreciation	1,748	1,397
Stock compensation	183	138
Gains on sales of other real estate owned	(269)	(589)
Write-downs of other real estate owned	656	551
Originations of loans held for sale	(10,028)	(7,321)
Proceeds from sale of loans held for sale	9,329	6,536
Gains from sale of loans held for sale	(74)	(48)
Losses on disposal of fixed assets	0	1
Net amortization of investment securities discounts and premiums- AFS	36	130
Net amortization of investment securities discounts and premiums- HTM	33	50
(Gains)/losses on sales/calls of investment securities – available-for-sale	(116)	44
Amortization of deferred loan fees	(565)	(427)
Increase in accrued interest receivable and other assets	(3,251)	(6,848)
(Increase)/decrease in deferred tax benefit	223	1,657
Increase in accrued interest payable and other liabilities	1,100	698
Earnings on bank owned life insurance	(872)	(894)
Net cash provided by operating activities	7,605	3,185
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	9,118	16,034
Proceeds from maturities/calls of investment securities held-to-maturity	4,760	5,332
Proceeds from sales of investment securities available-for-sale	2,005	18,530
Purchases of investment securities available-for-sale	(3,390)	(40,596)
Purchases of investment securities held-to-maturity	(4,887)	(4,188)
Proceeds from sales of other real estate owned	2,815	2,466
Proceeds from disposal of fixed assets	0	8
Net (increase)/decrease in FHLB stock	(190)	5
Net (increase)/decrease in loans	(46,415)	1,010
Purchases of loans	(25,168)	0
Purchases of premises and equipment	(7,761)	(4,509)
Net cash used in investing activities	(69,113)	(5,908)

Financing activities		
Net (decrease)/increase in deposits	(14,815)	27,239
Preferred stock dividends paid	0	(990)
Preferred stock redemption	0	(10,000)
Proceeds from sale of common stock	79	9,349
Rights Offering costs	0	(158)
Cash dividends on common stock	(1,911)	0
Net increase in short-term borrowings	37,960	9,815
Net decrease in long-term borrowings	(20,000)	(10,808)
Net cash provided by financing activities	1,313	24,447
(Decrease)/increase in cash and cash equivalents	(60,195)	21,724
Cash and cash equivalents at beginning of the year	83,752	63,310
Cash and cash equivalents at end of period	$23,557	$85,034
Supplemental information		
Interest paid	$5,549	$5,474
Taxes paid	$445	$175
Non-cash investing activities:		
Transfers from loans to other real estate owned	$543	$1,299

See accompanying notes to the consolidated financial statements

10

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 10-01 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, 2018 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, 2017. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2018 presentation. Such reclassifications had no impact on net income or equity.

As used in these notes, the term "the Corporation" refers to First United Corporation and, unless the context clearly requires otherwise, its consolidated subsidiaries.

The Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of September 30, 2018 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, *Subsequent Events*.

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. No common stock equivalents were outstanding at September 30, 2018 or September 30, 2017.

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, 2018 and 2017:

	Nine months ended September 30,					
	2018			2017		
(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	$8,285			$6,301		
Preferred stock dividends	0			(990)		
Net income available to common shareholders	$8,285	7,076	$ 1.17	$5,311	6,887	$ 0.77

	Three months ended September 30,					
	2018			2017		
(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	$2,763			$2,012		
Preferred stock dividends	0			(225)		
Net income available to common shareholders	$2,763	7,084	$ 0.39	$1,787	7,067	$ 0.25

Note 3 – Net Gains/(Losses)

The following table summarizes the gain/(loss) activity for the nine- and three-month periods ended September 30, 2018 and 2017:

	Nine months ended September 30,		Three months ended September 30,	
(in thousands)	2018	2017	2018	2017
Net gains/(losses):				
Available-for-sale securities:				
Realized gains	$ 151	$ 52	$ 6	$ 0
Realized losses	(35)	(96)	(16)	(27)
Gains on sale of consumer loans	74	48	19	16
Losses on disposal of fixed assets	0	(1)	0	0
Net gains/(losses):	$ 190	$ 3	$ 9	$ (11)

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, 2018	December 31, 2017
Cash and due from banks, weighted average interest rate of 0.67% (at September 30, 2018)	$ 21,725	$ 82,273

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, 2018 and December 31, 2017, consisted of daily funds invested at the Federal Home Loan Bank ("FHLB") of Atlanta and Merchants and Traders Bank ("M&T").

