SOUTHERN FIRST BANCSHARES INC
Form 10-Q
August 01, 2016

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission file number 000-27719

Southern First Bancshares, Inc.
(Exact name of registrant as specified in its charter)

South Carolina	**58-2459561**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Verdae Boulevard, Suite 100 **Greenville, S.C.**	**29606**
(Address of principal executive offices)	(Zip Code)

864-679-9000
(Registrant s telephone number, including area code)
Not Applicable
(Former name, former address, and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 preceding12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:
6,355,412 shares of common stock, par value $0.01 per share, were issued and outstanding as of July 25, 2016.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
June 30, 2016 Form 10-Q

INDEX

PART I. CONSOLIDATED FINANCIAL INFORMATION
Item 1. CONSOLIDATED FINANCIAL STATEMENTS

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)	June 30, 2016 (Unaudited)	December 31, 2015 (Audited)
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 14,500	12,280
Federal funds sold	41,624	33,582
Interest-bearing deposits with banks	15,395	17,004
Total cash and cash equivalents	71,519	62,866
Investment securities:		
Investment securities available for sale	84,520	89,939
Other investments	5,749	5,532
Total investment securities	90,269	95,471
Mortgage loans held for sale	14,367	4,943
Loans	1,065,496	1,004,944
Less allowance for loan losses	(14,317)	(13,629)
Loans, net	1,051,179	991,315
Bank owned life insurance	25,101	24,735
Property and equipment, net	26,036	24,185
Deferred income taxes	5,467	6,923
Other assets	6,772	6,855
Total assets	$1,290,710	1,217,293
LIABILITIES		
Deposits	$1,049,124	985,733
Federal Home Loan Bank advances and other borrowings	115,200	115,200
Junior subordinated debentures	13,403	13,403
Other liabilities	10,580	8,717
Total liabilities	1,188,307	1,123,053
SHAREHOLDERS EQUITY		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, par value $.01 per share, 10,000,000 shares authorized, 6,355,412 and 6,289,038 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	64	63
Nonvested restricted stock	(607)	(360)
Additional paid-in capital	71,178	70,037
Accumulated other comprehensive income (loss)	952	(4)
Retained earnings	30,816	24,504
Total shareholders equity	102,403	94,240
Total liabilities and shareholders equity	$1,290,710	1,217,293

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(dollars in thousands, except share data)	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
Interest income				
Loans	$ 11,999	10,941	23,794	21,341
Investment securities	458	356	947	731
Federal funds sold	46	19	91	45
Total interest income	12,503	11,316	24,832	22,117
Interest expense				
Deposits	946	854	1,934	1,621
Borrowings	1,044	971	2,078	1,935
Total interest expense	1,990	1,825	4,012	3,556
Net interest income	10,513	9,491	20,820	18,561
Provision for loan losses	575	1,000	1,200	1,625
Net interest income after provision for loan losses	9,938	8,491	19,620	16,936
Noninterest income				
Mortgage banking income	2,235	1,321	3,682	2,484
Service fees on deposit accounts	244	219	463	445
Income from bank owned life insurance	180	165	366	331
Gain on sale of investment securities	19	36	325	295
Other income	468	374	868	701
Total noninterest income	3,146	2,115	5,704	4,256
Noninterest expenses				
Compensation and benefits	4,855	4,106	9,405	8,382
Occupancy	892	842	1,762	1,579
Real estate owned expenses	359	93	644	855
Data processing and related costs	628	573	1,226	1,158
Insurance	217	213	450	415
Professional fees	284	233	538	466
Marketing	199	222	430	460
Other	419	364	914	791
Total noninterest expenses	7,853	6,646	15,369	14,106
Income before income tax expense	5,231	3,960	9,955	7,086
Income tax expense	1,925	1,400	3,643	2,498
Net income available to common shareholders	$ 3,306	2,560	6,312	4,588
Earnings per common share				
Basic	$ 0.52	0.41	1.00	0.74
Diluted	$ 0.49	0.39	0.94	0.70
Weighted average common shares outstanding				
Basic	6,301,853	6,233,745	6,287,350	6,229,522
Diluted	6,702,820	6,533,658	6,683,126	6,524,317

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
(dollars in thousands)	**2016**	**2015**	**2016**	**2015**
Net income	$3,306	2,560	6,312	4,588
Other comprehensive income (loss):				
Unrealized gain (loss) on securities available for sale:				
Unrealized holding gain (loss) arising during the period, pretax	682	(689)	1,774	(332)
Tax (expense) benefit	(232)	234	(603)	113
Reclassification of realized gain	(19)	(36)	(325)	(295)
Tax expense	7	12	110	100
Other comprehensive income (loss)	438	(479)	956	(414)
Comprehensive income	$3,744	2,081	7,268	4,174

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015
(Unaudited)

