FIDELITY D & D BANCORP INC
Form 10-Q
August 06, 2015
Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________to______________________

Commission file number: 333-90273

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION: IRS EMPLOYER IDENTIFICATION NO:

PENNSYLVANIA 23-3017653

Address of principal executive offices:

BLAKELY & DRINKER ST.

DUNMORE, PENNSYLVANIA 18512

TELEPHONE:

570-342-8281

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

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

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

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]

(Do not check if a smaller reporting company)

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

[ ] YES [X] NO

The number of outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on July 31, 2015, the latest practicable date, was 2,439,905 shares.

Table Of Contents

FIDELITY D & D BANCORP, INC.

Form 10-Q June 30, 2015

Index

2

Table Of Contents

PART I – Financial Information

Item 1: Financial Statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Balance Sheets
(Unaudited)

(dollars in thousands)	June 30, 2015	December 31, 2014
Assets:		
Cash and due from banks	$ 21,718	$ 11,808
Interest-bearing deposits with financial institutions	19	14,043
Total cash and cash equivalents	21,737	25,851
Available-for-sale securities	121,812	97,896
Held-to-maturity securities (fair value of $0 in 2015, $0 in 2014)	-	-
Federal Home Loan Bank stock	1,988	1,306
Loans and leases, net (allowance for loan losses of $9,259 in 2015; $9,173 in 2014)	528,486	506,327
Loans held-for-sale (fair value $3,085 in 2015, $1,186 in 2014)	3,042	1,161
Foreclosed assets held-for-sale	1,381	1,972
Bank premises and equipment, net	17,034	14,846
Cash surrender value of bank owned life insurance	10,909	10,741
Accrued interest receivable	2,198	2,086
Other assets	9,968	14,299
Total assets	$ 718,555	$ 676,485
Liabilities:		
Deposits:		
Interest-bearing	$ 469,204	$ 457,574
Non-interest-bearing	137,682	129,370
Total deposits	606,886	586,944
Accrued interest payable and other liabilities	3,707	3,353
Short-term borrowings	34,263	3,969
Long-term debt	-	10,000
Total liabilities	644,856	604,266
Shareholders' equity:		
Preferred stock authorized 5,000,000 shares with no par value; none issued	-	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 2,439,905 in 2015; and 2,427,767 in 2014)	26,505	26,272
Retained earnings	45,282	43,204
Accumulated other comprehensive income	1,912	2,743
Total shareholders' equity	73,699	72,219
Total liabilities and shareholders' equity	$ 718,555	$ 676,485

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Income

(Unaudited)	Three months ended		Six months ended	
(dollars in thousands except per share data)	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Interest income:				
Loans and leases:				
Taxable	$ 5,651	$ 5,393	$ 11,150	$ 10,669
Nontaxable	162	131	301	262
Interest-bearing deposits with financial institutions	1	5	17	12
Investment securities:				
U.S. government agency and corporations	273	257	533	502
States and political subdivisions (nontaxable)	329	333	642	654
Other securities	22	26	99	48
Total interest income	6,438	6,145	12,742	12,147
Interest expense:				
Deposits	508	498	1,065	987
Securities sold under repurchase agreements	4	4	12	12
Other short-term borrowings and other	11	6	12	6
Long-term debt	124	213	255	423
Total interest expense	647	721	1,344	1,428
Net interest income	5,791	5,424	11,398	10,719
Provision for loan losses	150	300	300	600
Net interest income after provision for loan losses	5,641	5,124	11,098	10,119
Other income:				
Service charges on deposit accounts	412	431	827	854
Interchange fees	337	332	639	637
Fees from trust fiduciary activities	197	172	414	336
Fees from financial services	110	153	237	292
Service charges on loans	224	307	400	424
Fees and other revenue	215	190	411	361
Earnings on bank-owned life insurance	84	84	169	167
Gain (loss) on sale or disposal of:				
Loans	238	124	467	252
Investment securities	16	94	18	301
Premises and equipment	-	(66)	1	(65)
Total other income	1,833	1,821	3,583	3,559
Other expenses:				
Salaries and employee benefits	2,643	2,488	5,296	4,964
Premises and equipment	875	878	1,816	1,796
Advertising and marketing	263	274	650	606

