MVB FINANCIAL CORP
Form 10-Q
October 29, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
or
¨ TRANSITION REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________.

Commission File Number: 000-50567

MVB Financial Corp.
(Exact name of registrant as specified in its charter)

West Virginia	20-0034461
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
301 Virginia Avenue, Fairmont, WV	26554
(Address of principal executive offices)	(Zip Code)

(304) 363-4800
Registrant's telephone number, including area code

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions 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 Non-accelerated filer

Smaller reporting company Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of October 28, 2018, the Registrant had 11,540,770 shares of common stock outstanding with a par value of $1.00 per share.

Table of Contents

TABLE OF CONTENTS

		Page
PART I	FINANCIAL INFORMATION	3
Item 1	Financial Statements	3
	Consolidated Balance Sheets	3
	Consolidated Statements of Income	4
	Consolidated Statements of Comprehensive Income	5
	Consolidated Statements of Changes in Stockholders' Equity	6
	Consolidated Statements of Cash Flows	7
	Notes to the Consolidated Financial Statements	8
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	41
Item 3	Quantitative and Qualitative Disclosures About Market Risk	59
Item 4	Controls and Procedures	59
PART II	OTHER INFORMATION	60
Item 1	Legal Proceedings	60
Item 1A	Risk Factors	60
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	60
Item 3	Defaults Upon Senior Securities	60
Item 4	Mine Safety Disclosures	60
Item 5	Other Information	60
Item 6	Exhibits	61
	SIGNATURES	61

Table of Contents

PART I – FINANCIAL INFORMATION
Item 1 – Financial Statements
MVB Financial Corp. and Subsidiaries
Consolidated Balance Sheets
(Unaudited) (Dollars in thousands except per share data)

	September 30, 2018 (Unaudited)	December 31, 2017 (Note 1)
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$18,641	$16,345
Interest bearing balances with banks	3,404	3,960
Total cash and cash equivalents	22,045	20,305
Certificates of deposit with other banks	14,778	14,778
Investment Securities:		
Securities available-for-sale, at fair value	216,714	231,507
Equity securities	9,592	—
Loans held for sale	63,706	66,794
Loans:	1,296,460	1,105,941
Less: Allowance for loan losses	(11,439)	(9,878)
Net Loans	1,285,021	1,096,063
Premises and equipment	26,706	26,686
Bank owned life insurance	32,918	32,666
Accrued interest receivable and other assets	33,144	27,023
Goodwill	18,480	18,480
TOTAL ASSETS	$1,723,104	$1,534,302
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$240,847	$125,963
Interest bearing	1,138,339	1,033,617
Total deposits	1,379,186	1,159,580
Accrued interest payable and other liabilities	16,763	16,434
Repurchase agreements	15,755	22,403
FHLB and other borrowings	122,000	152,169
Subordinated debt	18,524	33,524
Total liabilities	1,552,228	1,384,110
STOCKHOLDERS' EQUITY		
Preferred stock, par value $1,000; 20,000 authorized; 783 issued in 2018 and 2017, respectively (See Footnote 7)	7,834	7,834
Common stock, par value $1; 20,000,000 shares authorized; 11,588,070 shares issued and 11,536,993 shares outstanding in 2018 and 10,495,704 shares issued and 10,444,627 shares outstanding in 2017	11,588	10,496
Additional paid-in capital	115,497	98,698
Retained earnings	45,745	37,236
Accumulated other comprehensive loss	(8,704)	(2,988)
Treasury stock, 51,077 shares, at cost	(1,084)	(1,084)

Total stockholders' equity	170,876	150,192
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,723,104	$1,534,302

