FIRST NORTHERN COMMUNITY BANCORP
Form 10-Q
May 07, 2015
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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 March 31, 2015

OR

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

For the transition period from _______________ to _______________

Commission File Number 000-30707

First Northern Community Bancorp
(Exact name of registrant as specified in its charter)

California	68-0450397
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

195 N. First Street, Dixon, California	95620
(Address of principal executive offices)	(Zip Code)

707-678-3041
(Registrant's telephone number including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or Section 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 ¨

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

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

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

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

Yes ¨ No x

The number of shares of Common Stock outstanding as of April 30, 2015 was 10,256,219.

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PART I – FINANCIAL INFORMATION

FIRST NORTHERN COMMUNITY BANCORP

ITEM I. – FINANCIAL STATEMENTS (UNAUDITED)

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except shares and share amounts)	March 31, 2015	December 31, 2014
Assets		
Cash and cash equivalents	$254,328	$229,052
Investment securities – available-for-sale	163,587	151,226
Loans, net of allowance for loan losses of $8,894 at March 31, 2015 and $8,583 at December 31, 2014	536,934	537,979
Loans held-for-sale	4,185	491
Stock in Federal Home Loan Bank and other equity securities, at cost	3,934	3,934
Premises and equipment, net	7,220	7,278
Other real estate owned	—	736
Interest receivable and other assets	25,201	27,188
Total Assets	$995,389	$957,884
Liabilities and Stockholders' Equity		
Liabilities:		
Demand deposits	$296,697	$287,717
Interest-bearing transaction deposits	244,019	219,396
Savings and MMDA's	268,239	263,766
Time, under $250,000	64,206	65,570
Time, $250,000 and over	20,347	20,603
Total deposits	893,508	857,052
Interest payable and other liabilities	7,867	8,781
Total Liabilities	901,375	865,833
Stockholders' Equity:		
Preferred stock, no par value; $1,000 per share liquidation preference, 22,847 shares authorized; 12,847 shares issued and outstanding at March 31, 2015 and December 31, 2014	12,847	12,847
Common stock, no par value; 16,000,000 shares authorized; 10,256,219 shares issued and outstanding at March 31, 2015 and 10,207,043 shares issued and outstanding at December 31, 2014	70,163	70,015
Additional paid-in capital	977	977

Retained earnings	9,619	8,146
Accumulated other comprehensive income, net	408	66
Total Stockholders’ Equity	94,014	92,051
Total Liabilities and Stockholders’ Equity	$995,389	$957,884

See notes to unaudited condensed consolidated financial statements.

FIRST NORTHERN COMMUNITY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share amounts)	Three months ended March 31, 2015	Three months ended March 31, 2014
Interest and dividend income:		
Loans	$6,722	$6,414
Due from banks interest bearing accounts	156	125
Investment securities		
Taxable	741	774
Non-taxable	64	99
Other earning assets	76	67
Total interest and dividend income	7,759	7,479
Interest expense:		
Deposits	293	325
Total interest expense	293	325
Net interest income	7,466	7,154
Provision for loan losses	350	600
Net interest income after provision for loan losses	7,116	6,554
Other operating income:		
Service charges on deposit accounts	519	553
Gains on sales of other real estate owned	161	—
Gains on sales of loans held-for-sale	133	134
Investment and brokerage services income	144	157
Mortgage brokerage income	5	—
Loan servicing income	113	117
Fiduciary activities income	128	199
ATM fees	64	107
Signature based transaction fees	412	286
Other income	213	195
Total other operating income	1,892	1,748
Other operating expenses:		
Salaries and employee benefits	4,089	3,760
Occupancy and equipment	707	728
Data processing	411	367
Stationery and supplies	89	82
Advertising	80	106
Directors' fees	62	53
Other real estate owned expense	2	3
Other expense	1,283	1,214
Total other operating expenses	6,723	6,313
Income before provision for income taxes	2,285	1,989
Provision for income taxes	768	625

Net income	$1,517	$1,364
Preferred stock dividends	$(32)	$(32)
Net income available to common shareholders	$1,485	$1,332
Basic earnings per common share	$0.15	$0.13
Diluted earnings per common share	$0.15	$0.13

See notes to unaudited condensed consolidated financial statements.

FIRST NORTHERN COMMUNITY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)	Three months ended March 31, 2015	Three months ended March 31, 2014
Net income	$1,517	$1,364
Other comprehensive income, net of tax:		
Unrealized holding gains on securities:		
Unrealized holding gains arising during the period, net of tax effect of $250 and $345 for the three-month periods ended March 31, 2015 and March 31, 2014, respectively	375	516
Directors' and officer's retirement plan equity adjustments, net of tax effect of ($22), and $0 for the three-month periods ended March, 31 2015 and March 31, 2014, respectively	(33)	—
Other comprehensive income	$342	$516
Comprehensive income	$1,859	$1,880

See notes to unaudited condensed consolidated financial statements.

FIRST NORTHERN COMMUNITY BANCORP

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

(in thousands, except share data)

	Preferred Stock		Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	
	Shares	Amounts	Shares	Amounts	Capital	Earnings	Income	Total
Balance at December 31, 2014	12,847	$12,847	10,207,043	$70,015	$ 977	$8,146	$ 66	$92,051
Net income						1,517		1,517
Other comprehensive income							342	342
Stock dividend adjustment			682	6		(6)		—
Dividend on preferred stock						(32)		(32)
Cash in lieu of fractional shares			(128)			(6)		(6)
Stock-based compensation and related tax benefit				58				58
Common shares issued related to restricted stock grants, net			28,901					—
Stock options exercised			19,721	84				84
Balance at March 31, 2015	12,847	$12,847	10,256,219	$70,163	$ 977	$9,619	$ 408	$94,014

See notes to unaudited condensed consolidated financial statements.