Professional services	477	321	815	639
FDIC assessment	87	79	194	178
Loan collection	66	70	96	117
Other real estate owned	48	24	147	89
Office supplies and postage	112	100	213	207
Automated transaction processing	138	154	258	305
FHLB prepayment fee	570	-	570	-
Other	465	373	776	645
Total other expenses	5,744	4,761	10,831	9,546
Income before income taxes	1,730	2,184	3,850	4,132
Provision (credit) for income taxes	(50)	557	497	1,049
Net income	$ 1,780	$ 1,627	$ 3,353	$ 3,083
Per share data:				
Net income - basic	$ 0.73	$ 0.67	$ 1.38	$ 1.28
Net income - diluted	$ 0.73	$ 0.67	$ 1.37	$ 1.28
Dividends	$ 0.27	$ 0.25	$ 0.52	$ 0.50

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income (Unaudited) (dollars in thousands)	Three months ended June 30, 2015	2014	Six months ended June 30, 2015	2014
Net income	$ 1,780	$ 1,627	$ 3,353	$ 3,083
Other comprehensive (loss) income, before tax:				
Unrealized holding (loss) gain on available-for-sale securities	(1,476)	1,325	(1,241)	2,340
Reclassification adjustment for net gains realized in income	(16)	(94)	(18)	(301)
Net unrealized (loss) gain	(1,492)	1,231	(1,259)	2,039
Tax effect	507	(419)	428	(693)
Unrealized (loss) gain, net of tax	(985)	812	(831)	1,346
Other comprehensive (loss) income, net of tax	(985)	812	(831)	1,346
Total comprehensive income, net of tax	$ 795	$ 2,439	$ 2,522	$ 4,429

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
For the six months ended June 30, 2015 and 2014
(Unaudited)

(dollars in thousands)	Capital stock Shares	Amount	Retained earnings	Accumulated other comprehensive income	Total
Balance, December 31, 2013	2,391,617	$ 25,302	$ 39,519	$ 1,239	$ 66,060
Net income			3,083		3,083
Other comprehensive income				1,346	1,346
Issuance of common stock through Employee Stock Purchase Plan	4,373	80			80
Issuance of common stock through Dividend Reinvestment Plan	18,347	448			448
Issuance of common stock from vested restricted share grants through stock compensation plans	5,250				
Stock-based compensation expense		117			117
Cash dividends declared			(1,208)		(1,208)
Balance, June 30, 2014	2,419,587	$ 25,947	$ 41,394	$ 2,585	$ 69,926
Balance, December 31, 2014	2,427,767	$ 26,272	$ 43,204	$ 2,743	$ 72,219
Net income			3,353		3,353
Other comprehensive loss				(831)	(831)
Issuance of common stock through Employee Stock Purchase Plan	4,358	102			102
Issuance of common stock from vested restricted share grants through stock compensation plans	7,780				
Stock-based compensation expense		131			131
Cash dividends declared			(1,275)		(1,275)
Balance, June 30, 2015	2,439,905	$ 26,505	$ 45,282	$ 1,912	$ 73,699

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows

(Unaudited)	Six months ended June 30,	
(dollars in thousands)	2015	2014
Cash flows from operating activities:		
Net income	$ 3,353	$ 3,083
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	1,741	1,542
Provision for loan losses	300	600
Deferred income tax expense	453	47
Stock-based compensation expense	131	117
Proceeds from sale of loans held-for-sale	22,179	14,523
Originations of loans held-for-sale	(22,123)	(15,165)
Earnings from bank-owned life insurance	(169)	(167)
Net gain from sales of loans	(467)	(252)
Net gain from sales of investment securities	(18)	(301)
Net loss (gain) from sale and write-down of foreclosed assets held-for-sale	30	(57)
Net loss from disposal of equipment	-	66
Change in:		
Accrued interest receivable	(112)	(14)
Other assets	2,484	(1,011)
Accrued interest payable and other liabilities	354	580
Net cash provided by operating activities	8,136	3,591
Cash flows from investing activities:		
Held-to-maturity securities:		
Proceeds from sales	-	187
Proceeds from maturities, calls and principal pay-downs	-	3
Available-for-sale securities:		
Proceeds from sales	10,420	4,877
Proceeds from maturities, calls and principal pay-downs	10,593	6,319
Purchases	(46,959)	(14,944)
Increase in FHLB stock	(682)	(314)
Net increase in loans and leases	(24,676)	(19,949)
Acquisition of bank premises and equipment	(1,028)	(955)
Proceeds from sale of foreclosed assets held-for-sale	1,019	1,051
Net cash used in investing activities	(51,313)	(23,725)
Cash flows from financing activities:		
Net increase in deposits	19,942	8,805