	Common stock		**Preferred stock**		**Nonvested restricted**	**Additional paid-in**	**Accumulated other comprehensive income**	**Retai**
(dollars in thousands, except share data)	**Shares**	**Amount**	**Shares**	**Amount**	**stock**	**capital**	**(loss)**	**earni**
December 31, 2014	**6,219,002**	**$62**	**-**	**-**	**$(494)**	**$68,785**	**$ 302**	**$14,**
Net income	-	-	-	-	-	-	-	4,
Proceeds from exercise of stock options	17,142	-	-	-	-	117	-	
Amortization of deferred compensation on restricted stock	-	-	-	-	94	-	-	
Compensation expense related to stock options, net of tax	-	-	-	-	-	290	-	
Other comprehensive loss	-	-	-	-	-	-	(414)	
June 30, 2015	**6,236,144**	**62**	**-**	**-**	**(400)**	**69,192**	**(112)**	**18,**
December 31, 2015	**6,289,038**	**63**	**-**	**-**	**(360)**	**70,037**	**(4)**	**24,**
Net income	-	-	-	-	-	-	-	6,
Proceeds from exercise of stock options	49,374	1	-	-	-	368	-	
Issuance of restricted stock	17,000	-	-	-	(391)	391	-	
Amortization of deferred compensation on restricted stock	-	-	-	-	144	-	-	
Compensation expense related to stock options, net of tax	-	-	-	-	-	382	-	
Other comprehensive income	-	-	-	-	-	-	956	
June 30, 2016	**6,355,412**	**$64**	**-**	**$-**	**$(607)**	**$71,178**	**$ 952**	**$30,**

See notes to consolidated financial statements that are an integral part of these consolidated statements.

6

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(dollars in thousands)	For the six months ended June 30, 2016	2015
Operating activities		
Net income	$ 6,312	$ 4,588
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	1,200	1,625
Depreciation and other amortization	633	688
Accretion and amortization of securities discounts and premium, net	268	148
Gain on sale of investment securities available for sale	(325)	(295)
(Gain) loss on sale of real estate owned	51	(74)
Write-down of real estate owned	389	737
Compensation expense related to stock options and grants	526	384
Gain on sale of loans held for sale	(3,424)	(2,484)
Loans originated and held for sale	(122,495)	(106,754)
Proceeds from sale of loans held for sale	116,495	108,601
Increase in cash surrender value of bank owned life insurance	(366)	(332)
(Increase) decrease in deferred tax asset	963	(207)
(Increase) decrease in other assets, net	(432)	165
Increase (decrease) in other liabilities	1,863	(1,157)
Net cash provided by operating activities	1,658	5,633
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(61,309)	(92,843)
Purchase of property and equipment	(2,484)	(2,547)
Purchase of investment securities:		
Available for sale	(16,852)	(9,352)
Other	(169)	(149)
Payments and maturities, calls and repayments of investment securities:		
Available for sale	13,127	2,359
Other	-	1,140
Proceeds from sale of investment securities available for sale	10,602	10,071
Proceeds from sale of real estate owned	320	100
Net cash used for investing activities	(56,765)	(91,221)
Financing activities		
Increase (decrease) in cash realized from:		
Increase in deposits, net	63,391	105,617
Decrease in Federal Home Loan Bank advances and other borrowings	-	(20,000)
Proceeds from the exercise of stock options and warrants	369	117
Net cash provided by financing activities	63,760	85,734
Net increase in cash and cash equivalents	8,653	146
Cash and cash equivalents at beginning of the period	62,866	41,264
Cash and cash equivalents at end of the period	$ 71,519	$ 41,410
Supplemental information		
Cash paid for		
Interest	$ 4,012	$ 3,634
Income taxes	2,680	2,705
Schedule of non-cash transactions		
Real estate acquired in settlement of loans	245	343
Unrealized gain (loss) on securities, net of income taxes	1,171	(219)

See notes to consolidated financial statements that are an integral part of these consolidated statements.

7

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 Nature of Business and Basis of Presentation

Business Activity
Southern First Bancshares, Inc. (the "Company") is a South Carolina corporation that owns all of the capital stock of Southern First Bank (the "Bank") and all of the stock of Greenville First Statutory Trust I and II (collectively, the "Trusts"). The Trusts are special purpose non-consolidated entities organized for the sole purpose of issuing trust preferred securities. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions. The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the FDIC, and providing commercial, consumer and mortgage loans to the general public.

Basis of Presentation
The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the Securities and Exchange Commission on March 2, 2016. The consolidated financial statements include the accounts of the Company and the Bank. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810, Consolidation, the financial statements related to the Trusts have not been consolidated.

Use of Estimates
The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, real estate acquired in the settlement of loans, fair value of financial instruments, evaluating other-than-temporary-impairment of investment securities and valuation of deferred tax assets.

Business Segments
The Company reports its activities as three business segments Commercial and Retail Banking, Mortgage Banking and Corporate. In determining proper segment definition, the Company considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated, relative to a resource allocation and performance assessment. Please refer to Note 7 Reportable Segments for further information on the reporting for the three business segments.

Reclassifications
Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis and had no effect on shareholders equity or net income.

Subsequent Events
Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management performed an evaluation to determine whether there have been any subsequent events since the balance sheet date and determined that no subsequent events occurred requiring accrual or disclosure.