(in thousands)	September 30, 2018	December 31, 2017
FHLB daily investments, interest rate of 2.08% (at September 30, 2018)	$ 816	$ 464
M&T daily investments, interest rate of 0.15% (at September 30, 2018)	1,016	1,015

	$ 1,832	$ 1,479

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, 2018 and December 31, 2017:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCL
September 30, 2018					
Available for Sale:					
U.S. government agencies	$ 30,000	$ 0	$ 1,435	$ 28,565	$ 0
Commercial mortgage-backed agencies	39,433	0	1,802	37,631	0
Collateralized mortgage obligations	37,900	0	1,778	36,122	0
Obligations of states and political subdivisions	20,228	118	587	19,759	0
Collateralized debt obligations	18,338	87	1,857	16,568	(853)
Total available for sale	$ 145,899	$ 205	$ 7,459	$ 138,645	$ (853)
Held to Maturity:					
U.S. government agencies	$ 15,982	$ 0	$ 160	$ 15,822	$ 0
Residential mortgage-backed agencies	47,776	7	1,899	45,884	0
Commercial mortgage-backed agencies	16,569	0	340	16,229	0
Collateralized mortgage obligations	3,769	0	260	3,509	0
Obligations of states and political subdivisions	9,630	971	149	10,452	0
Total held to maturity	$ 93,726	$ 978	$ 2,808	$ 91,896	$ 0
December 31, 2017					
Available for Sale:					
U.S. government agencies	$ 30,000	$ 0	$ 744	$ 29,256	$ 0
Commercial mortgage-backed agencies	41,771	0	880	40,891	0
Collateralized mortgage obligations	41,298	2	916	40,384	0
Obligations of states and political subdivisions	20,772	365	118	21,019	0
Collateralized debt obligations	19,711	0	4,791	14,920	(3,389)
Total available for sale	$ 153,552	$ 367	$ 7,449	$ 146,470	$ (3,389)
Held to Maturity:					
U.S. government agencies	$ 15,876	$ 447	$ 0	$ 16,323	$ 0
Residential mortgage-backed agencies	47,771	94	423	47,442	0
Commercial mortgage-backed agencies	17,288	236	6	17,518	0
Collateralized mortgage obligations	4,187	0	69	4,118	0
Obligations of states and political subdivisions	8,510	1,443	8	9,945	0
Total held to maturity	$ 93,632	$ 2,220	$ 506	$ 95,346	$ 0

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

	Nine months ended	Three months ended

	September 30,		September 30,	
(in thousands)	2018	2017	2018	2017
Proceeds	$ 2,005	$ 18,530	$ 2,005	$ 0
Realized gains	151	52	6	0
Realized losses	35	96	16	27

13

The following table shows the Corporation's investment securities with gross unrealized losses and fair values at September 30, 2018 and December 31, 2017, 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, 2018				
Available for Sale:				
U.S. government agencies	$ 0	$ 0	$ 28,565	$ 1,435
Commercial mortgage-backed agencies	0	0	37,631	1,802
Collateralized mortgage obligations	300	1	35,822	1,777
Obligations of states and political subdivisions	10,019	344	4,842	243
Collateralized debt obligations	0	0	10,089	1,857
Total available for sale	$ 10,319	$ 345	$ 116,949	$ 7,114
Held to Maturity:				
U.S. government agencies	$ 15,822	$ 160	$ 0	$ 0
Residential mortgage-backed agencies	23,860	741	21,864	1,158
Commercial mortgage-backed agencies	16,229	340	0	0
Collateralized mortgage obligations	0	0	3,509	260
Obligations of states and political subdivisions	2,146	149	0	0
Total held to maturity	$ 58,057	$ 1,390	$ 25,373	$ 1,418
December 31, 2017				
Available for Sale:				
U.S. government agencies	$ 4,931	$ 69	$ 24,325	$ 675
Commercial mortgage-backed agencies	12,593	169	28,298	711
Collateralized mortgage obligations	27,387	472	12,447	443
Obligations of states and political subdivisions	2,683	44	2,747	75
Collateralized debt obligations	0	0	14,920	4,791
Total available for sale	$ 47,594	$ 754	$ 82,737	$ 6,695
Held to Maturity:				
Residential mortgage-backed agencies	$ 15,897	$ 135	$ 10,422	$ 288
Commercial mortgage-backed agencies	9,028	6	0	0
Collateralized mortgage obligations	0	0	4,118	69
Obligations of states and political subdivisions	2,377	8	0	0
Total held to maturity	$ 27,302	$ 149	$ 14,540	$ 357

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320 (ASC 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 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, 2018.

U.S. Government Agencies – Available for Sale – There were no U.S. government agency investments in an unrealized loss position for less than 12 months as of September 30, 2018. There were five U.S. government agency investments in an unrealized loss position for more than 12 months as of September 30, 2018. The securities are of investment grade and the Corporation does not intend to sell them, and it is not more than 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, 2018.

Commercial Mortgage-Backed Agencies – Available for Sale – There were no commercial mortgage-backed agencies in an unrealized loss position for less than 12 months as of September 30, 2018. There were eight commercial mortgage-backed agencies in an unrealized loss position for more than 12 months as of September 30, 2018. 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, 2018.

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, 2018. There were eight collateralized mortgage obligations in an unrealized loss position for more than 12 months as of September 30, 2018. 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, 2018.

Obligations of State and Political Subdivisions – Available for Sale – There were 11 obligations of state and political subdivisions that have been in an unrealized loss position for less than 12 months and three securities that have been in an unrealized loss position for 12 months or more at September 30, 2018. 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, 2018.

Collateralized Debt Obligations – Available for Sale - The $1.9 million in unrealized losses recorded with respect to the CDOs that had been in an unrealized loss position for 12 months or more as of September 30, 2018 relates to five pooled trust preferred securities. 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 2018. At September 30, 2018, four of the CDO securities were in an unrealized gain position.