Net increase in short-term borrowings	30,294	13,230
Repayment of long-term debt	(10,000)	-
Proceeds from employee stock purchase plan participants	102	80
Dividends paid, net of dividends reinvested	(1,275)	(864)
Proceeds from dividend reinvestment plan participants	-	104
Net cash provided by financing activities	39,063	21,355
Net (decrease) increase in cash and cash equivalents	(4,114)	1,221
Cash and cash equivalents, beginning	25,851	13,218
Cash and cash equivalents, ending	$ 21,737	$ 14,439

See notes to unaudited consolidated financial statements

7

Table Of Contents

FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements

(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

Fidelity Deposit and Discount Bank (the Bank) is a commercial bank chartered under the law of the Commonwealth of Pennsylvania and a wholly-owned subsidiary of Fidelity D & D Bancorp, Inc. (collectively, the Company). Having commenced operations in 1903, the Bank is committed to provide superior customer service, while offering a full range of banking products and financial and trust services to both our consumer and commercial customers from our main office located in Dunmore and other branches located throughout Lackawanna and Luzerne Counties.

Principles of consolidation

The accompanying unaudited consolidated financial statements of the Company and the Bank have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to this Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the periods have been included. All significant inter-company balances and transactions have been eliminated in consolidation.

For additional information and disclosures required under GAAP, refer to the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

Management is responsible for the fairness, integrity and objectivity of the unaudited financial statements included in this report. Management prepared the unaudited financial statements in accordance with GAAP. In meeting its responsibility for the financial statements, management depends on the Company's accounting systems and related internal controls. These systems and controls are designed to provide reasonable but not absolute assurance that the financial records accurately reflect the transactions of the Company, the Company’s assets are safeguarded and that the financial statements present fairly the financial condition and results of operations of the Company.

In the opinion of management, the consolidated balance sheets as of June 30, 2015 and December 31, 2014 and the related consolidated statements of income and consolidated statements of comprehensive income for the three and six months ended June 30, 2015 and 2014, and consolidated statements of changes in shareholders’ equity and consolidated statements of cash flows for the six months ended June 30, 2015 and 2014 present fairly the financial condition and results of operations of the Company. All material adjustments required for a fair presentation have been made. These adjustments are of a normal recurring nature. Certain reclassifications have been made to the 2014 financial statements to conform to the 2015 presentation.

In preparing these consolidated financial statements, the Company evaluated the events and transactions that occurred after June 30, 2015 through the date these consolidated financial statements were issued.

This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2014, and the notes included therein, included within the Company's Annual Report filed on Form 10-K.

Critical accounting policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at June 30, 2015 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Fair values of investment securities are determined by pricing provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes may be obtained from more than one source. The majority of the Company's investment securities are classified as available-for-sale (AFS). AFS securities are carried at fair value

Table Of Contents

on the consolidated balance sheets, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity as a component of accumulated other comprehensive income (loss) (OCI).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells residential mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. As of June 30, 2015 and December 31, 2014, loans classified as HFS consisted of residential mortgage loans.

Financing of automobiles, provided to customers under lease arrangements of varying terms, are accounted for as direct finance leases. Interest income on automobile direct finance leasing is determined using the interest method. Generally, the interest method is used to arrive at a level effective yield over the life of the lease.

Foreclosed assets held-for-sale includes other real estate acquired through foreclosure (ORE) and may, from time-to-time, include repossessed assets such as automobiles. ORE is carried at the lower of cost (principal balance at date of foreclosure) or fair value less estimated cost to sell. Any write-downs at the date of foreclosure or within a reasonable period of time after foreclosure are charged to the allowance for loan losses. Expenses incurred to maintain ORE properties, subsequent write downs to the asset's fair value, any rental income received and gains or losses on disposal are included as components of other real estate owned expense in the consolidated statements of income.

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and interest-bearing deposits with financial institutions. For the six months ended June 30, 2015 and 2014, the Company paid interest of $1.3 million and $1.4 million, respectively. The Company did not make an income tax payment in the first half of 2015 and paid income taxes of $0.4 million during the first half of 2014. Transfers from loans to foreclosed assets held-for-sale amounted to $0.6 million and $1.2 million during the six months ended June 30, 2015 and 2014, respectively. During the same respective periods, transfers from loans to loans HFS amounted to $1.8 million and $0 and from loans to bank premises and equipment amounted to $0 and $1.0 million. Expenditures for construction in process, a component of other assets in the consolidated balance sheets, are included in acquisition of bank premises and equipment.