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries
Consolidated Statements of Income
(Unaudited) (Dollars in thousands except per share data)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2018	2017	2018	2017
INTEREST INCOME				
Interest and fees on loans	$44,777	$ 37,695	$16,364	$ 13,275
Interest on deposits with other banks	284	250	103	89
Interest on investment securities - taxable	2,655	1,884	869	693
Interest on tax exempt loans and securities	2,458	1,683	840	573
Total interest income	50,174	41,512	18,176	14,630
INTEREST EXPENSE				
Interest on deposits	7,938	5,952	3,110	2,083
Interest on repurchase agreements	49	56	10	20
Interest on FHLB and other borrowings	3,110	1,216	1,199	548
Interest on subordinated debt	1,433	1,674	333	565
Total interest expense	12,530	8,898	4,652	3,216
NET INTEREST INCOME	37,644	32,614	13,524	11,414
Provision for loan losses	2,148	1,137	1,069	96
Net interest income after provision for loan losses	35,496	31,477	12,455	11,318
NONINTEREST INCOME				
Service charges on deposit accounts	741	559	275	207
Income on bank owned life insurance	958	453	520	151
Interchange and debit card transaction fees	459	906	167	293
Mortgage fee income	24,634	28,604	9,008	10,018
Gain on sale of portfolio loans	217	477	5	265
Insurance and investment services income	540	395	199	147
Gain on sale of available-for-sale securities, net	327	455	1	105
Gain (loss) on derivatives, net	509	(2,216)	(728)	(1,306)
Commercial swap fee income	419	322	6	52
Holding gain on equity securities	583	—	623	—
Other operating income	958	594	435	226
Total noninterest income	30,345	30,549	10,511	10,158
NONINTEREST EXPENSES				
Salary and employee benefits	34,487	33,009	11,520	11,249
Occupancy expense	3,178	3,083	1,049	1,042
Equipment depreciation and maintenance	2,439	2,214	834	783
Data processing and communications	2,735	3,833	938	1,139
Mortgage processing	2,751	2,455	867	818
Marketing, contributions, and sponsorships	966	867	271	263
Professional fees	2,548	2,264	1,015	851
Printing, postage, and supplies	597	783	198	320
Insurance, tax, and assessment expense	1,333	1,403	487	475
Travel, entertainment, dues, and subscriptions	1,991	1,621	712	562

Other operating expenses	1,380	1,254	526	464
Total noninterest expense	54,405	52,786	18,417	17,966
Income before income taxes	11,436	9,240	4,549	3,510
Income tax expense	2,432	3,088	970	1,192
Net income	$9,004	$6,152	$3,579	$2,318
Preferred dividends	366	374	123	123
Net income available to common shareholders	$8,638	$5,778	$3,456	$2,195
Earnings per share - basic	$0.80	$0.56	$0.30	$0.21
Earnings per share - diluted	$0.77	$0.56	$0.29	$0.21
Cash dividends declared	$0.080	$0.075	$0.030	$0.025
Weighted average shares outstanding - basic	10,845,166	10,262,944	11,416,202	10,443,443
Weighted average shares outstanding - diluted	11,690,314	10,288,534	13,113,259	12,410,070

See accompanying notes to unaudited consolidated financial statements.

4

Table of Contents

MVB Financial Corp. and Subsidiaries
Consolidated Statements of Comprehensive Income
(Unaudited) (Dollars in thousands)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2018	2017	2018	2017
Net Income	$9,004	$6,152	$3,579	$2,318
Other comprehensive income (loss):				
Unrealized holding gains (losses) on securities available-for-sale	(7,455)	3,158	(2,119)	160
Income tax effect	2,012	(1,263)	571	(64)
Reclassification adjustment for gain recognized in income	(327)	(455)	(1)	(105)
Income tax effect	88	182	—	42
Change in defined benefit pension plan	972	(336)	200	—
Income tax effect	(262)	134	(54)	—
Total other comprehensive income (loss)	(4,972)	1,420	(1,403)	33
Comprehensive income	$4,032	$7,572	$2,176	$2,351

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited) (Dollars in thousands except per share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Treasury Stock	Total Stockholders' Equity
Balance December 31, 2016	$16,334	$10,048	$93,412	$31,192	$ (4,277)	$(1,084)	$ 145,625
Net Income	—	—	—	6,152	—	—	6,152
Other comprehensive income	—	—	—	—	1,420	—	1,420
Cash dividends paid ($0.075 per share)	—	—	—	(773)	—	—	(773)
Dividends on preferred stock	—	—	—	(374)	—	—	(374)
Common stock issuance, net of issuance costs	—	444	4,487	—	—	—	4,931
Stock based compensation	—	—	506	—	—	—	506
Common stock options exercised	—	4	(14)	—	—	—	(10)
Redemption of preferred stock	(8,500)	—	—	—	—	—	(8,500)
Balance September 30, 2017	$7,834	$10,496	$98,391	$36,197	$ (2,857)	$(1,084)	$ 148,977
Balance December 31, 2017	7,834	10,496	98,698	37,236	(2,988)	(1,084)	150,192
Net Income	$—	$—	$—	$9,004	$ —	$—	$ 9,004
Other comprehensive loss	—	—	—	—	(4,972)	—	(4,972)
Cash dividends paid ($0.08 per share)	—	—	—	(873)	—	—	(873)
Dividends on preferred stock	—	—	—	(366)	—	—	(366)
Stock based compensation	—	—	920	—	—	—	920
Common stock options exercised	—	153	1,853	—	—	—	2,006
Restricted stock units vested	—	1	(1)	—	—	—	—
Stranded AOCI (See Footnote 2)	—	—	—	646	(646)	—	—
Mark to Market on equity positions held at December 31, 2017 (See Footnote 2)	—	—	—	98	(98)	—	—
Common stock issued from subordinated debt conversion, net of costs	—	938	14,027	—	—	—	14,965
Balance September 30, 2018	$7,834	$11,588	$115,497	$45,745	$ (8,704)	$(1,084)	$ 170,876