FIRST NORTHERN COMMUNITY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	(in thousands)	
	Three months ended March 31, 2015	Three months ended March 31, 2014
Cash Flows From Operating Activities		
Net income	$1,517	$1,364
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	166	166
Accretion and amortization of investment securities premiums and discounts, net	468	535
(Decrease)increase in deferred loan origination fees and costs, net	(2)	36
Provision for loan losses	350	600
Stock plan accruals	58	47
Gains on sales of other real estate owned	(161)	—
Gains on sales of loans held-for-sale	(133)	(134)
Proceeds from sales of loans held-for-sale	6,958	6,828
Originations of loans held-for-sale	(10,519)	(6,297)
Changes in assets and liabilities:		
Decrease in interest receivable and other assets	1,759	447
Net decrease in interest payable and other liabilities	(969)	(1,894)
Net cash (used in) provided by operating activities	(508)	1,698
Cash Flows From Investing Activities		
Proceeds from call or maturities of available-for-sale securities	540	5,000
Principal repayments on available-for-sale securities	5,808	5,113
Purchase of available-for-sale securities	(18,552)	(3,142)
Net decrease in loans	697	1,124
Proceeds from sale of other real estate owned	897	—
Purchases of premises and equipment, net	(108)	(128)
Net cash (used in) provided by investing activities	(10,718)	7,967
Cash Flows From Financing Activities		
Net increase in deposits	36,456	35,296
Cash dividends paid in lieu of fractional shares	(6)	(6)
Stock options exercised	84	—
Cash dividends paid on preferred stock	(32)	(32)
Net cash provided by financing activities	36,502	35,258
Net increase in Cash and Cash Equivalents	25,276	44,923
Cash and Cash Equivalents, beginning of period	229,052	177,254

Cash and Cash Equivalents, end of period	$254,328	$222,177
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$284	$316
Supplemental disclosures of non-cash investing and financing activities:		
Stock dividend distributed	$3,103	$2,065
Decrease in directors' & officer's retirement plan equity adjustment, net of tax	$33	$0
Unrealized holding gains on available for sale securities, net of taxes	$375	$516

See notes to unaudited condensed consolidated financial statements.

FIRST NORTHERN COMMUNITY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2015 and 2014 and December 31, 2014

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of First Northern Community Bancorp (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Articles 9 and 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP 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. The results of operations for any interim period are not necessarily indicative of results expected for the full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities and Exchange Commission. The preparation of financial statements in conformity with GAAP also requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates. All material intercompany balances and transactions have been eliminated in consolidation.

Recently Issued Accounting Pronouncements:

In January 2014, FASB issued ASU 2014-01, Investments – Equity Method and Joint Ventures. The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Disclosures for a change in accounting principle are required upon transition. The amendments should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The adoption of this update did not have a significant impact on its consolidated financial statements.

In January 2014, FASB issued ASU 2014-04, Receivables – Troubled Debt Restructurings by Creditors. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this ASU using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The adoption of this update did not have a significant impact on its consolidated financial statements.

In January, 2014, FASB issued ASU 2014-05, Service Concession Arrangements. The amendments specify that an operating entity should not account for a service concession arrangement that is within the scope of this ASU as a lease in accordance with Topic 840. An operating entity should refer to other Topics as applicable to account for various aspects of a service concession arrangement. The amendments also specify that the infrastructure used in a service concession arrangement should not be recognized as property, plant, and equipment of the operating entity. The amendments in this ASU should be applied on a modified retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. The modified retrospective approach requires the cumulative effect of applying this ASU to arrangements existing at the beginning of the period of adoption to be recognized as an adjustment to the opening retained earnings balance for the annual period of adoption. The amendments are effective for a public business entity for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of this update did not have a significant impact on its consolidated financial statements.

In August, 2014, FASB issued ASU 2014-14, Receivables- Troubled Debt Restructuring by Creditors: Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure. The amendment affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. It requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the following conditions are present:

- The loan has a government guarantee that is not separable from the loan before foreclosure.
- At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim.
- At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments are effective for a public business entity for annual periods and interim periods within those annual periods, beginning after December 15, 2014. The adoption of this update did not have a significant impact on its consolidated financial statements.

In August, 2014, FASB issued ASU 2014-15, Presentation of Financial Statements- Going Concern: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The amendment defines management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This ASU provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments are effective for a public business entity for annual periods ending after December 15, 2016, and interim periods within those annual periods, beginning after December 15, 2016. The Company does not expect the adoption of this update to have a significant impact on its consolidated financial statements.

Reclassifications

Certain reclassifications have been made to prior period balances in order to conform to the current year presentation. There was no impact to the net income, earnings per share, or stockholders' equity as a result of reclassifications.

2. LOANS

The composition of the Company's loan portfolio, by loan class, is as follows:

($ in thousands)	March 31, 2015	December 31, 2014
Commercial	$115,933	$120,751
Commercial Real Estate	264,880	256,955
Agriculture	54,719	61,144
Residential Mortgage	49,696	50,511
Residential Construction	10,096	5,963
Consumer	49,175	49,911
	544,499	545,235
Allowance for loan losses	(8,894)	(8,583)
Net deferred origination fees and costs	1,329	1,327
Loans, net	$536,934	$537,979

The Company manages asset quality and credit risk by maintaining diversification in its loan portfolio and through review processes that include analysis of credit requests and ongoing examination of outstanding loans and delinquencies, with particular attention to portfolio dynamics and loan mix. The Company strives to identify loans experiencing difficulty early enough to correct the problems, to record charge-offs promptly based on realistic assessments of collectability and current collateral values and to maintain an adequate allowance for loan losses at all times. Asset quality reviews of loans and other non-performing assets are administered using credit risk rating standards and criteria similar to those employed by state and federal banking regulatory agencies.