2. New accounting pronouncements

In an exposure draft issued in the fourth quarter of 2012, the Financial Accounting Standards Board (FASB) proposed changes to the accounting guidance related to the impairment of financial assets and the recognition of credit losses. The FASB proposal would require financial institutions to reserve for losses for the duration of the credit exposure as opposed to reserving for probable losses. The new methodology would be known as the "current expected credit losses" (CECL) methodology. The FASB is currently in the process of re-deliberating significant issues raised through feedback received from comment letters and outreach activities. Among other things, the guidance in the proposed update regarding an entity's estimate of expected credit losses will be clarified as follows:

- An entity should revert to a historical average loss experience for the future periods beyond which the entity is able to make or obtain reasonable and supportable forecasts;
- An entity should consider all contractual cash flows over the life of the related financial assets;
- When determining the contractual cash flows and the life of the related financial assets:

- o An entity should consider expected prepayments;
- o An entity should not consider expected extensions, renewals, and modifications unless the entity reasonably expects that it will execute a troubled debt restructuring with a borrower;
- · An entity's estimate of expected credit losses should always reflect the risk of loss, even when that risk is remote. However, an entity would not be required to recognize a loss on a financial asset in which the risk of nonpayment is greater than zero yet the amount of loss would be zero;
- · In addition to using a discounted cash flow model to estimate expected credit losses, an entity would not be prohibited from developing an estimate of credit losses using loss-rate methods, probability-of-default methods or a provision matrix using loss factors;
- · The final guidance on expected credit losses will include implementation guidance describing the factors that an entity should consider to adjust historical loss experience for current conditions and reasonable and supportable forecast.

FASB expects to issue this proposed accounting standard update in late 2015. An effective date has yet to be discussed. Upon adoption, the change in this accounting guidance could result in an increase in the Company's allowance for loan losses and require the Company to record loan losses more rapidly. Upon final issuance of the standard, the Company will be able to better evaluate the potential impact of this new standard on its consolidated financial statements.

In August 2014, the FASB issued an accounting standard update (ASU 2014-14) related to; Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure. The update requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) The loan has a government guarantee that is not separable from the loan before foreclosure; (2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; (3) At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in the update are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The Company adopted this accounting standard during the first quarter of 2015 and it did not have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period, an amendment to the stock compensation accounting guidance to clarify that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. This amendment is effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. Entities may apply the amendments in this update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. The Company does not expect this amendment to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP: identify the contract(s) with a customer; identify the performance obligations in the contract; determine the transaction price; allocate the transaction price to the performance obligations in the contract; recognize revenue when (or as) the entity satisfies a performance obligation. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements and has not yet determined the method by which it will adopt the standard effective in the first quarter of 2017.

In January 2014, the FASB issued ASU 2014-04 related to; Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The update applies to all creditors who obtain physical possession of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The amendments in this update clarify when an in-substance repossession or foreclosure occurs and requires disclosure of both (1) the amount of foreclosed residential real estate property held by a creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in the update are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The Company adopted this accounting standard during the first quarter of 2015 and it did not have a material impact on its consolidated financial statements.

3. Accumulated other comprehensive income

The following tables illustrate the changes in accumulated other comprehensive income by component and the details about the components of accumulated other comprehensive income as of and for the periods indicated:

As of and for the six months ended June 30, 2015

(dollars in thousands)	Unrealized gains on available-for-sale securities	Total
Beginning balance	$ 2,743	$ 2,743
Other comprehensive loss before reclassifications, net of tax	(819)	(819)
Amounts reclassified from accumulated other comprehensive income, net of tax	(12)	(12)
Net current-period other comprehensive loss	(831)	(831)
Ending balance	$ 1,912	$ 1,912

10

Table Of Contents

As of and for the three months ended June 30, 2015

(dollars in thousands)	Unrealized gains on available-for-sale securities	Total
Beginning balance	$ 2,897	$ 2,897
Other comprehensive loss before reclassifications, net of tax	(974)	(974)
Amounts reclassified from accumulated other comprehensive income, net of tax	(11)	(11)
Net current-period other comprehensive loss	(985)	(985)
Ending balance	$ 1,912	$ 1,912