U.S. Government Agencies – Held to Maturity – There were two U.S. government agencies in an unrealized loss position for less than 12 months as of September 30, 2018. There were no U.S. government agency investments in an unrealized loss position for more than 12 months as of September 30, 2018. The securities are of investment grade and the Corporation does not intend to sell them, and it is not more than 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, 2018.

Residential Mortgage-Backed Agencies – Held to Maturity – There were thirteen residential mortgage-backed agencies in an unrealized loss position for less than 12 months as of September 30, 2018. There were eighteen residential mortgage-backed agency investments in an unrealized loss position for more than 12 months as of September 30, 2018. 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, 2018.

Commercial Mortgage-Backed Agencies – Held to Maturity - There were four commercial mortgage-backed agency investments in an unrealized loss position for less than 12 months as of September 30, 2018. 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, 2018. There were no commercial mortgage-backed agencies in a loss position for more than 12 months as of September 30, 2018.

Collateralized Mortgage Obligations – Held to Maturity – There were no collateralized mortgage obligations in an unrealized loss position for less than 12 months as of September 30, 2018. There was one collateralized mortgage obligation in a loss position for more than 12 months as of September 30, 2018. 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, 2018.

Obligations of State and Political Subdivisions – Held to Maturity –There was one obligation of state and political subdivisions that has been in an unrealized loss for less than 12 months as of September 30, 2018. 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, 2018. There were no obligations of state and political subdivisions securities in an unrealized loss position for more than 12 months as of September 30, 2018.

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, 2018 and 2017:

	Nine months ended September 30,	
(in thousands)	2018	2017
Balance of credit-related OTTI at January 1	$ 2,958	$ 3,124
Reduction for increases in cash flows expected to be collected	(160)	(112)
Balance of credit-related OTTI at September 30	$ 2,798	$ 3,012

	Three months ended September 30,	
(in thousands)	2018	2017
Balance of credit-related OTTI at July 1	$ 2,851	$ 3,067
Reduction for increases in cash flows expected to be collected	(53)	(55)
Balance of credit-related OTTI at September 30	$ 2,798	$ 3,012

The amortized cost and estimated fair value of securities by contractual maturity at September 30, 2018 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, 2018	
(in thousands)	Amortized Cost	Fair Value
Contractual Maturity		
Available for sale:		
Due in one year or less	$231	$234
Due after one year through five years	16,083	15,629
Due after five years through ten years	22,840	21,676
Due after ten years	29,412	27,353
	68,566	64,892
Commercial mortgage-backed agencies	39,433	37,631
Collateralized mortgage obligations	37,900	36,122
Total available for sale	$145,899	$138,645
Held to Maturity:		
Due after five years through ten years	$15,982	$15,822
Due after ten years	9,630	10,452
	25,612	26,274
Residential mortgage-backed agencies	47,776	45,884
Commercial mortgage-backed agencies	16,569	16,229
Collateralized mortgage obligations	3,769	3,509
Total held to maturity	$93,726	$91,896

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 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, 2018.

The Corporation recognizes dividends received on its restricted stock investments on a cash basis. For the nine months ended September 30, 2018, dividends of $207,791 were recognized in earnings. For the comparable period of 2017, dividends of $188,126 were recognized in earnings. For the three months ended September 30, 2018, dividends of $72,448 were recognized in earnings. For the comparable period of 2017, dividends of $61,637 were recognized in earnings.

17

Note 7 – Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio at September 30, 2018 and December 31, 2017:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
September 30, 2018						
Individually evaluated for impairment	$ 5,801	$ 658	$ 17	$ 4,121	$ 21	$ 10,618
Collectively evaluated for impairment	$ 286,993	$ 113,031	$ 98,493	$ 421,348	$ 33,577	$ 953,442
Total loans	$ 292,794	$ 113,689	$ 98,510	$ 425,469	$ 33,598	$ 964,060
December 31, 2017						
Individually evaluated for impairment	$ 9,076	$ 976	$ 668	$ 4,201	$ 30	$ 14,951
Collectively evaluated for impairment	$ 274,086	$ 109,554	$ 76,055	$ 394,447	$ 23,425	$ 877,567
Total loans	$ 283,162	$ 110,530	$ 76,723	$ 398,648	$ 23,455	$ 892,518

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, which are primarily first lien loans and home equity lines of credit, which are generally second liens. 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 Departments perform 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 Departments continually review and assess 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 at September 30, 2018 and December 31, 2017:

(in thousands)	Pass	Special Mention	Substandard	Total
September 30, 2018				
Commercial real estate				
Non owner-occupied	$136,244	$ 2,938	$ 2,818	$142,000
All other CRE	143,329	1,768	5,697	150,794
Acquisition and development				
1-4 family residential construction	21,048	0	0	21,048
All other A&D	84,704	7,378	559	92,641
Commercial and industrial	94,024	3,871	615	98,510
Residential mortgage				
Residential mortgage - term	348,112	0	4,675	352,787
Residential mortgage - home equity	71,445	144	1,093	72,682
Consumer	33,469	4	125	33,598
Total	$932,375	$ 16,103	$ 15,582	$964,060
December 31, 2017				
Commercial real estate				
Non owner-occupied	$133,725	$ 0	$ 5,843	$139,568
All other CRE	133,905	2,061	7,628	143,594
Acquisition and development				
1-4 family residential construction	17,719	0	0	17,719
All other A&D	84,345	7,294	1,172	92,811
Commercial and industrial	75,299	17	1,407	76,723
Residential mortgage				
Residential mortgage - term	319,059	0	5,326	324,385
Residential mortgage - home equity	73,059	148	1,056	74,263
Consumer	23,391	5	59	23,455
Total	$860,502	$ 9,525	$ 22,491	$892,518

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.

19

The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans at September 30, 2018 and December 31, 2017:

(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, 2018							
Commercial real estate							
Non owner-occupied	$141,374	$ 17	$ 0	$ 0	$ 17	$ 609	$ 142,000
All other CRE	148,713	31	0	0	31	2,050	150,794
Acquisition and development							
1-4 family residential construction	21,048	0	0	0	0	0	21,048
All other A&D	92,450	0	0	151	151	40	92,641
Commercial and industrial	98,380	129	0	1	130	0	98,510
Residential mortgage							
Residential mortgage - term	348,861	467	1,498	390	2,355	1,571	352,787
Residential mortgage - home equity	71,524	427	197	0	624	534	72,682
Consumer	33,369	150	42	17	209	20	33,598
Total	$955,719	$ 1,221	$ 1,737	$ 559	$ 3,517	$ 4,824	$ 964,060
December 31, 2017							
Commercial real estate							
Non owner-occupied	$136,134	$ 186	$ 0	$ 0	$ 186	$ 3,248	$ 139,568
All other CRE	141,680	461	248	0	709	1,205	143,594
Acquisition and development							
1-4 family residential construction	17,719	0	0	0	0	0	17,719
All other A&D	92,291	0	165	144	309	211	92,811
Commercial and industrial	76,322	0	17	6	23	378	76,723
Residential mortgage							
Residential mortgage - term	319,633	322	2,534	430	3,286	1,466	324,385
Residential mortgage - home equity	72,683	600	400	0	1,000	580	74,263
Consumer	23,273	115	22	15	152	30	23,455
Total	$879,735	$ 1,684	$ 3,386	$ 595	$ 5,665	$ 7,118	$ 892,518

Non-accrual loans totaled $4.8 million at September 30, 2018, compared to $7.1 million at December 31, 2017. The decrease in non-accrual balances at September 30, 2018 was primarily due to payoffs of two relationships totaling $2.5 million and a charge-off of $.8 million on one relationship, offset by the addition of one large commercial real estate credit of $1.9 million. Non-accrual loans that have been subject to partial charge-offs totaled $.8 million at September 30, 2018, compared to $2.1 million at December 31, 2017. Loans secured by 1-4 family residential real estate properties in the process of foreclosure were $.4 million at September 30, 2018 and December 31, 2017.

Accruing loans past due 30 days or more decreased to .36% of the loan portfolio at September 30, 2018, compared to .63% at December 31, 2017. The decrease for the first nine months of 2018 was due primarily to improvements in the commercial real estate and residential mortgage portfolios.

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 at September 30, 2018 and December 31, 2017, 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, 2018							
Individually evaluated for impairment	$ 170	$ 26	$ 0	$ 116	$ 3	$ 0	$315
Collectively evaluated for impairment	$ 2,643	$ 1,469	$ 1,001	$ 4,102	$ 293	$ 500	$10,008
Total ALL	$ 2,813	$ 1,495	$ 1,001	$ 4,218	$ 296	$ 500	$10,323
December 31, 2017							
Individually evaluated for impairment	$ 245	$ 40	$ 0	$ 65	$ 12	$ 0	$362
Collectively evaluated for impairment	$ 3,454	$ 1,217	$ 869	$ 3,379	$ 191	$ 500	$9,610
Total ALL	$ 3,699	$ 1,257	$ 869	$ 3,444	$ 203	$ 500	$9,972

Management uses the following methodology for determining impairment on consumer and commercial loans. All nonaccrual loans and all loans designated as troubled debt restructurings ("TDRs") are considered to be impaired. Additionally, an impairment evaluation is performed on any account that meets either of the following criteria: (a) commercial loans that (1) are risk-rated substandard and (2) have a balance of at least $500,000; and (b) commercial loans that are (1) part of a relationship having an amount of $750,000 or more and (2) at least 60 days past-due. For those loans that are not classified as nonaccrual or troubled debt restructures, a judgment is made as to the likelihood that contractual principal and interest will be collected. 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.