Commercial loans, whether secured or unsecured, generally are made to support the short-term operations and other needs of small businesses. These loans are generally secured by the receivables, equipment, and real property of the business and are susceptible to the related risks described above. Problem commercial loans are generally identified by periodic review of financial information that may include financial statements, tax returns, and payment history of the borrower. Based on this information, the Company may decide to take any of several courses of action including demand for repayment, requiring the borrower to provide a significant principal payment and/or additional collateral or requiring similar support from guarantors. Notwithstanding, when repayment becomes unlikely based on the borrower's income and cash flow, repossession or foreclosure of the underlying collateral may become necessary. Collateral values may be determined by appraisals obtained through Bank-approved, licensed appraisers, qualified independent third parties, purchase invoices, or other appropriate means.

Commercial real estate loans generally fall into two categories, owner-occupied and non-owner occupied. Loans secured by owner-occupied real estate are primarily susceptible to changes in the market conditions of the related business. This may be driven by, among other things, industry changes, geographic business changes, changes in the individual financial capacity of the business owner, general economic conditions and changes in business cycles. These same risks apply to commercial loans whether secured by equipment, receivables or other personal property or unsecured. Losses on loans secured by owner-occupied real estate, equipment, or other personal property generally are dictated by the value of underlying collateral at the time of default and liquidation of the collateral. When default

is driven by issues related specifically to the business owner, collateral values tend to provide better repayment support and may result in little or no loss. Alternatively, when default is driven by more general economic conditions, underlying collateral generally has devalued more and results in larger losses due to default. Loans secured by non-owner occupied real estate are primarily susceptible to risks associated with swings in occupancy or vacancy and related shifts in lease rates, rental rates or room rates. Most often, these shifts are a result of changes in general economic or market conditions or overbuilding and resulting over-supply of space. Losses are dependent on the value of underlying collateral at the time of default. Values are generally driven by these same factors and influenced by interest rates and required rates of return as well as changes in occupancy costs. Collateral values may be determined by appraisals obtained through Bank-approved, licensed appraisers, qualified independent third parties, sales invoices, or other appropriate means.

Agricultural loans, whether secured or unsecured, generally are made to producers and processors of crops and livestock. Repayment is primarily from the sale of an agricultural product or payments for services. Agricultural loans are generally secured by inventory, receivables, equipment, and real property. Agricultural loans are susceptible to changes in market demand for specific commodities. This may be exacerbated by, among other things, industry changes, changes in the individual financial capacity of the business owner, general economic conditions and changes in business cycles, as well as adverse weather conditions, including drought conditions such as those affecting California. Problem agricultural loans are generally identified by periodic review of financial information that may include financial statements, tax returns, crop budgets, payment history, and crop inspections. Based on this information, the Company may decide to take any of several courses of action including demand for repayment, requiring the borrower to provide a significant principal payment and/or additional collateral or requiring similar support from guarantors. Notwithstanding, when repayment becomes unlikely based on the borrower's income and cash flow, repossession or foreclosure of the underlying collateral may become necessary.

Residential mortgage loans, which are secured by real estate, are primarily susceptible to four risks: non-payment due to diminished or lost income; over-extension of credit; a lack of borrower's cash flow to sustain payments; and shortfalls in collateral value. In general, non-payment is usually due to loss of employment and follows general economic trends in the economy, particularly the upward movement in the unemployment rate, loss of collateral value, and demand shifts.

Residential construction loans, whether owner-occupied or non-owner occupied residential development loans, are not only susceptible to the related risks described above but the added risks of construction, including cost over-runs, mismanagement of the project, or lack of demand and market changes experienced at time of completion. Losses are primarily related to underlying collateral value and changes therein as described above. Problem construction loans are generally identified by periodic review of financial information that may include financial statements, tax returns and payment history of the borrower. Based on this information the Company may decide to take any of several courses of action including demand for repayment, requiring the borrower to provide a significant principal payment and/or additional collateral or requiring similar support from guarantors, or repossession or foreclosure of the underlying collateral. Collateral values may be determined by appraisals obtained through Bank-approved, licensed appraisers, qualified independent third parties, purchase invoices, or other appropriate means.

Consumer loans, whether unsecured or secured are primarily susceptible to four risks: non-payment due to diminished or lost income; over-extension of credit; a lack of borrower's cash flow to sustain payments; and shortfall in the collateral value. In general, non-payment is usually due to loss of employment and will follow general economic trends in the economy, particularly upward movements in the unemployment rate, loss of collateral value, and demand shifts.

As of March 31, 2015, approximately 49% in principal amount of the Company's loans were secured by commercial real estate, consisting primarily of loans secured by commercial properties and construction and land development loans. Approximately 9% in principal amount of the Company's loans were residential mortgage loans. Approximately 2% in principal amount of the Company's loans were residential construction loans. Approximately 10% in principal amount of the Company's loans were for agriculture and 21% in principal amount of the Company's loans were for general commercial uses including professional, retail and small businesses. Approximately 9% in principal amount of the Company's loans were consumer loans.

Once a loan becomes delinquent and repayment becomes questionable, a Company collection officer will address collateral shortfalls with the borrower and attempt to obtain additional collateral or a principal payment. If this is not forthcoming and payment in full is unlikely, the Company will consider the loan to be collateral dependent and will estimate its probable loss, using a recent valuation as appropriate to the underlying collateral less estimated costs of

sale, and charge-off the loan down to the estimated net realizable amount. Depending on the length of time until final collection, the Company may periodically revalue the underlying collateral and take additional charge-offs as warranted. Revaluations may occur as often as every 3-12 months depending on the underlying collateral and volatility of values. Final charge-offs or recoveries are taken when collateral is liquidated and actual loss is known. Unpaid balances on loans after or during collection and liquidation may also be pursued through legal action and attachment of wages or judgment liens on the borrower's other assets.

At March 31, 2015 and December 31, 2014, all loans were pledged under a blanket collateral lien to secure actual and potential borrowings from the Federal Home Loan Bank ("FHLB") and the Federal Reserve Bank.