Initial Adoption of Fair Value Option

In accordance with ASC 825-10 *Financial Instruments*, the Company adopted the fair value option for mortgage loans held for sale beginning on April 1, 2016. ASC 825-10 allows the Company to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value and to offset changes in the fair values of derivative instruments and the related hedged item by selecting the fair value option for the hedged item. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. Prior to adoption, mortgage loans held for sale were carried at the lower of cost or fair value.

NOTE 2 Investment Securities

The amortized costs and fair value of investment securities are as follows:

				June 30, 2016
	Amortized	Gross Unrealized		Fair
(dollars in thousands)	Cost	Gains	Losses	Value
Available for sale				
US government agencies	$ 8,627	176	-	8,803
SBA securities	6,095	6	15	6,086
State and political subdivisions	22,056	850	-	22,906
Mortgage-backed securities	46,299	483	57	46,725
Total investment securities available for sale	$ 83,077	1,515	72	84,520

				December 31, 2015
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
Available for sale				
US government agencies	$ 14,711	1	113	14,599
SBA securities	6,410	-	133	6,277
State and political subdivisions	21,771	525	37	22,259
Mortgage-backed securities	47,053	191	440	46,804
Total investment securities available for sale	$ 89,945	717	723	89,939

During the first six months of 2016, approximately $19.8 million of investment securities were either sold or called, subsequently resulting in a gain on sale of investment securities of $325,000.

Contractual maturities and yields on the Company s investment securities at June 30, 2016 and December 31, 2015 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

										June 30, 2016
	Less than one year		One to five years		Five to ten years		Over ten years			Total
(dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										
US government agencies	$ -	-	2,024	1.34%	6,779	2.22%	-	-	8,803	2.02%
SBA securities	-	-	-	-	-	-	6,086	1.74%	6,086	1.74%
State and political subdivisions	-	-	2,230	1.69%	13,173	2.30%	7,503	2.88%	22,906	2.43%
Mortgage-backed securities	-	-	-	-	9,247	1.44%	37,478	1.81%	46,725	1.74%
Total	$ -	-	4,254	1.53%	29,199	2.01%	51,067	1.95%	84,520	1.95%

	Less than one year		One to five years		Five to ten years		Over ten years		December 31, 2015 Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										
US government agencies	$-	-	4,149	1.74%	8,704	2.49%	1,746	3.03%	14,599	2.34%
SBA securities	-	-	-	-	-	-	6,277	1.79%	6,277	1.79%
State and political subdivisions	-	-	464	1.63%	14,032	2.64%	7,763	2.84%	22,259	2.69%
Mortgage-backed securities	-	-	-	-	8,048	1.56%	38,756	2.08%	46,804	1.99%
Total	$ -	-	4,613	1.73%	30,784	2.31%	54,542	2.18%	89,939	2.20%

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities at June 30, 2016 and December 31, 2015, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 months			12 months or longer			June 30, 2016 Total		
(dollars in thousands)	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
Available for sale									
SBA securities	1	$1,520	$ 4	1	$1,537	$ 11	2	$3,057	$ 15
State and political subdivisions	-	-	-	-	-	-	-	-	-
Mortgage-backed securities	1	2,141	21	1	2,382	36	2	4,523	57
Total	2	$3,661	$ 25	2	$3,919	$ 47	4	$7,580	$ 72

	Less than 12 months			12 months or longer			December 31, 2015 Total		
	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
Available for sale									
US government agencies	9	$12,853	$113	-	$ -	$ -	9	$ 12,853	$113
SBA securities	-	-	-	2	4,691	133	2	4,691	133
State and political subdivisions	7	3,125	17	3	1,220	20	10	4,345	37
Mortgage-backed securities	27	40,868	440	-	-	-	27	40,868	440
Total	43	$56,846	$570	5	$5,911	$153	48	$ 62,757	$723

At June 30, 2016, the Company had two individual investments with a fair market value of $3.7 million that were in an unrealized loss position for less than 12 months and two individual investments with a fair market value of $3.9 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities are not other-than-temporarily impaired. The Company also considers other factors such as the financial condition of the issuer including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, the Company has concluded that these securities are not impaired on an other-than-temporary basis.

Other investments are comprised of the following and are recorded at cost which approximates fair value.

(dollars in thousands)	June 30, 2016	December 31, 2015
Federal Home Loan Bank stock	$ 5,173	5,005
Investment in Trust Preferred securities	403	403
Other investments	173	124
Total other investments	$ 5,749	5,532

10

The Company has evaluated the Federal Home Loan Bank (FHLB) stock for impairment and determined that the investment in the FHLB stock is not other than temporarily impaired as of June 30, 2016 and ultimate recoverability of the par value of this investment is probable. All of the FHLB stock is used to collateralize advances with the FHLB.

At June 30, 2016, $19.2 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $16.7 million of securities were pledged to secure client deposits. At December 31, 2015, $21.3 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $11.1 million of securities were pledged to secure client deposits.