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited) (Dollars in thousands)

	Nine Months Ended September 30,	
	2018	2017
OPERATING ACTIVITIES		
Net Income	$ 9,004	$ 6,152
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization and accretion of investments	994	801
Net amortization of deferred loan costs	105	95
Provision for loan losses	2,148	1,137
Depreciation and amortization	2,210	1,980
Stock based compensation	920	506
Loans originated for sale	(933,134)	(1,050,759)
Proceeds of loans sold	960,856	1,100,480
Mortgage fee income	(24,634)	(28,604)
Gain on sale of securities	(352)	(827)
Loss on sale of securities	25	372
Gain on sale of portfolio loans	(217)	(477)
Income on bank owned life insurance	(958)	(453)
Deferred taxes	263	(470)
Other, net	(4,056)	(5,385)
Net cash provided by operating activities	13,174	24,548
INVESTING ACTIVITIES		
Purchases of investment securities available-for-sale	(19,742)	(86,692)
Maturities/paydowns of investment securities available-for-sale	16,283	11,961
Sales of investment securities available-for-sale	2,794	52,108
Purchases of premises and equipment	(2,164)	(4,008)
Net increase in loans	(190,994)	(42,062)
Purchases of restricted bank stock	(17,750)	(15,450)
Redemptions of restricted bank stock	17,550	16,005
Proceeds from sale of certificates of deposit with banks	—	1,978
Purchases of certificates of deposit with banks	—	(2,229)
Proceeds from sale of other real estate owned	362	—
Purchase (redemption) of bank owned life insurance	706	(50)
Purchase of equity securities	(2,000)	—
Net cash used in investing activities	(194,955)	(68,439)
FINANCING ACTIVITIES		
Net increase in deposits	219,606	58,182
Net decrease in repurchase agreements	(6,648)	(115)
Net change in short-term FHLB borrowings	(67,909)	(32,605)
Principal payments on FHLB borrowings	(12,260)	(595)
Proceeds from new FHLB borrowings	50,000	26,682
Subordinated debt conversion costs	(35)	—
Proceeds from stock offering	—	4,931
Preferred stock redemption	—	(8,500)
Common stock options exercised	2,006	(10)
Cash dividends paid on common stock	(873)	(773)

Cash dividends paid on preferred stock	(366)	(374)
Net cash provided by financing activities	183,521	46,823
Increase in cash and cash equivalents	1,740	2,932
Cash and cash equivalents at beginning of period	20,305	17,340
Cash and cash equivalents at end of period	$ 22,045	$ 20,272
Supplemental disclosure of cash flow information:		
Loans transferred to other real estate owned	$ 720	$ 1,017
Cashless stock options exercised	$ 153	$ 4
Restricted stock units vested	$ 1	$ —
Common stock converted from subordinated debt	$ 15	$ —
Cash payments for:		
Interest on deposits, repurchase agreements and borrowings	$ 13,607	$ 9,100
Income taxes	$ 107	$ 6,025

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

Notes to the Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

Nature of Operations

MVB Financial Corp. ("the Company") is a financial holding company and was organized in 2003. MVB operates principally through its wholly-owned subsidiary, MVB Bank, Inc. ("MVB Bank"). MVB Bank's operating subsidiaries include MVB Mortgage, MVB Insurance, LLC ("MVB Insurance"), and MVB Community Development Corporation ("CDC").

Principles of Consolidation and Basis of Presentation

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with instructions to Form 10 Q. Accordingly, they do not include all the information and footnotes required by GAAP for annual year-end financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. The consolidated balance sheet as of December 31, 2017 has been derived from audited financial statements included in the Company's 2017 filing on Form 10-K. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States and practices in the banking industry. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates, such as the allowance for loan losses, are based upon known facts and circumstances. Estimates are revised by management in the period such facts and circumstances change. Actual results could differ from those estimates. All significant inter-company accounts and transactions have been eliminated in consolidation.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the company's December 31, 2017, Form 10-K filed with the Securities and Exchange Commission (the "SEC").