Non-accrual and Past Due Loans

The Company's non-accrual loans by loan class, as of March 31, 2015 and December 31, 2014 were as follows:

($ in thousands)	March 31, 2015	December 31, 2014
Commercial	$2,076	$2,151
Commercial Real Estate	659	672
Agriculture	—	—
Residential Mortgage	1,665	1,691
Residential Construction	66	71
Consumer	599	652
	$5,065	$5,237

Non-accrual loans amounted to $5,065,000 at March 31, 2015 and were comprised of seven commercial loans totaling $2,076,000, five commercial real estate loans totaling $659,000, six residential mortgage loans totaling $1,665,000, two residential construction loans totaling $66,000 and four consumer loans totaling $599,000. Non-accrual loans amounted to $5,237,000 at December 31, 2014 and were comprised of six residential mortgage loans totaling $1,691,000, two residential construction loans totaling $71,000, five commercial real estate loans totaling $672,000, seven commercial loans totaling $2,151,000, and five consumer loans totaling $652,000. It is generally the Company's policy to charge-off the portion of any non-accrual loan that the Company does not expect to collect by writing the loan down to the estimated net realizable value of the underlying collateral.

An age analysis of past due loans, segregated by loan class, as of March 31, 2015 and December 31, 2014 is as follows:

($ in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or more Past Due	Total Past Due	Current	Total Loans
March 31, 2015						
Commercial	$—	$—	$82	$82	$115,851	$115,933
Commercial Real Estate	—	—	239	239	264,641	264,880
Agriculture	—	—	—	—	54,719	54,719
Residential Mortgage	1,787	—	456	2,243	47,453	49,696
Residential Construction	—	—	—	—	10,096	10,096
Consumer	77	6	423	506	48,669	49,175
Total	$1,864	$6	$1,200	$3,070	$541,429	$544,499
December 31, 2014						
Commercial	$—	$—	$82	$82	$120,669	$120,751
Commercial Real Estate	—	—	239	239	256,716	256,955
Agriculture	—	—	—	—	61,144	61,144
Residential Mortgage	1,172	—	457	1,629	48,882	50,511
Residential Construction	—	—	—	—	5,963	5,963
Consumer	2	1	472	475	49,436	49,911
Total	$1,174	$1	$1,250	$2,425	$542,810	$545,235

The Company had no loans that were 90 days or more past due and still accruing at March 31, 2015 and December 31, 2014. Included in the aging loan category labeled "current" are non-accrual loans that were not delinquent with respect to contractual principal and interest payments as of March 31, 2015 and December 31, 2014. These loans are categorized as non-accrual loans and are not accruing interest as of March 31, 2015 and December 31, 2014. Non-accrual loans outstanding at March 31, 2015 and December 31, 2014 are disclosed in the table above.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. Loans considered for impairment include non-accrual loans, troubled debt restructurings and loans with a risk rating of 6 (substandard) or worse. Once identified, impaired loans are measured individually for impairment using one of three methods: present value of expected cash flows discounted at the loan's effective interest rate; the loan's observable market price; and the fair value of collateral if the loan is collateral dependent. In general, any portion of the recorded investment in a collateral dependent loan in excess of the fair value of the collateral that can be identified as uncollectible, and is, therefore, deemed a confirmed loss, is promptly charged-off against the allowance for loan losses.

Impaired loans, segregated by loan class, as of March 31, 2015 and December 31, 2014 were as follows:

($ in thousands)	Unpaid Contractual Principal Balance	Recorded Investment with no Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance
March 31, 2015					
Commercial	$2,704	$2,073	$505	$2,578	$31
Commercial Real Estate	974	659	301	960	45
Agriculture	—	—	—	—	—
Residential Mortgage	5,378	1,665	2,930	4,595	638
Residential Construction	1,012	66	819	885	105
Consumer	1,751	727	755	1,482	31
Total	$11,819	$5,190	$5,310	$10,500	$850
December 31, 2014					
Commercial	$2,803	$2,147	$531	$2,678	$39
Commercial Real Estate	990	672	304	976	45
Agriculture	—	—	—	—	—
Residential Mortgage	5,666	1,691	2,956	4,647	646
Residential Construction	1,065	71	826	897	107
Consumer	1,506	780	726	1,506	23
Total	$12,030	$5,361	$5,343	$10,704	$860

The average recorded investment in impaired loans and the amount of interest income recognized on impaired loans during the three-month periods ended March 31, 2015 and March 31, 2014 was as follows:

($ in thousands)	Three Months Ended March 31, 2015		Three Months Ended March 31, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial	$2,628	$8	$5,084	$9
Commercial Real Estate	968	4	3,711	19
Agriculture	—	—	1,310	—
Residential Mortgage	4,621	31	5,484	32
Residential Construction	891	9	937	10

Consumer	1,494	11	1,464	14
Total	$ 10,602	$ 63	$ 17,990	$ 84

Troubled Debt Restructurings

The Company's loan portfolio includes certain loans that have been modified in a Troubled Debt Restructuring ("TDR"), which are loans on which concessions in terms have been granted because of the borrowers' financial difficulties and, as a result, the Company receives less than the current market based compensation for the loan. These concessions may include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are placed on non-accrual status at the time of restructure and may only be returned to accruing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

When a loan is modified, it is measured based upon the present value of future cash flows discounted at the contractual interest rate of the original loan agreement, or the fair value of collateral less selling costs if the loan is collateral dependent. If the value of the modified loan is less than the recorded investment in the loan, impairment is recognized through a specific allowance or a charge-off of the loan.

The Company had $6,593,000 and $6,712,000 in TDR loans as of March 31, 2015 and December 31, 2014, respectively. Specific reserves for TDR loans totaled $850,000 and $860,000 as of March 31, 2015 and December 31, 2014, respectively. TDR loans performing in compliance with modified terms totaled $5,435,000 and $5,467,000 as of March 31, 2015 and December 31, 2014, respectively. There were no commitments to advance more funds on existing TDR loans as of March 31, 2015.