NOTE 3 Mortgage Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are reported as loans held for sale and carried at fair value under the fair value option, which was adopted on April 1, 2016, with changes in fair value recognized in current period earnings. At the date of funding of the mortgage loan held for sale, the funded amount of the loan, the related derivative asset or liability of the associated interest rate lock commitment, less direct loan costs becomes the initial recorded investment in the loan held for sale. Such amount approximates the fair value of the loan. At June 30, 2016, mortgage loans held for sale totaled $14.4 million compared to $4.9 million at December 31, 2015.

Mortgage loans held for sale are considered de-recognized, or sold, when the Company surrenders control over the financial assets. Control is considered to have been surrendered when the transferred assets have been isolated from the Company, beyond the reach of the Company and its creditors; the purchaser obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and the Company does not maintain effective control over the transferred assets through an agreement that both entitles and obligates the Company to repurchase or redeem the transferred assets before their maturity or the ability to unilaterally cause the holder to return specific assets.

Gains and losses from the sale of mortgage loans are recognized based upon the difference between the sales proceeds and carrying value of the related loans upon sale and are recorded in mortgage banking income in the statement of income. Mortgage banking income also includes the unrealized gains and losses associated with the loans held for sale and the realized and unrealized gains and losses from derivatives.

Mortgage loans sold to investors by the Company, and which were believed to have met investor and agency underwriting guidelines at the time of sale, may be subject to repurchase or indemnification in the event of specific default by the borrower or subsequent discovery that underwriting standards were not met. The Company may, upon mutual agreement, agree to repurchase the loans or indemnify the investor against future losses on such loans. In such cases, the Company bears any subsequent credit loss on the loans.

NOTE 4 Loans and Allowance for Loan Losses

The following table summarizes the composition of our loan portfolio. Total gross loans are recorded net of deferred loan fees and costs, which totaled $1.7 million as of June 30, 2016 and December 31, 2015.

	June 30, 2016		December 31, 2015	
(dollars in thousands)	Amount	% of Total	Amount	% of Total
Commercial				
Owner occupied RE	$ 254,266	23.9%	$ 236,083	23.5%
Non-owner occupied RE	221,922	20.8%	205,604	20.5%
Construction	36,107	3.4%	41,751	4.1%
Business	186,877	17.5%	171,743	17.1%
Total commercial loans	699,172	65.6%	655,181	65.2%
Consumer				
Real estate	193,935	18.2%	174,802	17.4%
Home equity	125,618	11.8%	116,563	11.6%
Construction	29,742	2.8%	43,318	4.3%
Other	17,029	1.6%	15,080	1.5%
Total consumer loans	366,324	34.4%	349,763	34.8%
Total gross loans, net of deferred fees	1,065,496	100.0%	1,004,944	100.0%
Less allowance for loan losses	(14,317)		(13,629)	
Total loans, net	$1,051,179		$ 991,315	

Maturities and Sensitivity of Loans to Changes in Interest Rates

The information in the following tables summarizes the loan maturity distribution by type and related interest rate characteristics based on the contractual maturities of individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below, because borrowers have the right to prepay obligations with or without prepayment penalties.

				June 30, 2016
(dollars in thousands)	One year or less	After one but within five years	After five years	Total
Commercial				
Owner occupied RE	$ 21,686	124,750	107,830	254,266
Non-owner occupied RE	34,365	132,867	54,690	221,922
Construction	5,348	19,438	11,321	36,107
Business	63,547	93,453	29,877	186,877
Total commercial loans	124,946	370,508	203,718	699,172
Consumer				
Real estate	28,600	43,763	121,572	193,935
Home equity	4,458	29,940	91,220	125,618
Construction	12,897	1,374	15,471	29,742
Other	6,046	8,608	2,375	17,029
Total consumer loans	52,001	83,685	230,638	366,324
Total gross loans, net of deferred fees	$ 176,947	454,193	434,356	1,065,496
Loans maturing after one year with:				
Fixed interest rates				$ 664,294
Floating interest rates				224,255

12

	December 31, 2015			
	One year or less	After one but within five years	After five years	Total
Commercial				
Owner occupied RE	$ 16,836	126,156	93,091	236,083
Non-owner occupied RE	40,690	111,087	53,827	205,604
Construction	9,183	23,206	9,362	41,751
Business	64,099	83,435	24,209	171,743
Total commercial loans	130,808	343,884	180,489	655,181
Consumer				
Real estate	28,348	35,509	110,945	174,802
Home equity	5,105	31,326	80,132	116,563
Construction	14,095	1,445	27,778	43,318
Other	6,430	6,270	2,380	15,080
Total consumer	53,978	74,550	221,235	349,763
Total gross loan, net of deferred fees	$184,786	418,434	401,724	1,004,944
Loans maturing after one year with:				
Fixed interest rates				$ 612,251
Floating interest rates				207,907

Portfolio Segment Methodology

Commercial
Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. The Company applies historic grade-specific loss factors to each loan class. In the development of statistically derived loan grade loss factors, the Company observes historical losses over 20 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. The allowance also includes an amount for the estimated impairment on nonaccrual commercial loans and commercial loans modified in a troubled debt restructuring (TDR), whether on accrual or nonaccrual status.