In certain instances, amounts reported in prior periods' consolidated financial statements have been reclassified to conform to the current presentation.

Information is presented in these notes with dollars expressed in thousands, unless otherwise noted or specified.

Note 2 – Recent Accounting Pronouncements

In February 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This update requires a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate in the Tax Reform Act, which was enacted on December 22, 2017. The Tax Reform Act included a reduction to the corporate income tax rate from 34 percent to 21 percent effective January 1, 2018. The amendments in the ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

The Company elected to early adopt ASU 2018-02 during the first quarter of 2018 and elected to reclassify the income tax effects of the Tax Reform Act from AOCI to retained earnings. The amount of the reclassification is the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate, which amounted to $646 thousand.

In March 2017, the FASB issued ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This ASU amends guidance on the amortization period of premiums on certain purchased callable debt securities. Specifically, the amendments shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date. The amendments affect all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). For public companies, this update will be effective for fiscal years effective for fiscal years beginning after December 15, 2018, including all interim periods within those fiscal years. The adoption of this guidance is not expected to be material to the consolidated financial statements, as it is our current policy to amortize premiums of investment securities to the earliest call date.

Table of Contents

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. Topic 350, Intangibles – Goodwill and Other (Topic 350), currently requires an entity that has not elected the private company alternative for goodwill to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit to address concerns over the cost and complexity of the two-step goodwill impairment test, the amendments in this Update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. For public companies, this update will be effective for fiscal years effective for fiscal years beginning after December 15, 2019, including all interim periods within those fiscal years. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new guidance replaces the incurred loss impairment methodology in current GAAP with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit impaired loans will receive an allowance account at the acquisition date that represents a component of the purchase price allocation. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses, with such allowance limited to the amount by which fair value is below amortized cost. The guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The Company's project management team and Management Loan Committee (“MLC”) engaged a third party to assist with a data gap analysis and will utilize the data to determine the impact of the pronouncement. Additionally, the Company has researched and acquired software to assist with implementation that will be tested throughout 2019.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:(1) A lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842 (Leases), which provides narrow amendments to clarify how to apply certain aspects of the new lease standard. In July 2018, the FASB also issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which allows for an alternative transition method of adoption by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company established a project management team, which is currently evaluating the impact of the new standard, and expects an increase to the Consolidated Balance Sheets for right-of-use assets and associated lease

liabilities, as well as resulting depreciation expense of the right-of-use assets and interest expense of the lease liabilities in the Consolidated Statements of Income, for arrangements previously accounted for as operating leases.

In January 2016, the FASB issued ASU 2016-01, Accounting for Financial Instruments - Overall: Classification and Measurement (Subtopic 825-10). Amendments within ASU 2016-01 that relate to non-public entities have been excluded from this presentation. The amendments in this ASU 2016-01 address the following: 1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; 2) simplify the impairment assessment of equity investments without readily-determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; 3) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; 4) require entities to use the exit price notion when measuring the fair value of financial

instruments for disclosure purposes; 5) require separate presentation in other comprehensive income for the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; 6) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and 7) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company adopted this guidance in the first quarter of 2018. The adoption of ASU 2016-01 on January 1, 2018 did not have a material impact on the Company's Consolidated Financial Statements. In accordance with 5) above, the Company measures the fair value of its loan portfolio on a quarterly basis using an exit price notion. See Note 6, “Fair Value of Financial Instruments” of the Notes to the Consolidated Financial Statements, included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new revenue pronouncement creates a single source of revenue guidance for all companies in all industries and is more principles-based than current revenue guidance. The pronouncement provides a five-step model for a company to recognize revenue when it transfers control of goods or services to customers at an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. The five steps are: (1) identify the contract with the customer, (2) identify the separate performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations and (5) recognize revenue when each performance obligation is satisfied. The Company evaluated the impact of this standard on individual customer contracts, while management evaluated the impact of this standard on the broad categories of its customer contracts and revenue streams. The Company determined that this standard did not have a material impact on its consolidated financial statements because revenue related to financial instruments, including loans and investment securities are not in scope of these updates. Loan interest income, investment interest income, insurance services revenue and BOLI are accounted for under other U.S. GAAP standards and out of scope of ASC 606 revenue standard. The Company also completed an evaluation of certain costs related to customer contracts and revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross versus net). Based on the evaluation, the Company determined that the classification of certain debit and credit card related costs should change (i.e., costs previously recorded as expense are now recorded as contra-revenue). This classification change resulted in immaterial changes to both revenue and expense. The Company adopted the revenue recognition standard and its related amendments as of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts for the debit and credit card related cost reclassifications noted above.