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. A valuation grid for impaired loans is used to determine when or how collateral values are to be updated based on size and collateral dependency for commercial loans and foreclosure status for consumer loans. 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 required at September 30, 2018 and December 31, 2017:

	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, 2018					
Commercial real estate					
Non owner-occupied	$ 685	$ 170	$ 46	$ 731	$ 8,516
All other CRE	0	0	5,070	5,070	5,070
Acquisition and development					
1-4 family residential construction	0	0	387	387	387
All other A&D	231	27	40	271	353
Commercial and industrial	0	0	17	17	2,231
Residential mortgage					
Residential mortgage - term	1,101	115	2,486	3,587	3,820
Residential mortgage – home equity	0	0	534	534	547
Consumer	10	3	11	21	21
Total impaired loans	$ 2,027	$ 315	$ 8,591	$ 10,618	$ 20,945
December 31, 2017					
Commercial real estate					
Non owner-occupied	$ 1,711	$ 245	$ 1,907	$ 3,618	$ 10,579
All other CRE	0	0	5,458	5,458	5,731
Acquisition and development					
1-4 family residential construction	0	0	527	527	527
All other A&D	295	40	154	449	722
Commercial and industrial	0	0	668	668	2,882
Residential mortgage					
Residential mortgage - term	598	65	3,023	3,621	3,919
Residential mortgage – home equity	0	0	580	580	593
Consumer	30	12	0	30	30
Total impaired loans	$ 2,634	$ 362	$ 12,317	$ 14,951	$ 24,983

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.

The following tables present the activity in the ALL for the nine- and three-month periods ended September 30, 2018 and 2017:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at January 1, 2018	$ 3,699	$ 1,257	$ 869	$ 3,444	$ 203	$ 500	$ 9,972
Charge-offs	(889)	(98)	(32)	(353)	(297)	0	(1,669)
Recoveries	60	290	44	323	116	0	833
Provision	(57)	46	120	804	274	0	1,187
ALL balance at September 30, 2018	$ 2,813	$ 1,495	$ 1,001	$ 4,218	$ 296	$ 500	$ 10,323
ALL balance at January 1, 2017	$ 3,913	$ 871	$ 858	$ 3,588	$ 188	$ 500	$ 9,918
Charge-offs	(2,798)	(79)	(37)	(252)	(254)	0	(3,420)
Recoveries	68	230	1,666	299	185	0	2,448
Provision	3,354	162	(1,683)	(101)	77	0	1,809
ALL balance at September 30, 2017	$ 4,537	$ 1,184	$ 804	$ 3,534	$ 196	$ 500	$ 10,755

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at July 1, 2018	$ 3,303	$ 1,172	$ 786	$ 3,744	$ 264	$ 500	$ 9,769
Charge-offs	0	0	(22)	(113)	(122)	0	(257)
Recoveries	0	32	13	258	37	0	340
Provision	(490)	291	224	329	117	0	471
ALL balance at September 30, 2018	$ 2,813	$ 1,495	$ 1,001	$ 4,218	$ 296	$ 500	$ 10,323
ALL balance at July 1, 2017	$ 3,649	$ 1,200	$ 836	$ 3,545	$ 192	$ 500	$ 9,922
Charge-offs	(53)	(61)	(4)	(16)	(111)	0	(245)
Recoveries	5	42	15	46	69	0	177
Provision	936	3	(43)	(41)	46	0	901
ALL balance at September 30, 2017	$ 4,537	$ 1,184	$ 804	$ 3,534	$ 196	$ 500	$ 10,755

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 table presents 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, 2018 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Nine months ended September 30, 2017 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$1,716	$ 9	$ 66	$6,255	$ 18	$ 0
All other CRE	5,495	153	56	8,314	157	0
Acquisition and development						
1-4 family residential construction	475	18	0	582	18	0
All other A&D	350	9	0	1,851	68	0
Commercial and industrial	327	13	0	393	9	0
Residential mortgage						
Residential mortgage - term	3,566	92	2	3,836	98	8
Residential mortgage – home equity	585	0	7	236	0	0
Consumer	25	0	0	0	0	0
Total	$12,539	$ 294	$ 131	$21,467	$ 368	$ 8

(in thousands)	Three months ended September 30, 2018 Average investment	Interest income recognized on an accrual basis	Interest Income recognized on a cash basis	Three months ended September 30, 2017 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$772	$ 2	$ 0	$6,144	$ 6	$ 0
All other CRE	5,848	54	0	7,308	52	0
Acquisition and development						
1-4 family residential construction	422	6	0	582	6	0
All other A&D	274	3	0	1,812	23	0
Commercial and industrial	161	3	0	496	3	0
Residential mortgage						
Residential mortgage - term	3,537	30	2	3,654	32	1
Residential mortgage – home equity	544	0	0	249	0	0
Consumer	22	0	0	0	0	0
Total	$11,580	$ 98	$ 2	$20,245	$ 122	$ 1

The Bank modifies loan terms in the normal course of business. Among other reasons, modifications might be made in an effort to retain the loan relationship, to remain competitive in the current interest rate environment and/or to re-amortize or extend the loan's term to better match the loan's payment stream with the borrower's cash flow. A modified loan is considered to be a 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 offered only for that time period. Where possible, the Bank obtains additional collateral and/or secondary payment sources at the time the loan is restructured 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.