Loans modified as troubled debt restructurings during the three-month period ended March 31, 2015 and March 31, 2014, were as follows:

($ in thousands)	Three Months Ended March 31, 2015		
	Number of Contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Consumer	1	109	109
Total	1	$ 109	$ 109

($ in thousands)	Three Months Ended March 31, 2014		
	Number of Contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Consumer	2	498	498
Total	2	$ 498	$ 498

The loan modifications generally involved reductions in the interest rate, payment extensions, forgiveness of principal, and forbearance. There were no loans modified as a troubled debt restructuring within the previous 12 months and for which there was a payment default during the three-month periods ended March 31, 2015 and March 31, 2014.

Credit Quality Indicators

All loans are rated using the credit risk ratings and criteria adopted by the Company. Risk ratings are adjusted as future circumstances warrant. All credits risk rated 1, 2, 3 or 4 equate to a Pass as indicated by Federal and State regulatory agencies; a 5 equates to a Special Mention; a 6 equates to Substandard; a 7 equates to Doubtful; and 8 equates to a Loss. For the definitions of each risk rating, see Note 4 to our condensed consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014.

The following table presents the risk ratings by loan class as of March 31, 2015 and December 31, 2014:

($ in thousands)	Pass	Special Mention	Substandard	Doubtful	Loss	Total
March 31, 2015						
Commercial	$109,143	$2,485	$4,305	$—	$—	$115,933
Commercial Real Estate	248,550	10,843	5,487	—	—	264,880
Agriculture	54,719	—	—	—	—	54,719
Residential Mortgage	44,498	1,429	3,769	—	—	49,696
Residential Construction	9,528	464	104	—	—	10,096
Consumer	45,559	945	2,671	—	—	49,175
Total	$511,997	$16,166	$16,336	$—	$—	$544,499
December 31, 2014						
Commercial	$112,751	$3,255	$4,745	$—	$—	$120,751
Commercial Real Estate	240,808	10,607	5,540	—	—	256,955
Agriculture	61,144	—	—	—	—	61,144
Residential Mortgage	46,043	997	3,471	—	—	50,511
Residential Construction	5,386	467	110	—	—	5,963
Consumer	46,234	944	2,733	—	—	49,911
Total	$512,366	$16,270	$16,599	$—	$—	$545,235

Allowance for Loan Losses

The following tables details activity in the allowance for loan losses by loan class for the three-month periods ended March 31, 2015 and March 31, 2014:

Three-month period ended March 31, 2015

($ in thousands)	Commercial	Commercial Real Estate	Agriculture	Residential Mortgage	Residential Construction	Consumer	Unallocated	Total
Balance as of December 31, 2014	$ 3,581	$ 1,825	$ 580	$ 1,181	$ 161	$ 886	$ 369	$ 8,583
Provision for loan losses	(268)	660	66	(134)	33	(8)	1	350
Charge-offs	—	—	—	—	—	(67)	—	(67)
Recoveries	12	—	—	—	1	15	—	28
Net charge-offs	12	—	—	—	1	(52)	—	(39)
Balance as of March 31, 2015	$ 3,325	$ 2,485	$ 646	$ 1,047	$ 195	$ 826	$ 370	$ 8,894
Period-end amount allocated to:								
Loans individually evaluated for impairment	31	45	—	638	105	31	—	850
Loans collectively evaluated for impairment	3,294	2,440	646	409	90	795	370	8,044
Balance as of March 31, 2015	$ 3,325	$ 2,485	$ 646	$ 1,047	$ 195	$ 826	$ 370	$ 8,894

Three-month period ended March 31, 2014

($ in thousands)	Commercial	Commercial Real Estate	Agriculture	Residential Mortgage	Residential Construction	Consumer	Unallocated	Total
Balance as of December 31, 2013	$ 3,199	$ 2,290	$ 557	$ 1,216	$ 441	$ 1,023	$ 627	$ 9,353
Provision for (reversal of) loan losses	1,133	(140)	(118)	(43)	(185)	203	(250)	600
Charge-offs	(1,062)	—	—	—	—	(302)	—	(1,364)
Recoveries	12	—	—	—	2	43	—	57
Net charge-offs	(1,050)	—	—	—	2	(259)	—	(1,307)
Balance as of March 31, 2014	$ 3,282	$ 2,150	$ 439	$ 1,173	$ 258	$ 967	$ 377	$ 8,646
Period-end amount allocated to:								
	54	56	—	693	118	19	—	940

Loans individually evaluated for impairment								
Loans collectively evaluated for impairment	3,228	2,094	439	480	140	948	377	7,706
Balance as of March 31, 2014	$ 3,282	$ 2,150	$ 439	$ 1,173	$ 258	$ 967	$ 377	$ 8,646

The following table details activity in the allowance for loan losses and the amount allocated to loans individually and collectively evaluated for impairment as of and for the period ended December 31, 2014.

Year ended December 31, 2014

($ in thousands)	Commercial	Commercial Real Estate	Agriculture	Residential Mortgage	Residential Construction	Consumer	Unallocated	Total
Balance as of December 31, 2013	$ 3,199	$ 2,290	$ 557	$ 1,216	$ 441	$ 1,023	$ 627	$ 9,353
Provision for (reversal of) loan losses	2,612	(396)	23	36	(366)	149	(258)	1,800
Charge-offs	(2,288)	(69)	—	(71)	—	(393)	—	(2,821)
Recoveries	58	—	—	—	86	107	—	251
Net charge-offs	(2,230)	(69)	—	(71)	86	(286)	—	(2,570)
Ending Balance	3,581	1,825	580	1,181	161	886	369	8,583
Period-end amount allocated to:								
Loans individually evaluated for impairment	39	45	—	646	107	23	—	860
Loans collectively evaluated for impairment	3,542	1,780	580	535	54	863	369	7,723
Balance as of December 31, 2014	$ 3,581	$ 1,825	$ 580	$ 1,181	$ 161	$ 886	$ 369	$ 8,583