As of and for the six months ended June 30, 2014

(dollars in thousands)	Unrealized gains on available-for-sale securities	Total
Beginning balance	$ 1,239	$ 1,239
Other comprehensive income before reclassifications, net of tax	1,545	1,545
Amounts reclassified from accumulated other comprehensive income, net of tax	(199)	(199)
Net current-period other comprehensive income	1,346	1,346
Ending balance	$ 2,585	$ 2,585

As of and for the three months ended June 30, 2014

(dollars in thousands)	Unrealized gains on available-for-sale securities	Total
Beginning balance	$ 1,773	$ 1,773

Other comprehensive income before reclassifications, net of tax	874	874
Amounts reclassified from accumulated other comprehensive income, net of tax	(62)	(62)
Net current-period other comprehensive income	812	812
Ending balance	$ 2,585	$ 2,585

Details about accumulated other comprehensive income components (dollars in thousands)	Amount reclassified from accumulated other comprehensive income				Affected line item in the statement where net income is presented
	Three months ended June 30,		Six months ended June 30,		
	2015	2014	2015	2014	
Unrealized gains on AFS securities	$ 16	$ 94	$ 18	$ 301	Gain on sale of investment securities
	(5)	(32)	(6)	(102)	Provision for income taxes
Total reclassifications for the period	$ 11	$ 62	$ 12	$ 199	Net income

11

Table Of Contents

4. Investment securities

Agency – Government-sponsored enterprise (GSE) and MBS - GSE residential

Agency – GSE and MBS – GSE residential securities consist of short- to long-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB) and Government National Mortgage Association (GNMA). These securities have interest rates that are fixed and adjustable, have varying short- to long-term maturity dates and have contractual cash flows guaranteed by the U.S. government or agencies of the U.S. government.

Obligations of states and political subdivisions

The municipal securities are bank qualified or bank eligible, general obligation and revenue bonds rated as investment grade by various credit rating agencies and have fixed rates of interest with mid- to long-term maturities. Fair values of these securities are highly driven by interest rates. Management performs ongoing credit quality reviews on these issues.

The amortized cost and fair value of investment securities at June 30, 2015 and December 31, 2014 are summarized as follows:

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2015				
Held-to-maturity securities:				
MBS - GSE residential	$ -	$ -	$ -	$ -
Available-for-sale securities:				
Agency - GSE	$ 18,468	$ 116	$ 12	$ 18,572
Obligations of states and political subdivisions	35,831	1,858	215	37,474
MBS - GSE residential	64,321	1,226	336	65,211
Total debt securities	118,620	3,200	563	121,257
Equity securities - financial services	294	261	-	555
Total available-for-sale securities	$ 118,914	$ 3,461	$ 563	$ 121,812

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2014				
Held-to-maturity securities:				
MBS - GSE residential	$ -	$ -	$ -	$ -
Available-for-sale securities:				
Agency - GSE	$ 14,380	$ 29	$ 11	$ 14,398
Obligations of states and political subdivisions	34,609	2,444	20	37,033
MBS - GSE residential	44,455	1,438	23	45,870
Total debt securities	93,444	3,911	54	97,301
Equity securities - financial services	295	300	-	595
Total available-for-sale securities	$ 93,739	$ 4,211	$ 54	$ 97,896

Table Of Contents

The amortized cost and fair value of debt securities at June 30, 2015 by contractual maturity are summarized below:

(dollars in thousands)	Amortized cost	Fair value
Held-to-maturity securities:		
MBS - GSE residential	$ -	$ -
Available-for-sale securities:		
Debt securities:		
Due in one year or less	$ 1,420	$ 1,421
Due after one year through five years	16,393	16,493
Due after five years through ten years	3,009	3,209
Due after ten years	33,477	34,923
Total debt securities	54,299	56,046
MBS - GSE residential	64,321	65,211
Total available-for-sale debt securities	$ 118,620	$ 121,257

Actual maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without a call or prepayment penalty. Agency – GSE and municipal securities are included based on their original stated maturity. MBS – GSE residential, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total. Most of the securities have fixed rates or have predetermined scheduled rate changes and many have call features that allow the issuer to call the security at par before its stated maturity without penalty.