There were 16 loans totaling $5.0 million and 19 loans totaling $6.0 million that were classified as TDRs at September 30, 2018 and December 31, 2017, respectively. The following tables present the volume and recorded investment at that time of modification of TDRs by class and type of modification that occurred during the periods indicated:

	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
(in thousands)	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Nine months ended September 30, 2018						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	1	$ 126
All other CRE	0	0	1	179	0	0
Acquisition and development						
1-4 family residential construction	0	0	1	387	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	2	$ 566	1	$ 126

	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
(in thousands)	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Nine months ended September 30, 2017						
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	1	244	0	0
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	0	0	1	259	1	439
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	2	$ 503	1	$ 439

During the nine months ended September 30, 2018, there were no new TDRs but three existing TDRs that had reached their original modification maturity dates were re-modified. This re-modification did not impact the ALL. During the nine months ended September 30, 2018, there were no payment defaults.

During the nine months ended September 30, 2017, there were no new TDRs but three existing TDRs that had reached their original modification maturity dates were re-modified. These re-modifications did not impact the ALL. During the nine months ended September 30, 2017, there were no payment defaults.

The following tables present the volume and recorded investment at that 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
Three months ended September 30, 2018						
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	1	387	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	1	$ 387	0	$ 0

(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, 2017						
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	1	439
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	0	$ 0	1	$ 439

During the three months ended September 30, 2018, there were no new TDRs but one existing TDR that had reached its original modification maturity was remodified. This re-modification did not impact the ALL. During the third quarter of 2018, there were no payment defaults.

During the three months ended September 30, 2017, there were no new TDR, but one existing TDR that had reached its original modification maturity date was re-modified. During the three months ended September 30, 2017, there were no payment defaults.

Note 8 - Other Real Estate Owned

The following table presents the components of other real estate owned ("OREO") at September 30, 2018 and December 31, 2017:

(in thousands)	September 30, 2018	December 31, 2017
Commercial real estate	$ 2,993	$ 3,605
Acquisition and development	3,620	5,295
Commercial and industrial	24	24
Residential mortgage	845	1,217
Total OREO	$ 7,482	$ 10,141

The following table presents the activity in the OREO valuation allowance for the nine- and three-month periods ended September 30, 2018 and 2017:

	For the Nine months Ended September 30,		For the Three months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Balance beginning of period	$ 2,740	$ 3,535	$ 2,947	$ 3,232
Fair value write-down	656	551	179	458
Sales of OREO	(651)	(1,005)	(381)	(609)
Balance at end of period	$ 2,745	$ 3,081	$ 2,745	$ 3,081

The following table presents the components of OREO expenses, net, for the nine- and three-month periods ended September 30, 2018 and 2017:

	For the Nine months Ended September 30,		For the Three months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Gains on real estate, net	$ (269)	$ (589)	$ (86)	$ (515)
Fair value write-down, net	656	551	179	458
Expenses, net	396	492	123	213
Rental and other income	(101)	(149)	(27)	(63)
Total OREO expense, net	$ 682	$ 305	$ 189	$ 93

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, 2018 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, 2018, the U.S. Government agencies, residential and commercial mortgage-backed securities, collateralized mortgage obligations, and state and political subdivisions bonds, excluding the TIF 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 TIF bonds are classified as Level 3 within the valuation hierarchy as they are not openly traded.

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, 2018, the Corporation owned nine pooled trust preferred securities with an amortized cost of $18.3 million and a fair value of $16.6 million. As of September 30, 2018, the market for these securities is not active and the 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, 2018, (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, 2018.

The approach used by the third party to determine fair value involved several steps, which included detailed credit and structural evaluation of each piece of collateral in each bond, projection of 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, with a limited market for highly-rated CDO securities that are more senior in the capital structure than the securities in the CDO portfolio. 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 swap agreements. Those classified as Level 2 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, 2018 and December 31, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

(in thousands)	Fair Value at September 30, 2018	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Recurring:				
Investment Securities – available for sale	$ 16,568	Discounted Cash Flow	Discount Rate	LIBOR+ 3.75%
Non-recurring:				
Impaired Loans	$ 1,525	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 11.4%)
Other Real Estate Owned	$ 1,279	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 13.7%)

(in thousands)	Fair Value at December 31, 2017	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Recurring:				
Investment Securities – available for sale	$ 14,920	Discounted Cash Flow	Discount Rate	Range of LIBOR+ 4.5% to 5.5%
Non-recurring:				
Impaired Loans	$ 2,507	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 10.9%)
Other Real Estate Owned	$ 1,841	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 13.3%)

NOTE:

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

32

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, 2018 and December 31, 2017 are as follows:

		Fair Value Measurements at September 30, 2018 Using		
	Assets Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(in thousands)	09/30/2018	(Level 1)	(Level 2)	(Level 3)
Recurring:				
Investment securities available-for-sale:				
U.S. government agencies	$ 28,565		$ 28,565	
Commercial mortgage-backed agencies	$ 37,631		$ 37,631	
Collateralized mortgage obligations	$ 36,122		$ 36,122	
Obligations of states and political subdivisions	$ 19,759		$ 19,759	
Collateralized debt obligations	$ 16,568			$ 16,568
Financial Derivatives	$ 1,689		$ 1,689	
Non-recurring:				
Impaired loans	$ 1,525			$ 1,525
Other real estate owned	$ 1,279			$ 1,279

