ACNB CORP
Form 10-Q
August 03, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

Commission file number 1-35015

ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	**23-2233457** (I.R.S. Employer Identification No.)
16 Lincoln Square, Gettysburg, Pennsylvania (Address of principal executive offices)	**17325** (Zip Code)

Registrant s telephone number, including area code: **(717) 334-3161**

Title of each class	**Name of each exchange on which registered**
Common Stock, $2.50 par value per share	The NASDAQ Stock Market, LLC

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 x No o

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

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.

Large accelerated filer o Accelerated filer x

Non-accelerated filer o (Do not check if a smaller reporting company)

Smaller reporting company o

Emerging growth company o

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. o

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

The number of shares of the Registrant s Common Stock outstanding on August 3, 2018, was 7,038,768.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands, except per share data		June 30, 2018		June 30, 2017		December 31, 2017
ASSETS						
Cash and due from banks	**$**	**18,403**	$	17,384	$	19,304
Interest bearing deposits with banks		**44,650**		8,896		15,137
Total Cash and Cash Equivalents		**63,053**		26,280		34,441
Equity securities with readily determinable fair values		**1,767**				
Debt securities available for sale		**152,424**		133,719		159,051
Securities held to maturity, fair value $39,145; $50,000; $44,549		**39,894**		50,088		44,829
Loans held for sale		**1,265**		1,278		1,736
Loans, net of allowance for loan losses $13,143; $14,148; $13,976		**1,233,655**		955,527		1,230,194
Premises and equipment		**26,379**		18,170		26,774
Restricted investment in bank stocks		**4,849**		4,899		4,773
Investment in bank-owned life insurance		**45,973**		41,273		44,935
Investments in low-income housing partnerships		**2,213**		2,690		2,446
Goodwill		**19,580**		6,308		19,580
Intangible assets		**2,801**		526		2,569
Foreclosed assets held for resale		**287**		63		436
Other assets		**29,202**		21,115		23,668
Total Assets	**$**	**1,623,342**	$	1,261,936	$	1,595,432
LIABILITIES AND STOCKHOLDERS EQUITY						
LIABILITIES						
Deposits:						
Non-interest bearing	**$**	**288,215**	$	190,572	$	279,413
Interest bearing		**1,045,760**		809,582		1,019,079
Total Deposits		**1,333,975**		1,000,154		1,298,492
Short-term borrowings		**26,418**		30,837		36,908
Long-term borrowings		**89,816**		95,850		94,600
Other liabilities		**12,826**		11,251		11,466
Total Liabilities		**1,463,035**		1,138,092		1,441,466
STOCKHOLDERS EQUITY						
Preferred stock, $2.50 par value; 20,000,000 shares authorized; no shares outstanding						
		17,753		15,349		17,716

Common stock, $2.50 par value; 20,000,000 shares authorized; 7,101,368, 6,139,499 and 7,086,258 shares issued; 7,038,768, 6,076,899 and 7,023,658 shares outstanding			
Treasury stock, at cost (62,600 shares)	**(728)**	(728)	(728)
Additional paid-in capital	**38,193**	11,287	37,777
Retained earnings	**113,772**	103,488	106,293
Accumulated other comprehensive loss	**(8,683)**	(5,552)	(7,092)
Total Stockholders Equity	**160,307**	123,844	153,966
Total Liabilities and Stockholders Equity	**$ 1,623,342**	$ 1,261,936	$ 1,595,432

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Dollars in thousands, except per share data	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
INTEREST AND DIVIDEND INCOME				
Loans, including fees	**$ 14,623**	$ 9,964	**$ 28,780**	$ 19,494
Securities:				
Taxable	**929**	784	**1,832**	1,584
Tax-exempt	**59**	117	**124**	267
Dividends	**74**	64	**152**	113
Other	**179**	33	**231**	37
Total Interest Income	**15,864**	10,962	**31,119**	21,495
INTEREST EXPENSE				
Deposits	**1,206**	687	**2,340**	1,322
Short-term borrowings	**11**	15	**27**	60
Long-term borrowings	**556**	429	**1,099**	816
Total Interest Expense	**1,773**	1,131	**3,466**	2,198
Net Interest Income	**14,091**	9,831	**27,653**	19,297
PROVISION FOR LOAN LOSSES	**320**		**570**	
Net Interest Income after Provision for Loan Losses	**13,771**	9,831	**27,083**	19,297
OTHER INCOME				
Service charges on deposit accounts	**810**	617	**1,626**	1,187
Income from fiduciary, investment management and brokerage activities	**559**	478	**1,130**	920
Earnings on investment in bank-owned life insurance	**281**	276	**538**	531
Gain on life insurance proceeds			**52**	
Net gains on sales of securities	**13**		**13**	
Net gains (losses) on equity securities	**6**		**(27)**	
Service charges on ATM and debit card transactions	**614**	381	**1,144**	739
Commissions from insurance sales	**1,707**	1,564	**2,908**	2,718
Other	**327**	212	**645**	515
Total Other Income	**4,317**	3,528	**8,029**	6,610
OTHER EXPENSES				
Salaries and employee benefits	**6,683**	5,934	**13,310**	11,682
Net occupancy	**720**	496	**1,499**	1,033
Equipment	**1,321**	844	**2,483**	1,627
Other tax	**235**	168	**441**	379
Professional services	**344**	344	**713**	583
Supplies and postage	**177**	168	**392**	337
Marketing and corporate relations	**165**	138	**268**	202
FDIC and regulatory	**164**	140	**348**	279
Merger related expenses		208		370
Intangible assets amortization	**182**	82	**366**	162
Foreclosed real estate expenses (income)	**84**	(14)	**132**	16

Other operating		**1,176**		1,126		**2,285**		1,964
Total Other Expenses		**11,251**		9,634		**22,237**		18,634
Income before Income Taxes		**6,837**		3,725		**12,875**		7,273
PROVISION FOR INCOME TAXES		**1,330**		1,003		**2,455**		1,914
Net Income	**$**	**5,507**	$	2,722	**$**	**10,420**	$	5,359
PER SHARE DATA								
Basic earnings	**$**	**0.78**	$	0.45	**$**	**1.48**	$	0.88
Cash dividends declared	**$**	**0.23**	$	0.20	**$**	**0.43**	$	0.40

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

Dollars in thousands	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
NET INCOME	**$ 5,507**	$ 2,722	**$ 10,420**	$ 5,359
OTHER COMPREHENSIVE (LOSS) INCOME				
SECURITIES				
Unrealized (losses) gains arising during the period, net of income taxes of $(228), $52, $(603) and $131, respectively	**(430)**	95	**(1,719)**	252
Reclassification adjustment for net gains included in net income, net of income taxes of $3, $0, $3 and $0, respectively (A) (C)	**10**		**10**	
PENSION				
Amortization of pension net loss, transition liability, and prior service cost, net of income taxes of $29, $59, $58 and $118, respectively (B) (C)	**100**	110	**200**	220
TOTAL OTHER COMPREHENSIVE (LOSS) INCOME	**(320)**	205	**(1,509)**	472
TOTAL COMPREHENSIVE INCOME	**$ 5,187**	$ 2,927	**$ 8,911**	$ 5,831

The accompanying notes are an integral part of the consolidated financial statements.

(A) Gross amounts are included in net gains on sales or calls of securities on the Consolidated Statements of Income in total other income.

(B) Gross amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income in total other expenses.

(C) Income tax amounts are included in the provision for income taxes on the Consolidated Statements of Income.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Six Months Ended June 30, 2018 and 2017

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
BALANCE JANUARY 1, 2017	$ 15,317	$ (728)	$ 10,941	$ 100,555	$ (6,024)	$ 120,061
Net income				5,359		5,359
Other comprehensive income, net of taxes					472	472
Common stock shares issued (6,568 shares)	17		121			138
Restricted stock grants (6,193 shares)	15		105			120
Restricted stock compensation expense			120			120
Cash dividends declared				(2,426)		(2,426)
BALANCE JUNE 30, 2017	$ 15,349	$ (728)	$ 11,287	$ 103,488	$ (5,552)	$ 123,844
BALANCE JANUARY 1, 2018	**$ 17,716**	**$ (728)**	**$ 37,777**	**$ 106,293**	**$ (7,092)**	**$ 153,966**
Net income				**10,420**		**10,420**
Other comprehensive loss, net of taxes					**(1,509)**	**(1,509)**
Reclassification of certain income tax effects from AOCI (1)				**82**	**(82)**	
Common stock shares issued (8,366 shares)	**20**		**234**			**254**
Restricted stock grants (6,744 shares)	**17**		**(4)**			**13**
Restricted stock compensation expense			**186**			**186**
Cash dividends declared				**(3,023)**		**(3,023)**
BALANCE JUNE 30, 2018	**$ 17,753**	**$ (728)**	**$ 38,193**	**$ 113,772**	**$ (8,683)**	**$ 160,307**

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(1) In January 2018, the Corporation adopted ASU 2018-02, as a result, the Corporation made a policy election to release income tax effects, as a result of the Tax Act, from AOCI to retained earnings.