Table of Contents

Note 3 – Investment Securities

There were no held-to-maturity securities at September 30, 2018 or December 31, 2017.

Amortized cost and fair values of investment securities available-for-sale at September 30, 2018 are summarized as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U. S. Agency securities	$ 80,486	$ —	$ (2,774)	$ 77,712
U.S. Sponsored Mortgage-backed securities	53,882	—	(2,928)	50,954
Municipal securities	81,143	71	(2,263)	78,951
Total debt securities	215,511	71	(7,965)	207,617
Other securities	9,126	35	(64)	9,097
Total investment securities available-for-sale	$ 224,637	$ 106	$ (8,029)	$ 216,714

Amortized cost and fair values of investment securities available-for-sale at December 31, 2017 are summarized as follows:

(Dollars in thousands)	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U. S. Agency securities	$ 81,705	$ 81	$ (841)	$ 80,945
U.S. Sponsored Mortgage-backed securities	59,387	31	(1,264)	58,154
Municipal securities	74,482	1,733	(373)	75,842
Total debt securities	215,574	1,845	(2,478)	214,941
Equity and other securities	15,940	644	(18)	16,566
Total investment securities available-for-sale	$ 231,514	$ 2,489	$ (2,496)	$ 231,507

The following table summarizes amortized cost and fair values of debt securities by maturity:

	September 30, 2018	
	Available for sale	
(Dollars in thousands)	Amortized Cost	Fair Value
Within one year	$—	$—
After one year, but within five	46,668	45,665
After five years, but within ten	28,213	26,818
After ten years	140,630	135,134
Total	$215,511	$207,617

Investment securities with a carrying value of $67.2 million at September 30, 2018, were pledged to secure public funds, repurchase agreements, and potential borrowings at the Federal Reserve discount window.

The Company's investment portfolio includes securities that are in an unrealized loss position as of September 30, 2018, the details of which are included in the following table. Although these securities, if sold at September 30, 2018 would result in a pretax loss of $8.0 million, the Company has no intent to sell the applicable securities at such fair values, and maintains the Company has the ability to hold these securities until all principal has been recovered. Management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis. Declines in the fair values of these securities can be traced to general market conditions which reflect the prospect for the economy as a whole. When determining other-than-temporary impairment on securities, the Company considers such factors as adverse conditions specifically

related to a certain security or to specific conditions in an industry or geographic area, the time frame securities have been in an unrealized loss position, the Company’s ability to hold the security for a period of time sufficient to allow for anticipated recovery in value, whether or not the security has been downgraded by a rating agency, and whether or not the financial condition of the security issuer has severely deteriorated. As of September 30, 2018, the Company considers all securities with unrealized loss positions to be temporarily impaired, and consequently, does not believe the Company will sustain any material realized losses as a result of the current temporary decline in fair value.

Table of Contents

The following table discloses investments in an unrealized loss position at September 30, 2018:

(Dollars in thousands)	Less than 12 months		12 months or more	
Description and number of positions	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Agency securities (56)	$ 35,654	$ (837)	$ 42,058	$ (1,937)
U.S. Sponsored Mortgage-backed securities (42)	11,646	(493)	39,309	(2,435)
Municipal securities (97)	34,043	(973)	20,585	(1,290)
Other securities (4)	$ 1,977	$ (44)	$ 501	$ (20)
	$ 83,320	$ (2,347)	$ 102,453	$ (5,682)

The following table discloses investments in an unrealized loss position at December 31, 2017:

(Dollars in thousands)	Less than 12 months		12 months or more	
Description and number of positions	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Agency securities (45)	$ 61,834	$ (659)	$ 7,709	$ (182)
U.S. Sponsored Mortgage-backed securities (39)	16,825	(159)	37,427	(1,105)
Municipal securities (47)	8,826	(48)	16,781	(325)
Equity and other securities (2)	1,034	(18)	—	—
	$ 88,519	$ (884)	$ 61,917	$ (1,612)

For the three-month periods ended September 30, 2018 and 2017, the Company sold investments available-for-sale of $2.1 million and $19.0 million, respectively. These sales resulted in gross gains of $27 thousand and $111 thousand and gross losses of $26 thousand and $6 thousand, respectively.