The Company’s investment in loans as of March 31, 2015, March 31, 2014, and December 31, 2014 related to each balance in the allowance for loan losses by loan class and disaggregated on the basis of the Company’s impairment methodology was as follows:

($ in thousands)	Commercial	Commercial Real Estate	Agriculture	Residential Mortgage	Residential Construction	Consumer	Total
March 31, 2015							
Loans individually evaluated for impairment	$ 2,578	$ 960	$ —	$ 4,595	$ 885	$ 1,482	$ 10,500
Loans collectively evaluated for impairment	113,355	263,920	54,719	45,101	9,211	47,693	533,999
Ending Balance	$ 115,933	$ 264,880	$ 54,719	$ 49,696	$ 10,096	$ 49,175	$ 544,499
March 31, 2014							
Loans individually evaluated for	$ 4,502	$ 3,692	$ 1,029	$ 5,394	$ 931	$ 1,674	$ 17,222

impairment							
Loans collectively evaluated for impairment	108,276	240,253	39,897	47,361	8,456	51,106	495,349
Ending Balance	$ 112,778	$ 243,945	$ 40,926	$ 52,755	$ 9,387	$ 52,780	$ 512,571
December 31, 2014							
Loans individually evaluated for impairment	$ 2,678	$ 976	$—	$ 4,647	$ 897	$ 1,506	$ 10,704
Loans collectively evaluated for impairment	118,073	255,979	61,144	45,864	5,066	48,405	534,531
Ending Balance	$ 120,751	$ 256,955	$ 61,144	$ 50,511	$ 5,963	$ 49,911	$ 545,235

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3. MORTGAGE OPERATIONS

Transfers and servicing of financial assets and extinguishments of liabilities are accounted for and reported based on consistent application of a financial-components approach that focuses on control. Transfers of financial assets that are sales are distinguished from transfers that are secured borrowings. Retained interests (mortgage servicing rights) in loans sold are measured by allocating the previous carrying amount of the transferred assets between the loans sold and retained interests, if any, based on their relative fair value at the date of transfer. Fair values are estimated using discounted cash flows based on a current market interest rate.

The Company recognizes a gain and a related asset for the fair value of the rights to service loans for others when loans are sold. The Company sold substantially its entire portfolio of conforming long-term residential mortgage loans originated during the three months ended March 31, 2015 for cash proceeds equal to the fair value of the loans.

The recorded value of mortgage servicing rights is included in other assets on the condensed consolidated balance sheets, and is amortized in proportion to, and over the period of, estimated net servicing revenues. The Company assesses capitalized mortgage servicing rights for impairment based upon the fair value of those rights at each reporting date. For purposes of measuring impairment, the rights are stratified based upon the product type, term and interest rates. Fair value is determined by discounting estimated net future cash flows from mortgage servicing activities using discount rates that approximate current market rates and estimated prepayment rates, among other assumptions. The amount of impairment recognized, if any, is the amount by which the capitalized mortgage servicing rights for a stratum exceeds their fair value. Impairment, if any, is recognized through a valuation allowance for each individual stratum. Changes in the carrying amount of mortgage servicing rights are reported in earnings under other operating income on the condensed consolidated statements of income.

Key assumptions used in measuring the fair value of mortgage servicing rights as of March 31, 2015 and December 31, 2014 were as follows:

	March 31, 2015	December 31, 2014
Constant prepayment rate	13.20 %	12.12 %
Discount rate	10.06 %	10.06 %
Weighted average life (years)	5.93	6.25

At March 31, 2015 and December 31, 2014, the Company’s mortgage loans held-for-sale was $4,185,000 and $491,000 respectively. At March 31, 2015, and December 31, 2014, the Company serviced real estate mortgage loans for others totaling $235,239,000 and $238,974,000, respectively.

The following table summarizes the Company’s mortgage servicing rights assets as of March 31, 2015 and December 31, 2014. Mortgage servicing rights are included in Interest Receivable and Other Assets on the condensed consolidated balance sheets:

	(in thousands)			
	December 31, 2014	Additions	Reductions	March 31, 2015
Mortgage servicing rights	$1,862	$56	$(94)	$1,824
Valuation allowance	—	—	—	—
Mortgage servicing rights, net of valuation allowance	$1,862	$56	$(94)	$1,824

At March 31, 2015 and December 31, 2014, the estimated fair market value of the Company's mortgage servicing rights asset was $1,960,000 and $2,068,000, respectively.
The Company received contractually specified servicing fees of $151,000 and $153,000 for the three month periods ended March 31, 2015 and March 31, 2014, respectively. Contractually specified servicing fees are included in other operating Income on the condensed consolidated statements of income.

4. OUTSTANDING SHARES AND EARNINGS PER SHARE

On January 22, 2015, the Board of Directors of the Company declared a 4% stock dividend payable as of March 31, 2015. All income per share amounts have been adjusted to give retroactive effect to stock dividends.

Earnings Per Share (EPS)

Basic EPS includes no dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the respective period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding plus dilutive shares for the quarter. Diluted shares include all common stock equivalents ("in-the-money" stock options, unvested restricted stock, stock units, warrants and rights, convertible bonds and preferred stock), which reflects the potential dilution of securities that could share in the earnings of the Company.

The following table presents a reconciliation of basic and diluted EPS for the three-month period ended March 31, 2015 and 2014.