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Dollars in thousands	Six Months Ended June 30, 2018		2017	
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	**$**	**10,420**	$	5,359
Adjustments to reconcile net income to net cash provided by operating activities:				
Gain on sales of loans originated for sale		**(272)**		(206)
Loss (gain) on sales of foreclosed assets held for resale, including writedowns		**45**		(36)
Earnings on investment in bank-owned life insurance		**(538)**		(531)
Gain on sales or calls of securities		**(13)**		
Loss on equity securities		**27**		
Restricted stock compensation expense		**186**		120
Depreciation and amortization		**1,418**		942
Provision for loan losses		**570**		
Net amortization of investment securities premiums		**238**		264
Increase in accrued interest receivable		**(698)**		(103)
Increase in accrued interest payable		**284**		103
Mortgage loans originated for sale		**(15,975)**		(12,102)
Proceeds from sales of loans originated for sale		**16,718**		12,800
Decrease (increase) in other assets		**440**		(943)
Decrease (increase) in deferred tax expense		**396**		(159)
Increase in other liabilities		**1,334**		1,688
Net Cash Provided by Operating Activities		**14,580**		7,196
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from maturities of investment securities held to maturity		**4,932**		5,438
Proceeds from maturities of investment securities available for sale		**7,418**		13,456
Proceeds from sales of investment securities available for sale		**1,446**		
Purchase of investment securities available for sale		**(11,459)**		(4,024)
Purchase of restricted investment in bank stocks		**(76)**		(550)
Net increase in loans		**(4,266)**		(61,811)
Purchase of bank-owned life insurance		**(500)**		
Insurance book- acquisition		**(600)**		
Capital expenditures		**(655)**		(803)
Proceeds from sales of premises and equipment				6
Proceeds from sales of foreclosed real estate		**339**		229
Net Cash Used in Investing Activities		**(3,421)**		(48,059)
CASH FLOWS FROM FINANCING ACTIVITIES				
Net increase in demand deposits		**8,802**		9,979
Net increase in time certificates of deposits and interest bearing deposits		**26,681**		22,554
Net decrease in short-term borrowings		**(10,490)**		(3,753)
Proceeds from long-term borrowings		**8,716**		24,600
Repayments on long-term borrowings		**(13,500)**		(3,000)
Dividends paid		**(3,023)**		(2,426)
Common stock issued		**267**		258
Net Cash Provided by Financing Activities		**17,453**		48,212
Net Increase in Cash and Cash Equivalents		**28,612**		7,349
CASH AND CASH EQUIVALENTS BEGINNING		**34,441**		18,931
CASH AND CASH EQUIVALENTS ENDING	**$**	**63,053**	$	26,280
Supplemental disclosures of cash flow information				
Interest paid	**$**	**3,182**	$	2,095
Income taxes paid	**$**	**1,700**	$	1,750
Loans transferred to foreclosed assets held for resale and other foreclosed transactions	**$**	**235**	$	

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Nature of Operations

ACNB Corporation (the Corporation or ACNB), headquartered in Gettysburg, Pennsylvania, provides banking, insurance, and financial services to businesses and consumers through its wholly-owned subsidiaries, ACNB Bank (Bank) and Russell Insurance Group, Inc. (RIG). The Bank engages in full-service commercial and consumer banking and wealth management services, including trust and retail brokerage, through twenty-two community banking office locations in Adams, Cumberland, Franklin and York Counties, Pennsylvania. There is also a loan production office situated in York County, Pennsylvania, as well as plans to establish, subject to regulatory requirements, another loan production office in Hunt Valley, Maryland.

On July 1, 2017, ACNB completed its acquisition of New Windsor Bancorp, Inc. (New Windsor) of Taneytown, Maryland. At the effective time of the acquisition, New Windsor merged with and into a wholly-owned subsidiary of ACNB, immediately followed by the merger of New Windsor State Bank (NWSB) with and into ACNB Bank. ACNB Bank now operates in the Maryland market as NWSB Bank, A Division of ACNB Bank and serves this marketplace with banking and wealth management services via a network of seven community banking offices located in Carroll County, Maryland.

RIG is a full-service insurance agency based in Westminster, Maryland, with a second location in Germantown, Maryland. The agency offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients.

The Corporation s primary source of revenue is interest income on loans and investment securities and fee income on its products and services. Expenses consist of interest expense on deposits and borrowed funds, provisions for loan losses, and other operating expenses.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly ACNB Corporation s financial position and the results of operations, comprehensive income, changes in stockholders equity, and cash flows. All such adjustments are of a normal recurring nature.

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s consolidated financial statements in the 2017 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 9, 2018. It is suggested that the consolidated financial statements contained herein be read in conjunction with the consolidated financial statements and notes included in the Corporation s Annual Report on Form 10-K. The results of operations for the three and six month periods ended June 30, 2018, are not necessarily indicative of the results to be expected for the full year.

On January 1, 2018, the Corporation adopted ASU 2014-09, *Revenue from Contracts with Customers,* and all subsequent amendments to the ASU (collectively ASC 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its

scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Corporation s revenue comes from interest income, including loans and securities, that are outside the scope of ASC 606. The Corporation s services that fall within the scope of ASC 606 are presented within other income on the consolidated statement of income and are recognized as revenue as the Corporation satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on deposit accounts, service charges on ATM and debit card transactions, income from fiduciary, investment management and brokerage activities and commissions from insurance sales. ASC 606 did not result in a change to the accounting for any in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

On January 1, 2018, the Corporation adopted ASU 2016-01, *Financial Instruments Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,* which amended the guidance on the classification and measurement of financial instruments. Upon adoption of ASU 2016-01, the Corporation recognized the equity securities fair value change in net income. Previously, the fair value changes were recognized, net of tax, in other comprehensive income (loss). The adoption of this ASU did not have a material effect on the Corporation s consolidated financial condition or results of operations.

The Corporation early adopted ASU 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* The amendments in this ASU required a reclassification from accumulated other comprehensive income to retained earnings for tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21% corporate income tax rate. The amendments in this ASU would be effective for the Corporation for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The adoption of this ASU did not have a material effect on the Corporation s consolidated financial condition or results of operations.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2018, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. Acquisition of New Windsor Bancorp, Inc.

On July 1, 2017, ACNB completed its acquisition of New Windsor Bancorp Inc. (New Windsor) of Taneytown, Maryland. New Windsor was a locally owned and managed institution with seven locations in north central Maryland that complemented, enhanced and expanded ACNB s physical presence in north central Maryland. ACNB transacted the acquisition to enhance its competitive strategic position, potential prospective business opportunities, operations, management, prospective financial condition, future earnings and business prospects. Specifically, ACNB believes that the acquisition will enhance its business opportunities in Northern Maryland due to the combined company having a greater market share, market presence and the ability to offer more diverse (i.e. Trust Services) and more profitable products, as well as a broader based and geographically diversified branch system to enhance deposit collection and potentially improve funding costs. The fair value of total assets acquired as a result of the acquisition totaled $319.8 million, loans totaled $263.5 million and deposits totaled $293.3 million. Goodwill recorded in the acquisition was $13.3 million. In accordance with the terms of the Reorganization Agreement, dated November 21, 2016, as amended, New Windsor shareholders received, in aggregate, $4.5 million in cash and 938,360 shares or approximately 13% of the post transaction outstanding shares of the Corporation s common stock. The transaction was valued at $33.3 million based on the Corporation s June 30, 2017 closing price of $30.50 as quoted on NASDAQ. The results of the combined entity s operations are included in the Corporation s Consolidated Financial Statements from the date of acquisition.

The acquisition of New Windsor is being accounted for as a business combination using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at estimated fair values on the acquisition date.

The following table summarizes the consideration paid for New Windsor and the fair value of assets acquired and liabilities assumed as of the acquisition date:

Purchase Price Consideration in Common Stock

New Windsor shares outstanding		1,003,703
Shares paid cash consideration		150,555
Cash consideration (per New Windsor share)	$	30.00
Cash portion of purchase price	$	4,519,995
New Windsor shares outstanding		1,003,703

Shares paid stock consideration		853,148
Exchange ratio		1.10
Total ACNB shares issued		938,360
ACNB s share price for purposes of calculation	$	30.50
Equity portion of purchase price	$	28,619,980
Cost of shares owned by buyer	$	150,000
Total consideration paid	$	33,289,975

	In thousands		
Allocation of Purchase Price			
Total Purchase Price		$	33,290
Fair Value of Assets Acquired			
Cash and cash equivalents	10,964		
Investment securities	21,624		
Loans held for sale	1,463		
Loans	263,450		
Restricted stock	486		
Premises and equipment	8,624		
Core deposit intangible asset	2,418		
Other assets	10,792		
Total assets	319,821		
Fair Value of Liabilities Assumed			
Non-interest bearing deposits	80,006		
Interest bearing deposits	213,327		
Subordinated debt	4,688		
Other liabilities	1,782		
Total liabilities	299,803		
Net Assets Acquired			20,018
Goodwill Recorded in Acquisition		$	13,272

Pursuant to the accounting requirements, the Corporation assigned a fair value to the assets acquired and liabilities assumed of New Windsor. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Goodwill and core deposit intangibles are allocated to the banking business segment.