		Fair Value Measurements at December 31, 2017 Using		
	Assets Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(in thousands)	12/31/2017	(Level 1)	(Level 2)	(Level 3)
Recurring:				
Investment securities available-for-sale:				
U.S. government agencies	$ 29,256		$ 29,256	
Commercial mortgage-backed agencies	$ 40,891		$ 40,891	
Collateralized mortgage obligations	$ 40,384		$ 40,384	

Obligations of states and political subdivisions	$ 21,019	$ 21,019	
Collateralized debt obligations	$ 14,920		$ 14,920
Financial Derivative	$ 781	$ 781	
Non-recurring:			
Impaired loans	$ 2,507		$ 2,507
Other real estate owned	$ 1,841		$ 1,841

There were no transfers of assets between any of the fair value hierarchy for the nine-month periods ended September 30, 2018 or 2017.

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, 2018 and 2017:

(In thousands)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Investment Securities Available for Sale	
Beginning balance January 1, 2018	$	14,920
Total gains realized/unrealized:		
Included in other comprehensive income		1,648
Ending balance September 30, 2018	$	16,568

(in thousands)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Investment Securities Available for Sale		
Beginning balance January 1, 2017	$	20,254	
Total losses realized/unrealized:			
Included in other comprehensive income		(5,536	)
Ending balance September 30, 2017	$	14,718	

(in thousands)	Fair Value Measurement Using Significant Unobservable Inputs (Level 3) **Investment Securities Available for Sale**	
Beginning balance July 1, 2018	$	16,147
Total gains realized/unrealized:		
Included in other comprehensive income		421
Ending balance September 30, 2018	$	16,568

(in thousands)	Fair Value Measurement Using Significant Unobservable Inputs (Level 3) **Investment Securities Available for Sale**	
Beginning balance July 1, 2017	$	14,347
Total gains realized/unrealized:		
Included in other comprehensive income		371
Ending balance September 30, 2017	$	14,718

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- month periods ended September 30, 2018 and 2017.

34

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 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, 2018		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	$21,725	$21,725	$21,725		
Interest bearing deposits in banks	1,832	1,832	1,832		
Investment securities - AFS	138,645	138,645		$ 122,077	$ 16,568
Investment securities - HTM	93,726	91,896		81,444	10,452
Restricted bank stock	5,394	5,394		5,394	
Loans, net [1]	953,737	938,110			938,110
Financial derivatives	1,689	1,689		1,689	
Accrued interest receivable	4,069	4,069		4,069	
Financial Liabilities:					
Deposits – non-maturity	801,017	801,017		801,017	
Deposits – time deposits	223,558	224,295		224,295	
Short-term borrowed funds	86,805	86,805		86,805	
Long-term borrowed funds	100,929	97,622		97,622	
Accrued interest payable	358	358		358	
Off balance sheet financial instruments	0	0	0		

	December 31, 2017		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	$82,273	$82,273	$82,273		
Interest bearing deposits in banks	1,479	1,479	1,479		
Investment securities - AFS	146,470	146,470		$ 131,550	$ 14,920
Investment securities - HTM	93,632	95,346		86,836	8,510
Restricted bank stock	5,204	5,204		5,204	
Loans, net [1]	882,546	883,936			883,936
Financial derivative	781	781		781	
Accrued interest receivable	3,814	3,814		3,814	
Financial Liabilities:					
Deposits- non-maturity	805,263	805,263		805,263	
Deposits- time deposits	234,127	235,489		235,489	
Short-term borrowed funds	48,845	48,845		48,845	
Long-term borrowed funds	120,929	123,906		123,906	
Accrued interest payable	453	453		453	
Off balance sheet financial instruments	0	0	0		

[1] In accordance with the prospective adoption of Accounting Standards Update (“ASU”) 2016-01, the fair value of loans at September 30, 2018 was measured using an exit price notion. The fair value of loans at December 31, 2017 was measured using an entry price notion.

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, 2017 and the three-month periods ended March 31, 2018, June 30, 2018 and September 30, 2018:

(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, 2017	$ (2,368)	$ (3,218)	$ (1,354)	$ 422	$(14,232)	$(715)	$(21,465)
Other comprehensive income/(loss) before reclassifications	31	638	0	59	(445)	(82)	201
Amounts reclassified from accumulated other comprehensive loss	(121)	36	253	0	781	105	1,054
Reclassification of certain tax effects	(481)	(435)	(246)	101	(3,170)	(152)	(4,383)
Balance – December 31, 2017	$ (2,939)	$ (2,979)	$ (1,347)	$ 582	$(17,066)	$(844)	$(24,593)
Other comprehensive income/(loss) before reclassifications	685	(1,085)	0	443	516	0	559
Amounts reclassified from accumulated other comprehensive loss	(40)	7	45	0	220	29	261
Balance – March 31, 2018	$ (2,294)	$ (4,057)	$ (1,302)	$ 1,025	$(16,330)	$(815)	$(23,773)
Other comprehensive income/(loss) before reclassifications	1,089	(237)	0	108	(1,750)	0	(790)
Amounts reclassified from accumulated other comprehensive loss	(144)	7	38	0	220	29	150
Balance - June 30, 2018	$ (1,349)	$ (4,287)	$ (1,264)	$ 1,133	$(17,860)	$(786)	$(24,413)
Other comprehensive income/(loss) before reclassifications	300	(672)	0	112	355	0	95
Amounts reclassified from accumulated other comprehensive loss	(39)	7	63	0	220	29	280
Balance - September 30, 2018	$ (1,088)	$ (4,952)	$ (1,201)	$ 1,245	$(17,285)	$(757)	$(24,038)