Consumer
For consumer loans, the Company determines the allowance on a collective basis utilizing historical losses over 20 quarters to represent its best estimate of inherent loss. The Company pools loans, generally by loan class with similar risk characteristics. The allowance also includes an amount for the estimated impairment on nonaccrual consumer loans and consumer loans modified in a TDR, whether on accrual or nonaccrual status.

Credit Quality Indicators

Commercial
The Company manages a consistent process for assessing commercial loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. The Company s risk categories include Pass, Special Mention, Substandard, and Doubtful, each of which is defined by banking regulatory agencies. Delinquency statistics are also an important indicator of credit quality in the establishment of the Company s allowance for credit losses.

The Company categorizes its loans into risk categories based on relevant information about the ability of the borrower to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. A description of the general characteristics of the risk grades is as follows:

Pass These loans range from minimal credit risk to average however still acceptable credit risk.

Special mention A special mention loan has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution s credit position at some future date.

Substandard A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that may jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful A doubtful loan has all of the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

The tables below provide a breakdown of outstanding commercial loans by risk category.

					June 30, 2016
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Pass	$ 250,609	215,334	36,107	177,228	679,278
Special mention	1,102	975	-	2,511	4,588
Substandard	2,555	5,613	-	7,138	15,306
Doubtful	-	-	-	-	-
	$ 254,266	221,922	36,107	186,877	699,172

					December 31, 2015
	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Pass	$ 230,460	198,144	39,678	161,920	630,202
Special mention	3,887	1,574	286	5,511	11,258
Substandard	1,736	5,886	1,787	4,312	13,721
Doubtful	-	-	-	-	-
	$ 236,083	205,604	41,751	171,743	655,181

The following tables provide past due information for outstanding commercial loans and include loans on nonaccrual status as well as accruing TDRs.

					June 30, 2016
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Current	$ 253,696	217,120	36,107	185,636	692,559
30-59 days past due	552	296	-	507	1,355
60-89 days past due	18	566	-	4	588
Greater than 90 Days	-	3,940	-	730	4,670
	$ 254,266	221,922	36,107	186,877	699,172

					December 31, 2015
	Owner	Non-owner			

	occupied RE	occupied RE	Construction	Business	Total
Current	$ 235,795	201,381	41,354	170,644	649,174
30-59 days past due	-	-	-	205	205
60-89 days past due	43	1,452	-	18	1,513
Greater than 90 Days	245	2,771	397	876	4,289
	$ 236,083	205,604	41,751	171,743	655,181

As of June 30, 2016 and December 31, 2015, loans 30 days or more past due represented 0.70% and 0.66% of the Company s total loan portfolio, respectively. Commercial loans 30 days or more past due were 0.62% and 0.60% of the Company s total loan portfolio as of June 30, 2016 and December 31, 2015, respectively.

Consumer
The Company manages a consistent process for assessing consumer loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. The Company s categories include Pass, Special Mention, Substandard, and Doubtful, which are defined above. Delinquency statistics are also an important indicator of credit quality in the establishment of the allowance for loan losses.

The tables below provide a breakdown of outstanding consumer loans by risk category.

					June 30, 2016
(dollars in thousands)	**Real estate**	**Home equity**	**Construction**	**Other**	**Total**
Pass	$190,628	123,012	29,742	16,552	359,934
Special mention	1,076	1,753	-	302	3,131
Substandard	2,231	853	-	175	3,259
Doubtful	-	-	-	-	-
	$193,935	125,618	29,742	17,029	366,324

					December 31, 2015
	Real estate	**Home equity**	**Construction**	**Other**	**Total**
Pass	$172,589	112,080	42,319	14,967	341,955
Special mention	961	3,388	-	45	4,394
Substandard	1,252	1,095	999	68	3,414
Doubtful	-	-	-	-	-
	$174,802	116,563	43,318	15,080	349,763

The following tables provide past due information for outstanding consumer loans and include loans on nonaccrual status as well as accruing TDRs.

					June 30, 2016
(dollars in thousands)	**Real estate**	**Home equity**	**Construction**	**Other**	**Total**
Current	$ 193,344	125,362	29,742	16,986	365,434
30-59 days past due	312	-	-	34	346
60-89 days past due	279	-	-	9	288
Greater than 90 Days	-	256	-	-	256
	$ 193,935	125,618	29,742	17,029	366,324

					December 31, 2015
	Real estate	**Home equity**	**Construction**	**Other**	**Total**
Current	$ 174,576	116,305	43,258	14,994	349,133
30-59 days past due	187	-	60	86	333
60-89 days past due	39	-	-	-	39
Greater than 90 Days	-	258	-	-	258
	$ 174,802	116,563	43,318	15,080	349,763

As of June 30, 2016 and December 31, 2015, consumer loans 30 days or more past due were 0.08% and 0.06% of total loans, respectively.

Nonperforming assets

The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when the Company believes, after considering economic and business conditions and collection efforts, that the borrower s financial condition is such that collection of the contractual principal or interest on the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

Following is a summary of our nonperforming assets, including nonaccruing TDRs.