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

Investment securities available-for-sale

The estimated fair values of the investment securities available for sale, primarily comprised of U.S. Government agency mortgage-backed securities, U.S. government agencies and municipal bonds, were determined using Level 2 inputs in the fair value hierarchy. The fair values were determined using independent pricing services. The Corporation s independent pricing service utilized matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather relying on the security s relationship to other benchmark quoted prices. Management reviewed the data and assumptions used in pricing the securities.

Loans

Acquired loans (impaired and non-impaired) are initially recorded at their acquisition-date fair values using Level 3 inputs. Fair values are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, expected life time losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Specifically, the Corporation has prepared three separate loan fair value adjustments that it believed a market participant might employ in estimating the entire fair value adjustment necessary under ASC 820-10 for the acquired loan portfolio. The three-separate fair valuation methodology employed are: 1) an interest rate loan fair value adjustment, 2) a general credit fair value adjustment, and 3) a specific credit fair value adjustment for purchased credit impaired loans subject to ASC 310-30 procedures. The acquired loans were recorded at fair value at the acquisition date without carryover of New Windsor s previously established allowance for loan losses. The fair value of the financial assets acquired included loans receivable with a gross amortized cost basis of $272,646,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired. The credit adjustment on purchased credit impaired loans is derived in accordance with ASC 310-30 and represents the portion of the loan balances that has been deemed uncollectible based on the Corporation s expectations of future cash flows for each respective loan.

In thousands		
Gross amortized cost basis at July 1, 2017	$	272,646
Interest rate fair value adjustment on pools of homogeneous loans		(731)
Credit fair value adjustment on pools of homogeneous loans		(4,501)
Credit fair value adjustment on purchased credit impaired loans		(3,964)
Fair value of acquired loans at July 1, 2017	$	263,450

For loans acquired without evidence of credit quality deterioration, ACNB prepared the interest rate loan fair value and credit fair value adjustments. Loans were grouped into homogeneous pools by characteristics such as loan type, term, collateral and rate. Market rates for similar loans were obtained from various internal and external data sources and reviewed by management for reasonableness. The average of these rates was used as the fair value interest rate a market participant would utilize. A present value approach was utilized to calculate the interest rate fair value discount of $731,000.

Additionally for loans acquired without credit deterioration, a credit fair value adjustment was calculated using a two-part credit fair value analysis: 1) expected lifetime credit migration losses; and 2) estimated fair value adjustment for certain qualitative factors. The expected lifetime losses were calculated using historical losses observed at the Bank, NWSB and peer banks. ACNB also estimated an environmental factor to apply to each loan type. The environmental factor represents a potential discount which may arise due to general credit and economic factors. A credit fair value discount of $4.5 million was determined. Both the interest rate and credit fair value adjustments relate to loans acquired without evidence of credit quality deterioration will be substantially recognized as interest income on a level yield amortization method over the expected life of the loans.

The following table presents the acquired purchased credit impaired loans receivable at the Acquisition Date:

In thousands		
Contractual principal and interest at acquisition	$	13,439
Nonaccretable difference		(5,651)
Expected cash flows at acquisition		7,788
Accretable yield		(1,458)
Fair value of purchased impaired loans	$	6,330

Premises and Equipment

The Corporation acquired seven branches from New Windsor. The fair value of New Windsor s premises, including land, buildings, and improvements, was determined based upon independent third-party appraisals and other data in the market in which the premises are located. The Corporation prepared an internal analysis to compare the lease contract obligations to comparable market rental rates. The Corporation believed that the leased contract rates were in a reasonable range of market rental rates and concluded that no fair market value adjustment related to leasehold interest was necessary.

Core Deposit Intangible

The fair value of the core deposit intangible was determined based on a discounted cash flow analysis using a discount rate commensurate with market participants. To calculate cash flows, deposit account servicing costs (net of deposit fee income) and interest expense on deposits were

compared to the cost of alternative funding sources available through national brokered CD offering rates. The projected cash flows were developed using projected deposit attrition rates. The core deposit intangible will be amortized over ten years using the sum-of-years digits method.

Time Deposits

The fair value adjustment for time deposits represents a discount from the value of the contractual repayments of fixed-maturity deposits using prevailing market interest rates for similar-term time deposits. The time deposit discount of approximately $847,500 is being amortized into income on a level yield amortization method over the contractual life of the deposits.

Long-term Borrowings

The Corporation assumed a trust preferred subordinated debt in connection with the acquisition. The fair value of the trust preferred subordinated debt was determined based upon an estimated fair value from an independent brokerage firm. The trust preferred capital note was valued at a discount of $312,500, which is being amortized into income on a level yield amortization method based upon the assumed market rate, and the term of the trust preferred subordinated debt instrument.

3. Earnings Per Share and Restricted Stock Plan

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 7,030,441 and 6,066,675 weighted average shares of common stock outstanding for the six months ended June 30, 2018 and 2017, respectively, and 7,035,237 and 6,068,673 for the three months ended June 30, 2018 and 2017, respectively. All outstanding unvested restricted stock awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation.

The Corporation has a restricted stock plan available to selected employees and directors of the Corporation and the Bank to advance the best interests of the Corporation and its stockholders. The plan provides those persons who have responsibility for its growth with additional incentives by allowing them to acquire ownership in the Corporation and, thereby, encouraging them to contribute to the success of the Corporation and the Bank. Plan expense is recognized over the vesting period of the stock issued under the plan. As of June 30, 2018, 26,045 shares were issued to employees under this plan, of which 19,485 were fully vested, no shares vested during the quarter, and the remaining 6,560 will vest over the next two years. $42,000 and $61,000 of compensation expenses related to the grants were recognized during the three months ended June 30, 2018 and 2017, respectively. $118,000 and $120,000 of compensation expenses related to the grants were recognized during the six months ended June 30, 2018 and 2017, respectively.

4. Retirement Benefits

The components of net periodic benefit expense related to the non-contributory, defined benefit pension plan for the three and six month periods ended June 30 were as follows:

In thousands	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30 2018	Six Months Ended June 30 2017
Service cost	**$ 215**	$ 210	**$ 430**	$ 420
Interest cost	**274**	284	**548**	568
Expected return on plan assets	**(692)**	(630)	**(1,384)**	(1,260)
Amortization of net loss	**129**	169	**257**	338
Net Periodic Benefit Expense	**$ (74)**	$ 33	**$ (149)**	$ 66

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2017, that it had not yet determined the amount the Bank planned on contributing to the defined benefit plan in 2018. As of June 30, 2018, this contribution amount had still not been determined. Effective April 1, 2012, no inactive or former participant in the plan is eligible to again participate in the plan, and no

employee hired after March 31, 2012, is eligible to participate in the plan. As of the last annual census, ACNB Bank had a combined 353 active, vested, terminated and retired persons in the plan.

5. **Guarantees**

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $4,980,000 in standby letters of credit as of June 30, 2018. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of June 30, 2018, for guarantees under standby letters of credit issued is not material.

6. **Accumulated Other Comprehensive Loss**

The components of accumulated other comprehensive loss, net of taxes, are as follows:

In thousands		Unrealized Losses on Securities		Pension Liability		Accumulated Other Comprehensive Loss
BALANCE JUNE 30, 2018	**$**	**(2,748)**	**$**	**(5,935)**	**$**	**(8,683)**
BALANCE DECEMBER 31, 2017	$	(957)	$	(6,135)	$	(7,092)
BALANCE JUNE 30, 2017	$	(13)	$	(5,539)	$	(5,552)

7. **Segment Reporting**

The Corporation has two reporting segments, the Bank and RIG. RIG is managed separately from the banking segment, which includes the Bank and related financial services that the Corporation offers through its banking subsidiary. RIG offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients.

Segment information for the six month periods ended June 30, 2018 and 2017, is as follows:

In thousands		Banking		Insurance		Total
2018						
Net interest income and other income from external customers	**$**	**32,780**	**$**	**2,902**	**$**	**35,682**
Income before income taxes		**12,031**		**844**		**12,875**
Total assets		**1,613,462**		**9,880**		**1,623,342**
Capital expenditures		**614**		**41**		**655**
2017						
Net interest income and other income from external customers	$	23,215	$	2,692	$	25,907
Income before income taxes		6,675		598		7,273
Total assets		1,252,723		9,213		1,261,936
Capital expenditures		803				803

Segment information for the three month periods ended June 30, 2018 and 2017, is as follows:

In thousands	Banking	Insurance	Total
2018			
Net interest income and other income from external customers	**$ 16,706**	**$ 1,702**	**$ 18,408**
Income before income taxes	**6,213**	**624**	**6,837**
Total assets	**1,613,462**	**9,880**	**1,623,342**
Capital expenditures	**257**	**41**	**298**
2017			
Net interest income and other income from external customers	$ 11,821	$ 1,538	$ 13,359
Income before income taxes	3,237	488	3,725
Total assets	1,252,723	9,213	1,261,936
Capital expenditures	436		436

Customer renewal lists are amortized over their estimated useful lives which range from eight to thirteen years. Core deposit intangible assets are primarily amortized over 10 years using accelerated methods. Goodwill is not amortized, but rather is analyzed annually for impairment. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. Tax amortization of goodwill and the intangible assets is deductible for tax purposes. Tax amortization of the goodwill associated with the New Windsor acquisition is not deductible for federal income tax purposes.

8. Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in other comprehensive income (loss). As of January 1, 2018, equity securities with readily determined fair values are recorded at fair value with changes in fair value recognized in net income. Prior to 2018, fair value changes were reported, net of tax, in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Amortized cost and fair value of securities at June 30, 2018, and December 31, 2017, were as follows:

In thousands		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
SECURITIES AVAILABLE FOR SALE								
JUNE 30, 2018								
U.S. Government and agencies	**$**	**115,580**	**$**	**2**	**$**	**3,159**	**$**	**112,423**
Mortgage-backed securities, residential		**29,110**		**145**		**551**		**28,704**
State and municipal		**11,282**		**76**		**61**		**11,297**
	$	**155,972**	**$**	**223**	**$**	**3,771**	**$**	**152,424**
DECEMBER 31, 2017								
U.S. Government and agencies	$	105,899	$	2	$	1,818	$	104,083
Mortgage-backed securities, residential		34,473		461		101		34,833
State and municipal		13,227		109		42		13,294
Corporate bonds		5,000		57				5,057
CRA mutual fund		1,044				9		1,035
Stock in other banks		647		102				749
	$	160,290	$	731	$	1,970	$	159,051
SECURITIES HELD TO MATURITY								
JUNE 30, 2018								
U.S. Government and agencies	**$**	**17,000**	**$**		**$**	**128**	**$**	**16,872**
Mortgage-backed securities, residential		**22,894**				**621**		**22,273**
	$	**39,894**	**$**		**$**	**749**	**$**	**39,145**
DECEMBER 31, 2017								
U.S. Government and agencies	$	19,000	$	2	$	99	$	18,903
Mortgage-backed securities, residential		25,829		55		238		25,646
	$	44,829	$	57	$	337	$	44,549

The Corporation adopted ASU 2016-01, *Financial Instruments Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* effective January 1, 2018. The required fair value disclosures are as follows:

In thousands		Fair Value at January 1, 2018		Unrealized Gains		Unrealized Losses		Fair Value at June 30, 2018
JUNE 30, 2018								
Equity securities with a readily determinable fair value	**$**	**1,793**	**$**	**22**	**$**	**48**	**$**	**1,767**

The following table shows the Corporation s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2018, and December 31, 2017:

In thousands	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
SECURITIES AVAILABLE FOR SALE						
JUNE 30, 2018						
U.S. Government and agencies	**$ 47,707**	**$ 892**	**$ 62,246**	**$ 2,267**	**$ 109,953**	**$ 3,159**
Mortgage-backed securities, residential	**19,950**	**496**	**1,378**	**55**	**21,328**	**551**
State and municipal	**1,475**	**8**	**1,925**	**53**	**3,400**	**61**
	$ 69,132	**$ 1,396**	**$ 65,549**	**$ 2,375**	**$ 134,681**	**$ 3,771**
DECEMBER 31, 2017						
U.S. Government and agencies	$ 42,775	$ 445	$ 58,279	$ 1,373	$ 101,054	$ 1,818
Mortgage-backed securities, residential	7,228	56	2,845	45	10,073	101
State and municipal	1,042	8	1,950	34	2,992	42
CRA Mutual Fund			1,035	9	1,035	9
	$ 51,045	$ 509	$ 64,109	$ 1,461	$ 115,154	$ 1,970
SECURITIES HELD TO MATURITY						
JUNE 30, 2018						
U.S. Government and agencies	**$ 2,966**	**$ 34**	**$ 12,906**	**$ 94**	**$ 15,872**	**$ 128**
Mortgage-backed securities, residential	**12,322**	**210**	**9,951**	**411**	**22,273**	**621**
	$ 15,288	**$ 244**	**$ 22,857**	**$ 505**	**$ 38,145**	**$ 749**
DECEMBER 31, 2017						
U.S. Government and agencies	$ 4,985	$ 15	$ 10,916	$ 84	$ 15,901	$ 99
Mortgage-backed securities, residential	4,946	29	11,070	209	16,016	238
	$ 9,931	$ 44	$ 21,986	$ 293	$ 31,917	$ 337

All mortgage-backed security investments are government sponsored enterprise (GSE) pass-through instruments issued by the Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA) or Federal Home Loan Mortgage Corporation (FHLMC), which guarantee the timely payment of principal on these investments.

At June 30, 2018, sixty-eight available for sale U.S. Government and agency securities had unrealized losses that individually did not exceed 7% of amortized cost. Thirty-five of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2018, thirty-four available for sale residential mortgage-backed securities had unrealized losses that individually did not exceed 5% of amortized cost. Two of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate

principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2018, twelve available for sale state and municipal securities had unrealized losses that individually did not exceed 9% of amortized cost. Eight of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2018, nine held to maturity U.S. Government and agency securities had unrealized losses that individually did not exceed 2% of amortized cost. Seven of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2018, thirty-four held to maturity residential mortgage-backed securities had unrealized losses that individually did not exceed 5% of amortized cost. Thirteen of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

In analyzing the issuer s financial condition, management considers industry analysts reports, financial performance, and projected target prices of investment analysts within a one-year time frame. Based on the above information, management has determined that none of these investments are other-than-temporarily impaired.

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses independent service providers to provide matrix pricing.

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At June 30, 2018, management had not identified any securities with an unrealized loss that it intends to sell or will be required to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses.

Amortized cost and fair value at June 30, 2018, by contractual maturity, where applicable, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	**$ 9,349**	**$ 9,321**	**$ 10,000**	**$ 9,973**
Over 1 year through 5 years	**110,627**	**107,677**	**7,000**	**6,899**
Over 5 years through 10 years	**6,886**	**6,721**		
Over 10 years				
Mortgage-backed securities, residential	**29,110**	**28,705**	**22,894**	**22,273**
	$ 155,972	**$ 152,424**	**$ 39,894**	**$ 39,145**

The Corporation realized $12,500 gross gains on sales of securities available for sale during the three and six month periods ended June 30, 2018. The corporation did not realize any gross gains or losses on sales of securities during the three and six month period ended June 30, 2017.

At June 30, 2018, and December 31, 2017, securities with a carrying value of $160,460,000 and $157,601,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

9. Loans

The Corporation grants commercial, residential, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout southcentral Pennsylvania and northern Maryland. The ability of the Corporation s debtors to honor their contracts is dependent upon the real estate values and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The loans receivable portfolio is segmented into commercial, residential mortgage, home equity lines of credit, and consumer loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, and commercial real estate construction.

The accrual of interest on residential mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued, but not collected, for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses (the allowance) is established as losses are estimated to occur through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The reserve for unfunded lending commitments represents management s estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statement of condition. The amount of the reserve for unfunded lending commitments is not material to the consolidated financial statements.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity, and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for the previous twelve quarters for each of these categories of loans, adjusted for qualitative risk factors. These qualitative risk factors include:

- lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;

- national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans;

- the nature and volume of the portfolio and terms of loans;
- the experience, ability and depth of lending management and staff;
- the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management s best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. It covers risks that are inherently difficult to quantify including, but not limited to, collateral risk, information risk, and historical charge-off risk.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal and/or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and/or interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. 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. Impairment is measured on a loan by loan basis for commercial and commercial construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

A specific allocation within the allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of the Corporation s impaired loans are measured based on the estimated fair value of the loan s collateral or the discounted cash flows method.

It is the policy of the Corporation to order an updated valuation on all real estate secured loans when the loan becomes 90 days past due and there has not been an updated valuation completed within the previous 12 months. In addition, the Corporation orders third-party valuations on all impaired real estate collateralized loans within 30 days of the loan being classified as impaired. Until the valuations are completed, the Corporation utilizes the most recent independent third-party real estate valuation to estimate the need for a specific allocation to be assigned to the loan. These existing valuations are discounted downward to account for such things as the age of the existing collateral valuation, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral. Once the updated valuation is completed, the collateral value is updated accordingly.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower s financial statements, inventory reports, accounts receivable aging reports, equipment appraisals, or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The Corporation actively monitors the values of collateral as well as the age of the valuation of impaired loans. Management believes that the Corporation s market area is not as volatile as other areas throughout the United States, therefore valuations are ordered at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined.

For impaired loans secured by collateral other than real estate, the Corporation considers the net book value of the collateral, as recorded in the most recent financial statements of the borrower, and determines fair value based on estimates made by management.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a troubled debt restructure.