For the nine-month periods ended September 30, 2018 and 2017, the Company sold investments available-for-sale of $2.8 million and $52.1 million, respectively. These sales resulted in gross gains of $352 thousand and $827 thousand and gross losses of $25 thousand and $372 thousand, respectively.

For the three and nine months ended September 30, 2018, the Company recognized an unrealized gain of $623 thousand and $583 thousand, respectively, on equity securities held as of September 30, 2018, which was recorded in noninterest income in the consolidated statements of income.

Note 4 – Loans and Allowance for Loan Losses

The components of loans in the Consolidated Balance Sheet at September 30, 2018 and December 31, 2017, were as follows:

(Dollars in thousands)	September 30, 2018	December 31, 2017
Commercial and Non-Residential Real Estate	$ 929,284	$ 783,909
Residential Real Estate	298,749	246,214
Home Equity	57,629	62,400
Consumer	10,463	12,783
Total Loans	$ 1,296,125	$ 1,105,306
Deferred loan origination fees and costs, net	335	635
Loans receivable	$ 1,296,460	$ 1,105,941

All loan origination fees and direct loan origination costs are deferred and recognized over the life of the loan.

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.

Table of Contents

The Bank’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank’s ALL. The Bank's methodology allows for the analysis of certain impaired loans in homogeneous pools, rather than on an individual basis, when those loans are below specific thresholds based on outstanding principal balance. More specifically, residential mortgage loans, home equity lines of credit, and consumer loans, when considered impaired, are evaluated collectively for impairment by applying allocation rates derived from the Bank’s historical losses specific to impaired loans. Total collectively evaluated impaired loans were $1.7 million and $1.3 million, while the related reserves were $168 thousand and $169 thousand as of September 30, 2018 and December 31, 2017.

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 qualified factors.

The segments described below in the impaired loans by class table, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Company and bank management tracks the historical net charge-off activity at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. All pools currently utilize a rolling 12 quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application 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.

Company and Bank management have identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: lending policies and procedures, nature and volume of the portfolio, experience and ability of lending management and staff, volume and severity of problem credits, conclusion of loan reviews, audits, and exams, changes in the value of underlying collateral, effect of concentrations of credit from a loan type, industry and/or geographic standpoint, changes in economic and business conditions consumer sentiment, and other external factors. The combination of historical charge-off and qualitative factors are then weighted for each risk grade. These weightings are determined internally based upon the likelihood of loss as a loan risk grading deteriorates.

To estimate the liability for off-balance sheet credit exposures, Bank management analyzed the portfolios of letters of credit, non-revolving lines of credit, and revolving lines of credit, and based its calculation on the expectation of future advances of each loan category. Letters of credit were determined to be highly unlikely to advance since they are generally in place only to ensure various forms of performance of the borrowers. In the Bank’s history, there have been no letters of credit drawn upon. In addition, many of the letters of credit are cash secured and do not warrant an allocation. Non-revolving lines of credit were determined to be highly likely to advance as these are typically construction lines. Meanwhile, the likelihood of revolving lines of credit advancing varies with each individual borrower. Therefore, the future usage of each line was estimated based on the average line utilization of the revolving line of credit portfolio as a whole.

Once the estimated future advances were calculated, an allocation rate, which was derived from the Bank’s historical losses and qualitative environmental factors, was applied in the similar manner as those used for the allowance for loan loss calculation. The resulting estimated loss allocations were totaled to determine the liability for unfunded commitments related to these loans, which Management considers necessary to anticipate potential losses on those

commitments that have a reasonable probability of funding. As of September 30, 2018 and December 31, 2017, the liability for unfunded commitments related to loans held for investment was $284 thousand.

Bank 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.

The ALL is based on estimates, and actual losses will 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.

Table of Contents

The following tables summarize the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of September 30, 2018:

(Dollars in thousands)	Commercial	Residential	Home Equity	Consumer	Total
ALL balance at December 31, 2017	$ 7,804	$ 1,119	$ 705	$ 250	$ 9,878
Charge-offs	(616)	(11)	—	(52)	(679)
Recoveries	10	19	58	5	92
Provision (recovery)	1,827	242	(139)	218	2,148
ALL balance at September 30, 2018	$ 9,025	$ 1,369	$ 624	$ 421	$ 11,439
Individually evaluated for impairment	$ 1,262	$ 88	$ —	$ 226	$ 1,576
Collectively evaluated for impairment	$ 7,763	$ 1,281	$ 624	$ 195	$