(dollars in thousands)	June 30, 2016	December 31, 2015
Commercial		
Owner occupied RE	$ 453	704
Non-owner occupied RE	3,973	4,170
Construction	-	-
Business	513	779
Consumer		
Real estate	38	-
Home equity	256	258
Construction	-	-
Other	-	5
Nonaccruing troubled debt restructurings	479	701
Total nonaccrual loans, including nonaccruing TDRs	5,712	6,617
Other real estate owned	1,960	2,475
Total nonperforming assets	$ 7,672	9,092
Nonperforming assets as a percentage of:		
Total assets	0.59%	0.75%
Gross loans	0.72%	0.90%
Total loans over 90 days past due	4,926	4,547
Loans over 90 days past due and still accruing	-	-
Accruing troubled debt restructurings	$ 8,813	7,266

Impaired Loans

The table below summarizes key information for impaired loans. The Company s impaired loans include loans on nonaccrual status and loans modified in a TDR, whether on accrual or nonaccrual status. These impaired loans may have estimated impairment which is included in the allowance for loan losses. The Company s commercial and consumer impaired loans are evaluated individually to determine the related allowance for loan losses.

				June 30, 2016
			Recorded investment	
(dollars in thousands)	Unpaid Principal Balance	Impaired loans	Impaired loans with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$ 2,015	1,992	1,992	246
Non-owner occupied RE	8,764	5,567	3,814	689
Construction	-	-	-	-
Business	5,913	5,267	2,078	1,520
Total commercial	16,692	12,826	7,884	2,455
Consumer				
Real estate	1,151	1,151	1,151	485
Home equity	259	256	-	-
Construction	-	-	-	-
Other	294	293	293	161
Total consumer	1,704	1,700	1,444	646
Total	$18,396	14,526	9,328	3,101

				December 31, 2015
	Unpaid Principal Balance	Impaired loans	Recorded investment Impaired loans with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$ 964	863	863	260
Non-owner occupied RE	9,144	5,792	4,161	1,321
Construction	1,855	1,787	397	31
Business	4,756	3,861	2,936	1,932
Total commercial	16,719	12,303	8,357	3,544
Consumer				
Real estate	1,121	1,121	805	489
Home equity	260	258	-	-
Construction	-	-	-	-
Other	201	201	201	191
Total consumer	1,582	1,580	1,006	680
Total	$18,301	13,883	9,363	4,224

The following table provides the average recorded investment in impaired loans and the amount of interest income recognized on impaired loans after impairment by portfolio segment and class.

	Three months ended June 30, 2016		Three months ended June 30, 2015	
(dollars in thousands)	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
Commercial				
Owner occupied RE	$ 1,994	21	1,292	10
Non-owner occupied RE	5,582	35	5,153	24
Construction	-	-	1,935	23
Business	5,272	54	4,194	33
Total commercial	12,848	110	12,574	90
Consumer				
Real estate	1,153	12	1,685	12
Home equity	257	1	376	8
Construction	-	-	-	-
Other	294	5	219	2
Total consumer	1,704	18	2,280	22
Total	$14,552	128	14,854	112

(dollars in thousands)	Six months ended June 30, 2016 Average recorded investment	Six months ended June 30, 2016 Recognized interest income	Six months ended June 30, 2015 Average recorded investment	Six months ended June 30, 2015 Recognized interest income	Year ended December 31, 2015 Average recorded investment	Year ended December 31, 2015 Recognized interest income
Commercial						
Owner occupied RE	$ 1,999	43	1,236	31	884	6
Non-owner occupied RE	5,642	86	4,942	47	6,137	128
Construction	-	-	2,198	41	1,888	74
Business	5,315	134	4,318	70	4,067	148
Total commercial	12,956	263	12,694	189	12,976	356
Consumer						
Real estate	1,155	21	1,664	24	1,112	46
Home equity	257	1	366	9	252	7
Construction	-	-	-	-	-	-
Other	295	6	249	4	208	7
Total consumer	1,707	28	2,279	37	1,572	60
Total	$14,663	291	14,973	226	14,548	416

Allowance for Loan Losses

The allowance for loan loss is management s estimate of credit losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred 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 allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability 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 Company has an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in the portfolio. While the Company attributes portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company s process involves procedures to appropriately consider the unique risk characteristics of the commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. The Company s allowance levels are influenced by loan volume, loan grade or delinquency status, historic loss experience and other economic conditions.