Loans whose terms are modified are classified as troubled debt restructured loans if the Corporation grants such borrowers concessions that it would not otherwise consider and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate, a below market interest rate given the risk associated with the loan, or an extension of a loan s stated maturity date. Nonaccrual troubled debt restructurings may be restored to accrual status if principal and interest payments, under the modified terms, are current for a sustained period of time and, based on a well-documented credit evaluation of the borrower s financial condition, there is reasonable assurance of repayment. Loans classified as troubled debt restructurings are generally designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into credit quality rating categories. The borrower s overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are generally evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments.

Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful, and loss. Loans classified special mention have potential weaknesses that deserve management s close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, federal and state regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management s comprehensive analysis of the loan portfolio and economic conditions, management believes the current level of the allowance for loan losses is adequate.

Commercial and Industrial Lending The Corporation originates commercial and industrial loans primarily to businesses located in its primary market area and surrounding areas. These loans are used for various business purposes which include short-term loans and lines of credit to finance machinery and equipment purchases, inventory, and accounts receivable. Generally, the maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Most business lines of credit are written on demand and may be renewed annually.

Commercial and industrial loans are generally secured with short-term assets; however, in many cases, additional collateral such as real estate is provided as additional security for the loan. Loan-to-value maximum values have been established by the Corporation and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, collateral appraisals, etc.

In underwriting commercial and industrial loans, an analysis is performed to evaluate the borrower s character and capacity to repay the loan, the adequacy of the borrower s capital and collateral, as well as the conditions affecting the borrower. Evaluation of the borrower s past, present and future cash flows is also an important aspect of the Corporation s analysis.

Commercial loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions.

Commercial Real Estate Lending The Corporation engages in commercial real estate lending in its primary market area and surrounding areas. The Corporation s commercial loan portfolio is secured primarily by commercial retail space, office buildings, and hotels. Generally, commercial real estate loans have terms that do not exceed 20 years, have loan-to-value ratios of up to 80% of the appraised value of the property, and are typically secured by personal guarantees of the borrowers.

In underwriting these loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower s credit history, and the reliability and predictability of the cash flow generated by the property securing the loan. Appraisals on properties securing commercial real estate loans originated by the Corporation are performed by independent appraisers.

Commercial real estate loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the complexities involved in valuing the underlying collateral.

Commercial Real Estate Construction Lending The Corporation engages in commercial real estate construction lending in its primary market area and surrounding areas. The Corporation s commercial real estate construction lending consists of commercial and residential site development loans, as well as commercial building construction and residential housing construction loans.

The Corporation s commercial real estate construction loans are generally secured with the subject property. Terms of construction loans depend on the specifics of the project, such as estimated absorption rates, estimated time to complete, etc.

In underwriting commercial real estate construction loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower s credit history, and the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate construction loans originated by the Corporation are performed by independent appraisers.

Commercial real estate construction loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the uncertainties surrounding total construction costs.

Residential Mortgage Lending One-to-four family residential mortgage loan originations, including home equity closed-end loans, are generated by the Corporation s marketing efforts, its present customers, walk-in customers, and referrals. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

The Corporation offers fixed-rate and adjustable-rate mortgage loans with terms up to a maximum of 30 years for both permanent structures and those under construction. The Corporation s one-to-four family residential mortgage originations are secured primarily by properties located in its primary market area and surrounding areas. The majority of the Corporation s residential mortgage loans originate with a loan-to-value of 80% or less. Loans in excess of 80% are required to have private mortgage insurance.

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower s financial ability to repay the loan as agreed and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney s title opinion or title insurance, as well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged

in subprime residential mortgage originations.

Residential mortgage loans present a moderate level of risk due primarily to general economic conditions, as well as a continued weak housing market.

Home Equity Lines of Credit Lending The Corporation originates home equity lines of credit primarily within the Corporation s market area or with customers primarily from the market area. Home equity lines of credit are generated by the Corporation s marketing efforts, its present customers, walk-in customers, and referrals.

Home equity lines of credit are secured by the borrower s primary residence with a maximum loan-to-value of 90% and a maximum term of 20 years. In underwriting home equity lines of credit, the Corporation evaluates both the value of the property securing the loan and the borrower s financial ability to repay the loan as agreed. The ability to repay is determined by the borrower s employment history, current financial condition, and credit background.

Home equity lines of credit generally present a moderate level of risk due primarily to general economic conditions, as well as a continued weak housing market.

Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values deteriorate.

Consumer Lending The Corporation offers a variety of secured and unsecured consumer loans, including those for vehicles and mobile homes and loans secured by savings deposits. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

Consumer loan terms vary according to the type and value of collateral and the creditworthiness of the borrower. In underwriting consumer loans, a thorough analysis of the borrower s financial ability to repay the loan as agreed is performed. The ability to repay is determined by the borrower s employment history, current financial condition, and credit background.

Consumer loans may entail greater credit risk than residential mortgage loans or home equity lines of credit, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Acquired Loans

Acquired loans (impaired and non-impaired) are initially recorded at their acquisition-date fair values using Level 3 inputs. Fair values are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, expected lifetime losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Specifically, the Corporation has prepared three separate loan fair value adjustments that it believed a market participant might employ in estimating the entire fair value adjustment necessary under ASC 820-10 for the acquired loan portfolio. The three-separate fair valuation methodology employed are: 1) an interest rate loan fair value adjustment, 2) a general credit fair value adjustment, and 3) a specific credit fair value adjustment for purchased credit impaired loans subject to ASC 310-30 procedures.

The carryover of allowance for loan losses related to acquired loans is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. The allowance for loan losses on acquired loans reflects only those losses incurred after acquisition and represents the present value of cash flows expected at acquisition that is no longer expected to be collected. Acquired loans are marked to fair value on the date of acquisition. In conjunction with the quarterly evaluation of the adequacy of the allowance for loan losses, the Corporation performs an analysis on acquired loans to determine whether or not there has been subsequent deterioration in relation to those loans. If deterioration has occurred, the Corporation will include these loans in the calculation of the allowance for loan losses after the initial valuation, and provide accordingly.

Upon acquisition, in accordance with US GAAP, the Corporation has individually determined whether each acquired loan is within the scope of ASC 310-30. The Corporation s senior lending management reviewed the accounting seller s loan portfolio on a loan by loan basis to determine if any loans met the two-part definition of an impaired loan as defined by ASC 310-30: 1) Credit deterioration on the loan from its inception until the acquisition date, and 2) It is probable that not all of the contractual cash flows will be collected on the loan.

Acquired ASC 310-20 loans, which are loans that did not meet the criteria above, were pooled into groups of similar loans based on various factors including borrower type, loan purpose, and collateral type. For these pools, the Corporation used certain loan information, including outstanding principal balance, estimated expected losses, weighted average maturity, weighted average margin, and weighted average interest rate along with estimated prepayment rates, expected lifetime losses, environment factors to estimate the expected cash flow for each loan pool. With regards to ASC 310-30 loans, for external disclosure purposes, the aggregate contractual cash flows less the aggregate expected cash flows resulted in a credit related non-accretable yield amount. The aggregate expected cash flows less the acquisition date fair value resulted in an accretable yield amount. The accretable yield reflects the contractual cash flows management expects to collect above the loan s acquisition date fair value and will be recognized over the life of the loan on a level-yield basis as a component of interest income.

Over the life of the acquired ASC 310-30 loan, the Corporation continues to estimate cash flows expected to be collected. Decreases in expected cash flows, other than from prepayments or rate adjustments, are recognized as impairments through a charge to the provision for credit losses resulting in an increase in the allowance for credit losses. Subsequent improvements in cash flows result in first, reversal of existing valuation allowances recognized subsequent to acquisition, if any, and next, an increase in the amount of accretable yield to be subsequently recognized on a prospective basis over the loan s remaining life.

Acquired ASC 310-30 loans that met the criteria for non-accrual of interest prior to acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if we can reasonably estimate the timing and amount of expected cash flows on such loans. Accordingly, we do not consider acquired contractually delinquent loans to be non-accruing and continue to recognize interest income on these loans using the accretion model.