	Three months ended March 31,	
	2015	2014
Basic earnings per share:		
Net income	$1,517	$1,364
Preferred stock dividend	$(32)	$(32)
Net income available to common stockholders	$1,485	$1,332
Weighted average common shares outstanding	10,135,245	10,106,062
Basic EPS	$0.15	$0.13
Diluted earnings per share:		
Net income	$1,517	$1,364
Preferred stock dividend	$(32)	$(32)
Net income available to common stockholders	$1,485	$1,332
Weighted average common shares outstanding	10,135,245	10,106,062
Effect of dilutive shares	61,596	52,882
Adjusted weighted average common shares outstanding	10,196,841	10,158,944
Diluted EPS	$0.15	$0.13

Stock options which were not included in the computation of diluted earnings per share because they would have had an anti-dilutive effect amounted to 183,437 shares and 253,865 shares for the three-month periods ended March 31, 2015 and 2014, respectively. Non-vested shares of restricted stock not included in the computation of diluted earnings per share because they would have an anti-dilutive effect amounted to zero shares and 25,886 shares for the three-month periods ended March 31, 2015 and 2014, respectively.

5. STOCK PLANS

On January 22, 2015, the Board of Directors of the Company declared a 4% stock dividend payable as of March 31, 2015. All stock options and restricted stock outstanding have been adjusted to give retroactive effect to stock dividends.

The following table presents the activity related to stock options for the three months ended March 31, 2015:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term (in years)
Options outstanding at Beginning of Period	313,483	$11.54		
Granted	41,047	$7.60		
Expired	(86,875)	$10.00		
Cancelled / Forfeited	—	—		
Exercised	(19,846)	$4.23		
Options outstanding at End of Period	247,809	$12.02	$236,940	4.65
Exercisable (vested) at End of Period	176,160	$14.07	$169,885	2.82

The weighted average grant date fair value per share of options granted during the three-month period ended March 31, 2015 was $2.67 per share.

As of March 31, 2015, there was $182,000 of total unrecognized compensation cost related to non-vested stock options. This cost is expected to be recognized over a weighted average period of approximately 3.21 years.

There was $16,000 of recognized compensation cost related to stock options granted for the three months ended March 31, 2015.

A summary of the weighted average assumptions used in valuing stock options during the three months ended March 31, 2015 is presented below:

	Three Months Ended March 31, 2015
Risk Free Interest Rate	1.61 %
Expected Dividend Yield	0.00 %
Expected Life in Years	5
Expected Price Volatility	37.38 %

The following table presents the activity related to non-vested restricted stock for the three months ended March 31, 2015:

	Number of Shares	Weighted Average Grant-Date Fair Value	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term (in years)
Non-vested Restricted stock outstanding at Beginning of Period	73,827	$ 5.64		
Granted	30,056	$ 7.59		
Cancelled/Forfeited	—	—		
Exercised/Released/Vested	(18,304)	$ 4.66		
Non-vested restricted stock outstanding at End of Period	85,579	$ 6.54	$ 676,074	8.74

The weighted average fair value of restricted stock granted during the three month period ended March 31, 2015 was $7.59 per share.

As of March 31, 2015, there was $402,000 of total unrecognized compensation cost related to non-vested restricted stock. This cost is expected to be recognized over a weighted average period of approximately 3.17 years.

There was $36,000 of recognized compensation cost related to restricted stock awards for the three month ended March 31, 2015.

The Company has an Employee Stock Purchase Plan ("ESPP"). Under the ESPP, the Company is authorized to issue to eligible employees shares of common stock. There are 322,385 (adjusted for the 2015 stock dividend) shares authorized under the ESPP. The ESPP will expire March 15, 2016. The ESPP is implemented by participation periods of not more than twenty-seven months each. The Board of Directors determines the commencement date and duration of each participation period. The Board of Directors approved the current participation period of November 24, 2014 to November 23, 2015. An eligible employee is one who has been continually employed for at least 90 days prior to commencement of a participation period. Under the terms of the ESPP, employees can choose to have up to 10 percent of their compensation withheld to purchase the Company's common stock each participation period. The purchase price of the stock is 85 percent of the lower of the fair value on the last trading day before the date of participation or the fair value on the last trading day during the participation period.

As of March 31, 2015, there was $16,000 of unrecognized compensation cost related to ESPP issuances. This cost is expected to be recognized over a weighted average period of approximately 0.75 years.

There was $7,000 of recognized compensation cost related to ESPP issuances for the three-month period ended March 31, 2015.

The weighted average fair value at issuance date during the three-month period ended March 31, 2015 was $1.67.

A summary of the weighted average assumptions used in valuing ESPP issuances during the three months ended March 31, 2015 is presented below:

	Three Months Ended March 31, 2015	
Risk Free Interest Rate	0.14	%
Expected Dividend Yield	0.00	%
Expected Life in Years	1.00	
Expected Price Volatility	15.10	%

6. FAIR VALUE MEASUREMENT

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale and trading securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a non-recurring basis, such as loans held-for-sale, loans held-for-investment and certain other assets. These non-recurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally corresponds with the Company's quarterly valuation process.

Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1	Valuation is based upon quoted prices for identical instruments traded in active markets.
Level 2	Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.
Level 3	Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models, and similar techniques and include management judgment and estimation which may be significant.

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

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, 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 issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets where valuations include significant unobservable assumptions.

Loans Held-for-Sale

Loans held-for-sale are carried at the lower of cost or fair value. The fair value of loans held-for-sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies

loans subjected to non-recurring fair value adjustments as Level 2. At March 31, 2015 there were no loans held-for-sale that required a write-down.

Impaired Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is 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, the Company measures impairment. 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. Inputs include external appraised values, management assumptions regarding market trends or other relevant factors, selling and commission costs ranging from 6% to 7%, and amount and timing of cash flows based upon current discount rates. 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 March 31, 2015, certain impaired loans were considered collateral dependent and were evaluated based on the fair value of the underlying collateral securing the loan. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When a loan is evaluated based on the fair value of the underlying collateral securing the loan, the Company records the impaired loan as non-recurring Level 3.

Other Real Estate Owned

Other real estate assets ("OREO") acquired through, or in lieu of, foreclosure are held-for-sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses. Appraisals or evaluations are then done periodically thereafter charging any additional write-downs or valuation allowances to the appropriate expense accounts. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. OREO is classified within Level 3 of the hierarchy.