The following table summarizes the activity related to the allowance for loan losses by commercial and consumer portfolio segments:

Six months ended June 30, 2016

	Commercial				Consumer				
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Real Estate	Home equity	Construction	Other	Total
Balance, beginning of period	$2,347	3,187	338	3,800	2,070	1,202	313	372	13,629
Provision for loan losses	455	(128)	55	330	418	101	(101)	70	1,200
Loan charge-offs	(5)	(75)	(42)	(348)	(187)	(7)	-	(115)	(779)
Loan recoveries	-	27	-	237	-	-	-	3	267
Net loan charge-offs	(5)	(48)	(42)	(111)	(187)	(7)	-	(112)	(512)
Balance, end of period	$2,797	3,011	351	4,019	2,301	1,296	212	330	14,317
Net charge-offs to average loans (annualized)									0.10%
Allowance for loan losses to gross loans									1.34%
Allowance for loan losses to nonperforming loans									250.63%

18

	Commercial						Consumer		Six months ended June 30, 2015
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Real Estate	Home equity	Construction	Other	Total
Balance, beginning of period	$1,645	2,332	614	3,625	1,714	1,162	236	424	11,752
Provision for loan losses	643	574	(216)	272	263	131	36	(78)	1,625
Loan charge-offs	(24)	(204)	-	(218)	(39)	(13)	-	(1)	(499)
Loan recoveries	-	6	-	42	-	1	-	-	49
Net loan charge-offs	(24)	(198)	-	(176)	(39)	(12)	-	(1)	(450)
Balance, end of period	$2,264	2,708	398	3,721	1,938	1,281	272	345	12,927
Net charge-offs to average loans (annualized)									0.10%
Allowance for loan losses to gross loans									1.34%
Allowance for loan losses to nonperforming loans									193.73%

The following table disaggregates the allowance for loan losses and recorded investment in loans by impairment methodology.

	Allowance for loan losses			Recorded investment in loans		June 30, 2016
(dollars in thousands)	Commercial	Consumer	Total	Commercial	Consumer	Total
Individually evaluated	$ 2,455	646	3,101	12,826	1,700	14,526
Collectively evaluated	7,723	3,493	11,216	686,346	364,624	1,050,970
Total	$ 10,178	4,139	14,317	699,172	366,324	1,065,496

	Allowance for loan losses			Recorded investment in loans		December 31, 2015
	Commercial	Consumer	Total	Commercial	Consumer	Total
Individually evaluated	$3,544	680	4,224	12,303	1,580	13,883
Collectively evaluated	6,128	3,277	9,405	642,878	348,183	991,061
Total	$9,672	3,957	13,629	655,181	349,763	1,004,944

NOTE 5 Troubled Debt Restructurings

At June 30, 2016, the Company had 27 loans totaling $9.3 million compared to 29 loans totaling $8.0 million at December 31, 2015, which were considered as TDRs. The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company grants a concession to the debtor that it would not normally consider. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of the workout plan for individual loan relationships, the Company may restructure loan terms to assist borrowers facing financial challenges in the current economic environment. To date, the Company has restored three commercial loans previously classified as TDRs to accrual status.

The following table summarizes the concession at the time of modification and the recorded investment in the Company s TDRs before and after their modification during the six months ended June 30, 2016 and 2015, respectively.

							For the six months ended June 30, 2016
(dollars in thousands)	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial							
Business	1	-	-	-	1	$2,381	$2,381
Consumer							
Other	2	-	-	-	2	110	114

Total loans	3	-	-	-	3	$2,491	$2,495

	For the six months ended June 30, 2015						
(dollars in thousands)	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial							
Non-owner occupied RE	1	-	-	1	2	$112	$112
Business	-	-	-	1	1	21	21
Total loans	1	-	-	2	3	$133	$133

As of June 30, 2016 and 2015, there were no loans modified as TDRs for which there was a payment default (60 days past due) within 12 months of the restructuring date.

NOTE 6 Derivative Financial Instruments

The Company utilizes derivative financial instruments primarily to hedge its exposure to changes in interest rates. All derivative financial instruments are recognized as either assets or liabilities and measured at fair value. The Company accounts for all of its derivatives as free-standing derivatives and does not designate any of these instruments for hedge accounting. Therefore, the gain or loss resulting from the change in the fair value of the derivative is recognized in the Company s statement of income during the period of change.

The Company enters into commitments to originate residential mortgage loans held for sale, at specified interest rates and within a specified period of time, with clients who have applied for a loan and meet certain credit and underwriting criteria (interest rate lock commitments). These interest rate lock commitments (IRLCs) meet the definition of a derivative financial instrument and are reflected in the balance sheet at fair value with changes in fair value recognized in current period earnings. Unrealized gains and losses on the IRLCs are recorded as derivative assets and derivative liabilities, respectively, and are measured based on the value of the underlying mortgage loan, quoted mortgage-backed securities (MBS) prices and an estimate of the probability that the mortgage loan will fund within the terms of the interest rate lock commitment, net of estimated commission expenses.

The Company manages the interest rate and price risk associated with its outstanding IRLCs and mortgage loans held for sale by entering into derivative instruments such as forward sales of MBS. Management expects these derivatives will experience changes in fair value opposite to changes in fair value of the IRLCs and mortgage loans held for sale, thereby reducing earnings volatility. The Company takes into account various factors and strategies in determining the portion of the mortgage pipeline (IRLCs and mortgage loans held for sale) it wants to economically hedge.

The following table summarizes the Company s outstanding financial derivative instruments as of June 30, 2016. Derivative financial instruments were not material at December 31, 2015.