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within the Corporation s internal risk rating system as of June 30, 2018, and December 31, 2017:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
JUNE 30, 2018					
Originated Loans					
Commercial and industrial	$ 151,426	$ 3,170	$ 178	$	$ 154,774
Commercial real estate	355,784	16,948	8,094		380,826
Commercial real estate construction	13,506	881	249		14,636
Residential mortgage	372,632	7,050	101		379,783
Home equity lines of credit	85,100	276			85,376
Consumer	14,293				14,293
Total Originated Loans	992,741	28,325	8,622		1,029,688
Acquired Loans					
Commercial and industrial	5,681	220	(1)		5,900
Commercial real estate	120,854	9,331	3,508		133,693
Commercial real estate construction	4,247	732			4,979
Residential mortgage	45,680	2,360	3,226		51,266
Home equity lines of credit	20,225	88	400		20,713
Consumer	558		1		559
Total Acquired Loans	197,245	12,731	7,134		217,110
Total Loans					
Commercial and industrial	157,107	3,390	177		160,674
Commercial real estate	476,638	26,279	11,602		514,519
Commercial real estate construction	17,753	1,613	249		19,615
Residential mortgage	418,312	9,410	3,327		431,049
Home equity lines of credit	105,325	364	400		106,089
Consumer	14,851		1		14,852
Total Loans	$ 1,189,986	$ 41,056	$ 15,756	$	$ 1,246,798

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
DECEMBER 31, 2017					
Originated Loans					
Commercial and industrial	$ 154,177	$ 3,466	$ 1,812	$	$ 159,455
Commercial real estate	325,002	17,666	9,277		351,945
Commercial real estate construction	27,413	767	250		28,430
Residential mortgage	363,195	3,251	478		366,924
Home equity lines of credit	81,976	360			82,336
Consumer	14,454				14,454
Total Originated Loans	966,217	25,510	11,817		1,003,544
Acquired Loans					
Commercial and industrial	6,120	244	10		6,374
Commercial real estate	124,852	12,734	3,228		140,814
Commercial real estate construction	6,742	388			7,130
Residential mortgage	52,959	2,762	3,248		58,969
Home equity lines of credit	24,990	88	378		25,456
Consumer	1,525	358			1,883
Total Acquired Loans	217,188	16,574	6,864		240,626
Total Loans					
Commercial and industrial	160,297	3,710	1,822		165,829
Commercial real estate	449,854	30,400	12,505		492,759
Commercial real estate construction	34,155	1,155	250		35,560
Residential mortgage	416,154	6,013	3,726		425,893
Home equity lines of credit	106,966	448	378		107,792
Consumer	15,979	358			16,337
Total Loans	$ 1,183,405	$ 42,084	$ 18,681	$	$ 1,244,170

The following table provides changes in accretable yield for all acquired loans accounted for under ASC 310-30. Loans accounted for under ASC 310-20 are not included in this table.

In thousands	Six Months Ended June 30, 2018
Balance at beginning of period	**$ 1,234**
Acquisitions of impaired loans	
Reclassification from non-accretable differences	**114**
Accretion to loan interest income	**(350)**
Balance at end of period	**$ 998**

Cash flows expected to be collected on acquired loans are estimated quarterly by incorporating several key assumptions similar to the initial estimate of fair value. These key assumptions include probability of default and the amount of actual prepayments after the acquisition date. Prepayments affect the estimated life of the loans and could change the amount of interest income, and possibly principal expected to be collected. In reforecasting future estimated cash flows, credit loss expectations are adjusted as necessary. Improved cash flow expectations for loans or pools are recorded first as a reversal of previously recorded impairment, if any, and then as an increase in prospective yield when all previously recorded impairment has been recaptured. Decreases in expected cash flows are recognized as impairment through a charge to the provision for loan losses and credit to the allowance for loan losses.

The following table summarizes information relative to impaired loans by loan portfolio class as of June 30, 2018, and December 31, 2017:

	Impaired Loans with Allowance			Impaired Loans with No Allowance	
In thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
JUNE 30, 2018					
Commercial and industrial	**$**	**$**	**$**	**$**	**$**
Commercial real estate				**7,242**	**7,242**
Commercial real estate construction					
Residential mortgage				**101**	**101**
	$	**$**	**$**	**$ 7,343**	**$ 7,343**
DECEMBER 31, 2017					
Commercial and industrial	$ 1,311	$ 1,311	$ 792	$ 188	$ 188
Commercial real estate	832	832	60	7,528	7,528
Commercial real estate construction					
Residential mortgage	377	377	377	101	101
	$ 2,520	$ 2,520	$ 1,229	$ 7,817	$ 7,817

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the three months ended June 30, 2018 and 2017:

	Impaired Loans with Allowance		Impaired Loans with No Allowance	
In thousands	Average Recorded Investment	Interest Income	Average Recorded Investment	Interest Income
JUNE 30, 2018				
Commercial and industrial	**$ 434**	**$**	**$ 89**	**$ 44**
Commercial real estate			**7,275**	**35**
Commercial real estate construction				
Residential mortgage			**101**	
	$ 434	**$**	**$ 7,465**	**$ 79**
JUNE 30, 2017				
Commercial and industrial	$ 1,156	$	$ 1,101	$
Commercial real estate	416		8,144	123
Commercial real estate construction				
Residential mortgage	377		235	1
	$ 1,949	$	$ 9,480	$ 124

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the six months ended June 30, 2018 and 2017:

	Impaired Loans with Allowance		Impaired Loans with No Allowance	
In thousands	Average Recorded Investment	Interest Income	Average Recorded Investment	Interest Income
JUNE 30, 2018				
Commercial and industrial	**$ 726**	**$**	**$ 122**	**$ 44**
Commercial real estate			**7,637**	**82**
Commercial real estate construction				
Residential mortgage	**126**		**101**	
	$ 852	**$**	**$ 7,860**	**$ 126**
JUNE 30, 2017				
Commercial and industrial	$ 1,085	$	$ 1,115	$
Commercial real estate			8,346	213
Commercial real estate construction	277		100	25
Residential mortgage	377		283	15
	$ 1,739	$	$ 9,844	$ 253

No additional funds are committed to be advanced in connection with impaired loans.

The following table presents nonaccrual loans by loan portfolio class as of June 30, 2018, and December 31, 2017, the table below excludes $6.9 million in purchase credit impaired loans, net of unamortized fair value adjustments:

In thousands	June 30, 2018	December 31, 2017
Commercial and industrial	**$**	$ 1,499
Commercial real estate	**3,310**	4,378
Commercial real estate construction		
Residential mortgage	**101**	478
	$ 3,411	$ 6,355

The following table summarizes information relative to troubled debt restructurings by loan portfolio class as of June 30, 2018, and December 31, 2017:

In thousands	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment at Period End
JUNE 30, 2018			
Nonaccruing troubled debt restructurings:			
Commercial real estate	**$ 3,189**	**$ 3,241**	**$ 2,542**
Total nonaccruing troubled debt restructurings	**3,189**	**3,241**	**2,542**
Accruing troubled debt restructurings:			
Commercial real estate	**4,577**	**4,577**	**3,932**
Total accruing troubled debt restructurings	**4,577**	**4,577**	**3,932**
Total Troubled Debt Restructurings	**$ 7,766**	**$ 7,818**	**$ 6,474**
DECEMBER 31, 2017			
Nonaccruing troubled debt restructurings:			
Commercial real estate	$ 4,015	$ 4,073	$ 3,405
Total nonaccruing troubled debt restructurings	4,015	4,073	3,405
Accruing troubled debt restructurings:			
Commercial real estate	4,577	4,577	3,982
Total accruing troubled debt restructurings	4,577	4,577	3,982
Total Troubled Debt Restructurings	$ 8,592	$ 8,650	$ 7,387

All of the Corporation s troubled debt restructured loans are also impaired loans, of which some have resulted in a specific allocation and, subsequently, a charge-off as appropriate. As of June 30, 2018 and 2017, there were no defaulted troubled debt restructured loans. There were no charge-offs or specific allocation on any of the troubled debt restructured loans for the three and six months ended June 30, 2018 and 2017. One troubled debt restructured loan paid off during 2018 in the amount of $832,000 and one paid off during 2017 in the amount of $283,000. All other troubled debt restructured loans were current as of June 30, 2018, with respect to their associated forbearance agreement, except for one loan which has had periodic late payments. As of June 30, 2018, no loans classified as a troubled debt restructured loan have active forbearance agreements. The forbearance agreements have expired or the loans have paid off.

There were no loans whose terms have been modified resulting in troubled debt restructurings during the three and six months ended June 30, 2018 and 2017.

Consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process at June 30, 2018 and December 31, 2017, totaled $1,137,000 and $848,000, respectively.

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due.