The following tables present the components of other comprehensive income/(loss) for the nine- and three-month periods ended September 30, 2018 and 2017:

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the nine months ended September 30, 2018			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 2,842	$ (768)	$2,074
Less: gains recognized in income	145	(39)	106
Less: accretable yield recognized in income	160	(43)	117
Net unrealized gains on investments with OTTI	2,537	(686)	1,851
Available for sale securities – all other:			
Unrealized holding losses	(2,733)	739	(1,994)
Less: losses recognized in income	(29)	8	(21)
Net unrealized losses on all other AFS securities	(2,704)	731	(1,973)
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(200)	54	(146)
Net unrealized gains on HTM securities	200	(54)	146
Cash flow hedges:			
Unrealized holding gains	908	(245)	663
Pension Plan:			
Unrealized net actuarial loss	(1,206)	326	(880)
Less: amortization of unrecognized loss	(900)	244	(656)
Less: amortization of prior service costs	(6)	2	(4)
Net pension plan liability adjustment	(300)	80	(220)
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized loss	(121)	33	(88)
Less: amortization of prior service costs	2	(1)	1
Net SERP liability adjustment	119	(32)	87
Other comprehensive income	$ 760	$ (206)	$554

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the nine months ended September 30, 2017			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 517	$ (204)	$313
Less: accretable yield recognized in income	112	(43)	69
Net unrealized gains on investments with OTTI	405	(161)	244
Available for sale securities – all other:			
Unrealized holding gains	2,859	(1,139)	1,720
Less: losses recognized in income	(44)	17	(27)
Net unrealized gains on all other AFS securities	2,903	(1,156)	1,747
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(262)	104	(158)
Net unrealized gains on HTM securities	262	(104)	158
Cash flow hedges:			
Unrealized holding losses	(156)	62	(94)
Pension Plan:			
Unrealized net actuarial loss	(170)	68	(102)
Less: amortization of unrecognized loss	(792)	315	(477)
Less: amortization of prior service costs	(9)	4	(5)
Net pension plan liability adjustment	613	(251)	380
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized loss	(110)	44	(66)
Less: amortization of prior service costs	2	(1)	1
Net SERP liability adjustment	108	(43)	65
Other comprehensive income	$ 4,135	$ (1,653)	$2,500

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the three months ended September 30, 2018			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 410	$ (110)	$ 300
Less: accretable yield recognized in income	53	(14)	39
Net unrealized gains on investments with OTTI	357	(96)	261
Available for sale securities – all other:			
Unrealized holding losses	(921)	249	(672)
Less: Losses recognized in income	(10)	3	(7)
Net unrealized losses on all other AFS securities	(911)	246	(665)
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(86)	23	(63)
Net unrealized gains on HTM securities	86	(23)	63
Cash flow hedges:			
Unrealized holding gains	153	(41)	112
Pension Plan:			
Unrealized net actuarial gain	486	(132)	354
Less: amortization of unrecognized loss	(300)	82	(218)
Less: amortization of prior service costs	(2)	0	(2)
Net pension plan liability adjustment	788	(214)	574
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized loss	(40)	11	(29)
Less: amortization of prior service costs	1	(1)	0
Net SERP liability adjustment	39	(10)	29
Other comprehensive income	$ 512	$ (138)	$ 374

Components of Other Comprehensive Income (in thousands)	**Before Tax Amount**	**Tax (Expense) Benefit**	**Net**
For the three months ended September 30, 2017			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 407	$ (162)	$245
Less: accretable yield recognized in income	55	(22)	33
Net unrealized gains on investments with OTTI	352	(140)	212
Available for sale securities – all other:			
Unrealized holding losses	(95)	44	(51)
Less: losses recognized in income	(27)	15	(12)
Net unrealized losses on all other AFS securities	(68)	29	(39)
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(90)	36	(54)
Net unrealized gains on HTM securities	90	(36)	54
Cash flow hedges:			
Unrealized holding gains	7	(3)	4
Pension Plan:			
Unrealized net actuarial gain	38	(14)	24
Less: amortization of unrecognized loss	(264)	105	(159)
Less: amortization of prior service costs	(3)	2	(1)
Net pension plan liability adjustment	305	(121)	184
SERP:			
Unrealized net actuarial loss	0	0	0
Less: amortization of unrecognized loss	(37)	14	(23)
Less: amortization of prior service costs	1	0	1
Net SERP liability adjustment	36	(14)	