The following table presents the fair value and gross unrealized losses of investment securities aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of June 30, 2015 and December 31, 2014:

	Less than 12 months		More than 12 months		Total	
(dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
June 30, 2015						
Agency - GSE	$ 2,036	$ 12	$ -	$ -	$ 2,036	$ 12
Obligations of states and political subdivisions	6,918	215	-	-	6,918	215
MBS - GSE residential	34,267	336	-	-	34,267	336
Total	$ 43,221	$ 563	$ -	$ -	$ 43,221	$ 563
Number of securities	33		-		33	

December 31, 2014						
Agency - GSE	$ 4,100	$ 11	$ 1,024	$ -	$ 5,124	$ 11
Obligations of states and political subdivisions	1,767	11	670	9	2,437	20
MBS - GSE residential	3,761	23	-	-	3,761	23
Total	$ 9,628	$ 45	$ 1,694	$ 9	$ 11,322	$ 54
Number of securities	9		3		12	

Management believes the cause of the unrealized losses is related to changes in interest rates, instability in the capital markets or the limited trading activity due to illiquid conditions in the debt market and is not directly related to credit quality. Quarterly, management conducts a formal review of investment securities for the presence of other-than-temporary impairment (OTTI). The accounting guidance related to OTTI requires the Company to assess whether OTTI is present when the fair value of a debt security is less than its amortized cost as of the balance sheet date. Under those circumstances, OTTI is considered to have occurred if: (1) the entity has intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost. The accounting guidance requires that credit-related OTTI be recognized in earnings while non-credit-related OTTI on securities not

Table Of Contents

expected to be sold be recognized in other comprehensive income (loss) (OCI). Non-credit-related OTTI is based on other factors affecting market value, including illiquidity.

The Company's OTTI evaluation process also follows the guidance set forth in topics related to debt and equity securities. The guidance set forth in the pronouncements require the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value which may be to maturity and other factors when evaluating for the existence of OTTI. The guidance requires that credit-related OTTI be recognized as a realized loss through earnings when there has been an adverse change in the holder's expected cash flows such that the full amount (principal and interest) will probably not be received. This requirement is consistent with the impairment model in the guidance for accounting for debt and equity securities.

For all security types, as of June 30, 2015, the Company applied the criteria provided in the recognition and presentation guidance related to OTTI. That is, management has no intent to sell the securities and no conditions were identified by management that more likely than not would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI in the Company's security portfolio. In addition, management believes the change in fair value is attributable to changes in interest rates.

5. Loans and leases

The classifications of loans and leases at June 30, 2015 and December 31, 2014 are summarized as follows:

(dollars in thousands)	June 30, 2015	December 31, 2014
Commercial and industrial	$ 87,774	$ 80,301
Commercial real estate:		
Non-owner occupied	95,113	94,771
Owner occupied	101,171	95,780
Construction	3,902	5,911
Consumer:		
Home equity installment	32,061	32,819
Home equity line of credit	44,698	42,188
Auto loans and leases	29,544	27,972
Other	6,742	6,501
Residential:		
Real estate	127,868	119,154
Construction	9,142	10,298
Total	538,015	515,695
Less:		
Allowance for loan losses	(9,259)	(9,173)
Unearned lease revenue	(270)	(195)
Loans and leases, net	$ 528,486	$ 506,327

Net deferred loan costs of $1.5 million and $1.4 million have been added to the carrying values of loans at June 30, 2015 and December 31, 2014, respectively.

Unearned lease revenue represents the difference between the lessor's investment in the property and the gross investment in the lease. Unearned revenue accretes over the life of the lease using the effective income method.

The Company services real estate loans for investors in the secondary mortgage market which are not included in the accompanying consolidated balance sheets. The approximate amount of mortgages serviced amounted to $258.0 million as of June 30, 2015 and $256.8 million as of December 31, 2014. Mortgage servicing rights amounted to $1.0 million as of both June 30, 2015 and December 31, 2014, respectively.

Management is responsible for conducting the Company's credit risk evaluation process, which includes credit risk grading of individual commercial and industrial and commercial real estate loans. Commercial and industrial and commercial real estate loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed as the case may be. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The Company utilizes an external independent loan review firm that reviews and validates the credit risk program on at least an annual basis. Results of these reviews are presented to management and the

Table Of Contents

board of directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Non-accrual loans

The decision to place loans on non-accrual status is made on an individual basis after considering factors pertaining to each specific loan. Commercial and industrial (C&I) and commercial real estate (CRE) loans are placed on non-accrual status when management has determined that payment of all contractual principal and interest is in doubt or the loan is past due 90 days or more as to principal and interest, unless well-secured and in the process of collection. Consumer loans secured by real estate and residential mortgage loans are placed on non-accrual status at 120 days past due as to principal and interest and unsecured consumer loans are charged-off when the loan is 90 days or more past due as to principal and interest. The Company considers all non-accrual loans to be impaired loans.