The following table presents the classes of the loan portfolio summarized by the past due status as of June 30, 2018, and December 31, 2017:

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
JUNE 30, 2018							
Originated Loans							
Commercial and industrial	$ 19	$ 56	$ 4	$ 79	$ 154,695	$ 154,774	$ 4
Commercial real estate	321	286	2,577	3,184	377,642	380,826	
Commercial real estate construction					14,636	14,636	
Residential mortgage	240	186	1,380	1,806	377,977	379,783	1,279
Home equity lines of credit	115		133	248	85,128	85,376	133
Consumer	23	17		40	14,253	14,293	
Total originated loans	718	545	4,094	5,357	1,024,331	1,029,688	1,416
Acquired Loans							
Commercial and industrial					5,900	5,900	
Commercial real estate			861	861	132,832	133,693	861
Commercial real estate construction		115	420	535	4,444	4,979	420
Residential mortgage	52	449		501	50,765	51,266	
Home equity lines of credit	266	198	55	519	20,194	20,713	55
Consumer			1	1	558	559	1
Total acquired loans	318	762	1,337	2,417	214,693	217,110	1,337
Total Loans							
Commercial and industrial	19	56	4	79	160,595	160,674	4
Commercial real estate	321	286	3,438	4,045	510,474	514,519	861
Commercial real estate construction		115	420	535	19,080	19,615	420
Residential mortgage	292	635	1,380	2,307	428,742	431,049	1,279
Home equity lines of credit	381	198	188	767	105,322	106,089	188
Consumer	23	17	1	41	14,811	14,852	1
Total Loans	$ 1,036	$ 1,307	$ 5,431	$ 7,774	$ 1,239,024	$ 1,246,798	$ 2,753

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
DECEMBER 31, 2017							
Originated Loans							
Commercial and industrial	$ 55	$ 76	$ 1,503	$ 1,634	$ 157,821	$ 159,455	$ 4
Commercial real estate	436	317	1,400	2,153	349,792	351,945	88
Commercial real estate construction	252			252	28,178	28,430	
Residential mortgage	3,006	646	1,500	5,152	361,772	366,924	1,022
Home equity lines of credit	254	29	183	466	81,870	82,336	183
Consumer	72	26	3	101	14,353	14,454	3
Total originated loans	4,075	1,094	4,589	9,758	993,786	1,003,544	1,300
Acquired Loans							
Commercial and industrial	83			83	6,291	6,374	
Commercial real estate	916			916	139,898	140,814	
Commercial real estate construction					7,130	7,130	
Residential mortgage	930	304	137	1,371	57,598	58,969	137
Home equity lines of credit	83		70	153	25,303	25,456	70
Consumer					1,883	1,883	
Total acquired loans	2,012	304	207	2,523	238,103	240,626	207
Total Loans							
Commercial and industrial	138	76	1,503	1,717	164,112	165,829	4
Commercial real estate	1,352	317	1,400	3,069	489,690	492,759	88
Commercial real estate construction	252			252	35,308	35,560	
Residential mortgage	3,936	950	1,637	6,523	419,370	425,893	1,159
Home equity lines of credit	337	29	253	619	107,173	107,792	253
Consumer	72	26	3	101	16,236	16,337	3
Total Loans	$ 6,087	$ 1,398	$ 4,796	$ 12,281	$ 1,231,889	$ 1,244,170	$ 1,507

The following tables summarize the allowance for loan losses and recorded investment in loans receivable:

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF AND FOR THE PERIOD ENDED JUNE 30, 2018								
Allowance for Loan Losses								
Beginning balance - April 1, 2018	**$ 2,974**	**$ 5,455**	**$ 135**	**$ 2,936**	**$ 593**	**$ 725**	**$ 599**	**$ 13,417**
Charge-offs	**(489)**			**(106)**		**(16)**		**(611)**
Recoveries	**4**			**12**		**1**		**17**
Provisions	**(56)**	**266**	**11**	**(2)**	**(29)**	**(37)**	**167**	**320**
Ending balance - June 30, 2018	**$ 2,433**	**$ 5,721**	**$ 146**	**$ 2,840**	**$ 564**	**$ 673**	**$ 766**	**$ 13,143**
Beginning balance - January 1, 2018	**$ 3,219**	**$ 5,228**	**$ 126**	**$ 3,226**	**$ 612**	**$ 749**	**$ 816**	**$ 13,976**
Charge-offs	**(878)**	**(33)**		**(489)**		**(37)**		**(1,437)**
Recoveries	**11**			**22**		**1**		**34**
Provisions	**81**	**526**	**20**	**81**	**(48)**	**(40)**	**(50)**	**570**
Ending balance - June 30, 2018	**$ 2,433**	**$ 5,721**	**$ 146**	**$ 2,840**	**$ 564**	**$ 673**	**$ 766**	**$ 13,143**
Ending balance: individually evaluated for impairment	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Ending balance: collectively evaluated for impairment	**$ 2,433**	**$ 5,721**	**$ 146**	**$ 2,840**	**$ 564**	**$ 673**	**$ 766**	**$ 13,143**
Loans Receivable								
Ending balance	**$ 160,674**	**$ 514,519**	**$ 19,615**	**$ 431,049**	**$ 106,089**	**$ 14,852**	**$**	**$ 1,246,798**
Ending balance: individually evaluated for impairment	**$**	**$ 7,242**	**$**	**$ 101**	**$**	**$**	**$**	**$ 7,343**
Ending balance: collectively evaluated for impairment	**$ 160,674**	**$ 507,277**	**$ 19,615**	**$ 430,948**	**$ 106,089**	**$ 14,852**	**$**	**$ 1,239,455**
AS OF AND FOR THE PERIOD ENDED JUNE 30, 2017								
Allowance for Loan Losses								
Beginning Balance - April 1, 2017	$ 3,252	$ 4,961	$ 149	$ 3,304	$ 605	$ 839	$ 1,035	$ 14,145
Charge-offs	(29)					(12)		(41)
Recoveries	3			32		9		44
Provisions	20	249	(14)	32	2	(21)	(268)	
Ending balance - June 30, 2017	$ 3,246	$ 5,210	$ 135	$ 3,368	$ 607	$ 815	$ 767	$ 14,148
Beginning Balance - January 1, 2017	$ 3,055	$ 4,968	$ 147	$ 3,478	$ 648	$ 923	$ 975	$ 14,194
Charge-offs	(69)			(17)		(84)		(170)
Recoveries	9	61		42		12		124
Provisions	251	181	(12)	(135)	(41)	(36)	(208)	
Ending balance - June 30, 2017	$ 3,246	$ 5,210	$ 135	$ 3,368	$ 607	$ 815	$ 767	$ 14,148

Ending balance: individually evaluated for impairment	$ 711	$ 117	$	$ 342	$	$	$	$ 1,170
Ending balance: collectively evaluated for impairment	$ 2,535	$ 5,093	$ 135	$ 3,026	$ 607	$ 815	$ 767	$ 12,978
Loans Receivable								
Ending balance	$ 161,225	$ 339,026	$ 24,327	$ 354,734	$ 76,040	$ 14,323	$	$ 969,675
Ending balance: individually evaluated for impairment	$ 2,446	$ 8,503	$	$ 480	$	$	$	$ 11,429
Ending balance: collectively evaluated for impairment	$ 158,779	$ 330,523	$ 24,327	$ 354,254	$ 76,040	$ 14,323	$	$ 958,246

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF DECEMBER 31, 2017								
Allowance for Loan Losses								
Ending balance	$ 3,219	$ 5,228	$ 126	$ 3,226	$ 612	$ 749	$ 816	$ 13,976
Ending balance: individually evaluated for impairment	$ 792	$ 60	$	$ 377	$	$	$	$ 1,229
Ending balance: collectively evaluated for impairment	$ 2,427	$ 5,168	$ 126	$ 2,849	$ 612	$ 749	$ 816	$ 12,747
Loans Receivable								
Ending balance	$ 165,829	$ 492,759	$ 35,560	$ 425,893	$ 107,792	$ 16,337	$	$ 1,244,170
Ending balance: individually evaluated for impairment	$ 1,499	$ 8,360	$	$ 478	$	$	$	$ 10,337
Ending balance: collectively evaluated for impairment	$ 164,330	$ 484,399	$ 35,560	$ 425,415	$ 107,792	$ 16,337	$	$ 1,233,833

10. **Fair Value Measurements**

Management uses its best judgment in estimating the fair value of the Corporation s financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective reporting dates and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance further clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value measurement and disclosure guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. 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 the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis of measurement used, at June 30, 2018, and December 31, 2017, are as follows:

In thousands	Basis			June 30, 2018					
			Total		Level 1		Level 2		Level 3
U.S. Government and agencies		**$**	**112,423**	**$**		**$**	**112,423**	**$**	
Mortgage-backed securities, residential			**28,704**				**28,704**		
State and municipal			**11,297**				**11,297**		
Total securities available for sale	**Recurring**	**$**	**152,424**	**$**		**$**	**152,424**	**$**	
Equity securities with readily determinable fair values	**Recurring**	**$**	**1,767**	**$**	**1,767**	**$**		**$**	
Collateral dependent impaired loans	**Nonrecurring**	**$**	**3,932**	**$**		**$**		**$**	**3,932**

In thousands	Basis			December 31, 2017					
			Total		Level 1		Level 2		Level 3
U.S. Government and agencies		$	104,083	$		$	104,083	$	
Mortgage-backed securities, residential			34,833				34,833		
State and municipal			13,294				13,294		
Corporate bonds			5,057				5,057		
CRA mutual fund			1,035		1,035				
Stock in other banks			749		749				
Total securities available for sale	Recurring	$	159,051	$	1,784	$	157,267	$	
Collateral dependent impaired loans	Nonrecurring	$	5,426	$		$		$	5,426

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Corporation has utilized Level 3 inputs to determine fair value:

	Quantitative Information about Level 3 Fair Value Measurements							
Dollars in thousands		Fair Value Estimate	Valuation Technique		Unobservable Input		Range	Weighted Average
June 30, 2018								
Impaired loans	**$**	**3,932**	**Appraisal of collateral**	**(a)**	**Appraisal adjustments**	**(b)**	**(10) - (50)%**	**(16)%**
December 31, 2017								
Impaired loans	$	5,426	Appraisal of collateral	(a)	Appraisal adjustments	(b)	(10) - (50)%	(36)%

(a) Fair value is generally determined through management s estimate or independent third-party appraisals of the underlying collateral, which generally includes various Level 3 inputs which are not observable.