(dollars in thousands)	Notional	Balance Sheet Location	Fair Value Asset/(Liability)
Mortgage loan interest rate lock commitments	$36,304	Other assets	$ 673
MBS forward sales commitments	24,000	Other assets	(241)
Total derivative financial instruments	$60,304		$ 432

NOTE 7 Fair Value Accounting

FASB ASC 820, Fair Value Measurement and Disclosures, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted market price in active markets
Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities that are traded in an active exchange market.

Level 2 Significant other observable inputs
Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company s available-for-sale portfolio and valued by a third-party pricing service, as well as certain impaired loans.

Level 3 Significant unobservable inputs
Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

Following is a description of valuation methodologies used for assets recorded at fair value.

Investment Securities
Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as FHLB stock, approximates fair value based on their redemption provisions.

Mortgage Loans Held for Sale
Loans held for sale include mortgage loans which are saleable into the secondary mortgage markets and their fair values are estimated using observable quoted market or contracted prices or market price equivalents, which would be used by other market participants. These saleable loans are considered Level 2.

Loans
The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, Receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2016, a significant portion of the impaired loans were evaluated based on the fair value of the collateral. In accordance with FASB ASC 820, Fair Value Measurement and Disclosures, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. The Company s current loan and appraisal policies require the Bank to obtain updated appraisals on an as is basis at renewal, or in the case of an impaired loan, on an annual basis, either through a new external appraisal or an appraisal evaluation. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3. The fair value of impaired loans may also be estimated using the

present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

Other Real Estate Owned (OREO)

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the OREO as nonrecurring Level 3.

Derivative Financial Instruments

The Company estimates the fair value of IRLCs based on the value of the underlying mortgage loan, quoted MBS prices and an estimate of the probability that the mortgage loan will fund within the terms of the IRLC, net of commission expenses (Level 2). The Company estimates the fair value of forward sales commitments based on quoted MBS prices (Level 2).

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis as of June 30, 2016 and December 31, 2015.

				June 30, 2016
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Securities available for sale				
US government agencies	$ -	8,803	-	8,803
SBA securities	-	6,086	-	6,086
State and political subdivisions	-	22,906	-	22,906
Mortgage-backed securities	-	46,725	-	46,725
Interest rate lock commitments	-	673	-	673
Total assets measured at fair value on a recurring basis	$ -	85,196	-	85,196
Liabilities				
MBS forward sales commitments	$ -	241	-	241
Total liabilities measured at fair value on a recurring basis	$ -	241	-	241

				December 31, 2015
	Level 1	Level 2	Level 3	Total
Assets				
Securities available for sale				
US government agencies	$ -	14,599	-	14,599
SBA securities	-	6,277	-	6,277
State and political subdivisions	-	22,259	-	22,259
Mortgage-backed securities	-	46,804	-	46,804
Total assets measured at fair value on a recurring basis	$ -	89,939	-	89,939

The Company has no liabilities carried at fair value or measured at fair value on a recurring basis as of December 31, 2015.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company is predominantly an asset based lender with real estate serving as collateral on more than 80% of loans as of June 30, 2016. Loans which are deemed to be impaired are valued net of the allowance for loan losses, and other real estate owned is valued at the lower of cost or net realizable value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The tables below present the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of June 30, 2016 and December 31, 2015.

				As of June 30, 2016
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Impaired loans	$ -	7,527	3,898	11,425
Other real estate owned	-	1,847	113	1,960
Total assets measured at fair value on a nonrecurring basis	$ -	9,374	4,011	13,385

				As of December 31, 2015
	Level 1	Level 2	Level 3	Total
Assets				
Impaired loans	$ -	9,102	557	9,659
Other real estate owned	-	2,208	267	2,475
Total assets measured at fair value on a nonrecurring basis	$ -	11,310	824	12,134

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis as of June 30, 2016 and December 31, 2015.

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of June 30, 2016, the significant unobservable inputs used in the fair value measurements were as follows:

	Valuation Technique	Significant Unobservable Inputs	Range of Inputs
Impaired loans	Appraised Value/ Discounted Cash Flows	Discounts to appraisals or cash flows for estimated holding and/or selling costs or age of appraisal	0-25%
Other real estate owned	Appraised Value/ Comparable Sales	Discounts to appraisals for estimated holding or selling costs	0-25%

Fair Value of Financial Instruments

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company s common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, federal funds purchased, and securities sold under agreement to repurchase.

Deposits Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

FHLB Advances and Other Borrowings Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

Junior subordinated debentures Fair value for junior subordinated debentures are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management s best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

The estimated fair values of the Company s financial instruments at June 30, 2016 and December 31, 2015 are as follows:

					June 30, 2016
(dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Other investments, at cost	$ 5,749	5,749	-	-	5,749
Mortgage loans held for sale	14,367	14,367	-	14,367	-
Loans, net	1,051,179	1,052,204	-	7,527	1,044,677
Financial Liabilities:					
Deposits	1,049,124	996,177	-	996,177	-
FHLB and other borrowings	115,200	117,086	-	117,086	-
Junior subordinated debentures	13,403	11,401			