Non-accrual loans, segregated by class, at June 30, 2015 and December 31, 2014, were as follows:

(dollars in thousands)	June 30, 2015	December 31, 2014
Commercial and industrial	$ 55	$ 27
Commercial real estate:		
Non-owner occupied	755	620
Owner occupied	1,930	2,013
Construction	240	256
Consumer:		
Home equity installment	252	312
Home equity line of credit	430	417
Auto loans and leases	1	1
Other	7	20
Residential:		
Real estate	580	549
Total	$ 4,250	$ 4,215

Troubled Debt Restructuring

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company considers all TDRs to be impaired loans. The Company offers various types of concessions when modifying a loan, however, forgiveness of principal is rarely granted. C&I loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. CRE loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Commercial real estate construction loans modified in a TDR may also involve extending the interest-only payment period. Residential mortgage loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers' financial needs for an extended period of time. After the lowered monthly payment period ends, the borrower would revert back to paying principal and interest pursuant to the original terms with the maturity date adjusted accordingly. Consumer loan modifications are typically not granted and therefore standard modification terms do not exist for loans of this type.

Loans modified in a TDR may or may not be placed on non-accrual status. As of June 30, 2015, total TDRs amounted to $3.4 million (consisting of 8 CRE loans and 2 C&I loans to 6 unrelated borrowers), of which one with a balance of $0.8 million was on non-accrual status, compared to $1.6 million (consisting of 4 CRE loans and 1 C&I loan to 3 unrelated borrowers) and $0.9 million, respectively, as of December 31, 2014. Of the TDRs outstanding as of June 30, 2015 and December 31, 2014, when modified, the concessions granted consisted of temporary interest-only payments or a reduction in the rate of interest to a below-market rate for a contractual period of time. Other than the TDR that was on non-accrual status, the TDRs were performing in accordance with their modified terms.

Table Of Contents

The following presents by class, information related to loans modified in a TDR:

(dollars in thousands)	Loans modified as TDRs for the: Three months ended June 30, 2015			Six months ended June 30, 2015		
	Number of contracts	Recorded investment (as of period end)	Increase in allowance (as of period end)	Number of contracts	Recorded investment (as of period end)	Increase in allowance (as of period end)
Commercial and industrial	-	$ -	$ -	1	$ 500	$ 331
Commercial real estate - owner occupied	2	158	-	4	1,265	251
Total	2	$ 158	$ -	5	$ 1,765	$ 582

In the above table, the period end balances are inclusive of all partial pay downs and charge-offs since the modification date.

Loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. There were no loans modified as a TDR within the previous twelve months that subsequently defaulted during the three and six months ended June 30, 2015.

The allowance for loan losses (allowance) may be increased, adjustments may be made in the allocation of the allowance or partial charge-offs may be taken to further write-down the carrying value of the loan. An allowance for impaired loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price. If the loan is collateral dependent, the estimated fair value of the collateral, less any selling costs, is used to establish the allowance.

Past due loans

Loans are considered past due when the contractual principal and/or interest is not received by the due date. An aging analysis of past due loans, segregated by class of loans, as of the period indicated is as follows (dollars in thousands):

	Past due						Recorded investment past
June 30, 2015	30 - 59 Days past due	60 - 89 Days past due	90 days or more (1)	Total past due	Current	Total loans (3)	due ≥ 90 days and accruing
Commercial and industrial	$ 87	$ -	$ 55	$ 142	$ 87,632	$ 87,774	$ -

Commercial real estate:								
Non-owner occupied	600	254	755	1,609	93,504	95,113		-
Owner occupied	228	98	1,930	2,256	98,915	101,171		-
Construction	-	-	240	240	3,662	3,902		-
Consumer:								
Home equity installment	205	206	252	663	31,398	32,061		-
Home equity line of credit	335	232	430	997	43,701	44,698		-
Auto loans and leases	364	59	1	424	28,850	29,274	(2)	-
Other	18	6	7	31	6,711	6,742		-
Residential:								
Real estate	603	469	580	1,652	126,216	127,868		-
Construction	-	-	-	-	9,142			