(b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percentage of the appraisal. Higher downward

adjustments are caused by negative changes to the collateral or conditions in the real estate market, actual offers or sales contracts received, and/or age of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of certain Corporation financial instruments at June 30, 2018, and December 31, 2017:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the consolidated statement of condition for cash and short-term instruments approximate those assets fair value. U.S. currency is Level 1 and cash equivalents are Level 2.

Securities

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing, and uses the valuation of another provider to compare for reasonableness.

Loans Held for Sale (Carried at Lower of Cost or Fair Value)

The fair values of mortgage loans held for sale are determined based on amounts to be received at settlement by establishing the respective buyer requirement or market interest rates.

Loans (Carried at Cost)

The fair values of non-impaired loans are estimated using discounted cash flow analyses with the exit pricing concept, as well as using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments, and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Loans for which the Corporation has measured impairment are generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, 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. The fair value consists of the loan balances less the valuation allowance and/or charge-offs.

Foreclosed Assets Held for Resale

The fair value of real estate acquired through foreclosure is based on independent third-party appraisals of the properties. These assets are included as Level 3 fair values, based upon appraisals that consider the sales prices of similar properties in the proximate vicinity.

It is the policy of the Corporation to have the initial market value of a foreclosed asset held for resale determined by an independent third-party valuation. If the Corporation already has a valid appraisal on file for the property and that appraisal has been completed within the previous 12 months, another appraisal shall not be required when the Corporation acquires ownership of that real estate. Further, the Corporation shall update the market value of each foreclosed asset with an independent third-party valuation at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined. These valuations may be adjusted downward to account for specialized use of the property, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral.

Restricted Investment in Bank Stock (Carried at Cost)

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amounts of accrued interest receivable and accrued interest payable approximate their fair value.

Deposits (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (e.g., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings (Carried at Cost)

The carrying amounts of short-term borrowings approximate their fair values.

Long-Term Borrowings (Carried at Cost)

The fair values of long-term borrowings are estimated using discounted cash flow analysis with the exit pricing concept, based on quoted prices for new borrowings with similar credit risk characteristics, terms, and remaining maturity. The prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party. The fair value of the trust preferred subordinated debt, included in long-term borrowings, was determined based upon an estimated fair value from an independent brokerage firm.

Off-Balance Sheet Credit-Related Instruments

The fair values for the Corporation s off-balance sheet financial instruments (specifically, lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing.

The following presents the carrying amount, exit pricing concept fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of June 30, 2018:

	June 30, 2018				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	$ 18,403	$ 18,403	$ 8,020	$ 10,383	$
Interest-bearing deposits in banks	44,650	44,650	44,650		
Equity securities with readily determinable fair value	1,767	1,767	1,767		
Investment securities available for sale	152,424	152,424		152,424	
Investment securities held to maturity	39,894	39,145		39,145	
Loans held for sale	1,265	1,265		1,265	
Loans, less allowance for loan losses	1,233,655	1,199,718			1,199,718
Accrued interest receivable	4,368	4,368		4,368	
Restricted investment in bank stocks	4,849	4,849		4,849	
Financial liabilities:					
Demand deposits and savings	981,505	981,505		981,505	
Time deposits	352,470	347,307		347,307	
Short-term borrowings	26,418	26,418		26,418	
Long-term borrowings	84,816	84,567		84,567	
Trust preferred subordinated debt	5,000	4,694		4,694	
Accrued interest payable	1,447	1,447		1,447	
Off-balance sheet financial instruments					

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of December 31, 2017:

	December 31, 2017				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	$ 19,304	$ 19,304	$ 8,313	$ 10,991	$
Interest-bearing deposits in banks	15,137	15,137	15,137		
Investment securities available for sale	159,051	159,051	1,784	157,267	
Investment securities held to maturity	44,829	44,549		44,549	
Loans held for sale	1,736	1,736		1,736	
Loans, less allowance for loan losses	1,230,194	1,213,932			1,213,932
Accrued interest receivable	3,670	3,670		3,670	
Restricted investment in bank stocks	4,773	4,773		4,773	
Financial liabilities:					
Deposits	1,298,492	1,295,456		1,295,456	
Short-term borrowings	36,908	36,908		36,908	
Long-term borrowings	89,600	89,571		89,571	
Trust preferred subordinated debt	5,000	4,692		4,692	
Accrued interest payable	1,163	1,163		1,163	
Off-balance sheet financial instruments					

11. Securities Sold Under Agreements to Repurchase (Repurchase Agreements)

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Corporation s consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Corporation be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Corporation could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third-party financial institution in the counterparty s custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Corporation in a segregated custodial account under a tri-party agreement.

The following table presents the short-term borrowings subject to an enforceable master netting arrangement or repurchase agreement as of June 30, 2018, and December 31, 2017:

In thousands		Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
					Financial Instruments	Cash Collateral Pledged	
June 30, 2018							
Repurchase agreements							
Commercial customers and government entities	(a)	**$ 26,418**	**$**	**$ 26,418**	**$ (26,418)**	**$**	**$**
December 31, 2017							
Repurchase agreements							
Commercial customers and government entities	(a)	$ 36,908	$	$ 36,908	$ (36,908)	$	$

(a) As of June 30, 2018, and December 31, 2017, the fair value of securities pledged in connection with repurchase agreements was $54,319,000 and $42,397,000, respectively.

The following table presents the remaining contractual maturity of the master netting arrangement or repurchase agreements as of June 30, 2018:

	Remaining Contractual Maturity of the Agreements				
In thousands	Overnight and Continuous	Up to 30 Days	30 - 90 Days	Greater than 90 Days	Total
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	**$ 26,418**	**$**	**$**	**$**	**$ 26,418**
Total	**$ 26,418**	**$**	**$**	**$**	**$ 26,418**

12. Borrowings

The Corporation had long-term debt outstanding as follows:

In thousands	June 30, 2018	December 31, 2017
FHLB advances	**$ 80,216**	$ 85,000
Loan payable to local bank	**4,600**	4,600
Trust preferred subordinated debt	**5,000**	5,000
	$ 89,816	$ 94,600

The FHLB advances are collateralized by the assets defined in the security agreement and FHLB capital stock. FHLB advances have maturity dates from 2018 to 2022 with a weighted average rate of 1.98%.

The loan payable to a local bank has a fixed rate of 4.5% for the first five years and a variable rate of interest with Prime Rate thereafter to final maturity in June 2028. The principal balance of this note may be prepaid at any time without penalty.

The trust preferred subordinated debt is comprised of debt securities issued by New Windsor in June 2005 and assumed by ACNB Corporation through the acquisition. New Windsor issued $5,000,000 of 6.39% fixed rate capital securities to institutional investors in a private pooled transaction. The proceeds were transferred to New Windsor as trust preferred subordinated debt under the same terms and conditions. The Corporation then contributed the full amount to the Bank in the form of Tier 1 capital. The Corporation has, through various contractual arrangements, fully and unconditionally guaranteed all of the trust obligations with respect to the capital securities.

13. Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. Intangible assets that have finite lives, such as core deposit intangibles, customer relationship intangibles and renewal lists, are amortized over their estimated useful lives and subject to periodic impairment testing. Core deposit intangibles are primarily amortized over ten years using accelerated methods. Customer renewal lists are amortized over their estimated useful lives which range from eight to thirteen years.

This acquisition of New Windsor resulted in goodwill of approximately $13,272,000 and generated $2,418,000 in core deposit intangibles.

Combining goodwill resulting from this transaction with existing goodwill from the 2005 RIG purchase of $6,308,000, total goodwill included in the Corporation s consolidated statement of condition is $19,580,000. Goodwill is not deductible for federal income tax purposes. Goodwill, which has an indefinite useful life, is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired.

The carrying value and accumulated amortization of the intangible assets (RIG customer lists and New Windsor core deposit intangibles) are as follows:

In thousands	Gross carrying amount	Accumulated amortization
RIG amortized intangible assets	$ 7,263	$ 6,440
New Windsor core deposit intangibles	2,418	440

The RIG intangible assets are being amortized over 10 years on a straight line basis. The New Windsor core deposit intangible is being amortized using a sum of the year s method over a 10-year period.

Goodwill is subject to impairment testing at the reporting unit level, which must be conducted at least annually. The Corporation performs impairment testing during the fourth quarter of each year, or more frequently if impairment indicators exist. We also continue to monitor other intangibles for impairment and to evaluate carrying amounts, as necessary.

14. New Accounting Pronouncements

ASU 2016-02

In February 2016, the FASB issued ASU 2016-02, *Leases*.

From the lessee s perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record an ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessee. From the lessor s perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing lease. If the lessor doesn t convey risks and rewards or control, an operating lease results.

The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operati