Loan Servicing Rights

Loan servicing rights are subject to impairment testing. The Company utilizes a third party service provider to calculate the fair value of the Company's loan servicing rights. Loan servicing rights are measured at fair value as of the date of sale. The Company uses quoted market prices when available. Subsequent fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of the loan servicing rights, the present value of expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income.

The model used to calculate the fair value of the Company's loan servicing rights is periodically validated by an independent external model validation group. The model assumptions and the loan servicing rights fair value estimates are also compared to observable trades of similar portfolios as well as to loan servicing rights broker valuations and industry surveys, as available. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Company classifies loan servicing rights subjected to non-recurring fair value adjustments as Level 3.

Assets Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of March 31, 2015:

	(in thousands)			
March 31, 2015	Total	Level 1	Level 2	Level 3
Securities of U.S. government agencies and corporations	$33,777	$—	$33,777	$—
Obligations of states and political subdivisions	20,331	—	20,331	—
Collateralized mortgage obligations	13,909	—	13,909	—
Mortgage-backed securities	95,570	—	95,570	—
Total investments at fair value	$163,587	$—	$163,587	$—

There were no transfers of assets measured at fair value on a recurring basis between level 1 and level 2 of the fair value hierarchy.

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of December 31, 2014:

	(in thousands)			
December 31, 2014	Total	Level 1	Level 2	Level 3
Securities of U.S. government agencies and corporations	$28,429	$—	$28,429	$—
Obligations of states and political subdivisions	20,763	—	20,763	—
Collateralized mortgage obligations	12,553	—	12,553	
Mortgage-backed securities	89,481	—	89,481	—
Total investments at fair value	$151,226	$—	$151,226	$—

Assets Recorded at Fair Value on a Non-Recurring Basis

No assets were measured at fair value on a non-recurring basis at March 31, 2015.

Assets measured at fair value on a non-recurring basis are included in the table below by level within the fair value hierarchy as of December 31, 2014:

	(in thousands)			
December 31, 2014	Total	Level 1	Level 2	Level 3
Impaired loans	$568	$—	$—	$568
Other real estate owned	736	—	—	736
Total assets at fair value	$1,304	$—	$—	$1,304

There were no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2014.

Key methods and assumptions used in measuring the fair value of impaired loans and other real estate owned as of December 31, 2014 were as follows:

	Method	Assumption Inputs
Impaired loans	Collateral, market, income, enterprise, liquidation and discounted Cash Flows	External appraised values, management assumptions regarding market trends or other relevant factors; selling costs ranging 6% to 7%.
Other real estate owned	Collateral	External appraised values, management assumptions regarding market trends or other relevant factors; selling costs ranging 6% to 11%.

7. PREFERRED STOCK

On September 15, 2011, the Company issued to the U.S. Treasury under the United States Department of Treasury Small Business Lending Fund (SBLF) 22,847 shares of the Company's Non-Cumulative Perpetual Preferred Stock, Series A (SBLF Shares), having a liquidation preference per share equal to $1,000, for an aggregate purchase price of $22,847,000.

On September 15, 2011, the Company redeemed from the U.S. Treasury, using the partial proceeds from the issuance of the SBLF Shares, all 17,390 outstanding shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A, liquidation amount $1,000 per share, for a redemption price of $17,390,000, plus accrued but unpaid dividends at the date of redemption.

On February 8, 2013, the Company redeemed $10,000,000 of the $22,847,000 in preferred stock it issued to the U.S. Treasury under the SBLF program.

8. FAIR VALUES OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amounts reported in the condensed consolidated balance sheets for cash and short-term instruments are a reasonable estimate of fair value. The carrying amount is a reasonable estimate of fair value because of the relatively short term between the origination of the instrument and its expected realization. Therefore, the Company believes the measurement of fair value of cash and cash equivalents is derived from Level 1 inputs.

Other Equity Securities

The carrying amounts reported in the condensed consolidated balance sheets approximate fair value as the shares can only be redeemed by the issuing institution. The Company believes the measurement of the fair value of other equity securities is derived from Level 2 inputs.

Loans Receivable

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., commercial real estate and rental property mortgage loans, commercial and industrial loans, and agricultural loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered to be a reasonable estimate of loan discount due to credit risks. Given that there are loans with specific terms that are not readily available, the Company believes the fair value of loans receivable is derived from Level 3 inputs.

Loans Held-for-Sale

For loans held for sale, the fair value is based on what secondary markets are currently offering for portfolios with similar characteristics. See FN(6), Fair Value Measurement.

Mortgage Servicing Rights

The Company measures fair value of mortgage servicing rights using Level 2 and Level 3 inputs. The Company uses quoted market prices when available. Subsequent fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of the MSR, the present value of expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income. This model is periodically validated by an independent external model validation group. The model assumptions and the MSR fair value estimates are also compared to observable trades of similar portfolios as well as to MSR broker valuations and industry surveys, as available.

Interest Receivable and Payable

The carrying amount of interest receivable and payable approximates its fair value. The Company believes the measurement of the fair value of interest receivable and payable is derived from Level 2 inputs.

Deposit Liabilities

The Company measures fair value of deposits using Level 2 and Level 3 inputs. The fair value of deposits were derived by discounting their expected future cash flows back to their present values based on the FHLB yield curve, and their expected decay rates for non maturing deposits. The Company is able to obtain FHLB yield curve rates as of the measurement date, and believes these inputs fall under Level 2 of the fair value hierarchy. Decay rates were developed through internal analysis, and are supported by recent years of the Bank's transaction history. The inputs used by the Company to derive the decay rate assumptions are unobservable inputs, and therefore fall under Level 3 of the fair value hierarchy.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on-and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax liabilities and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in many of the estimates.

The estimated fair values of the Company's financial instruments for the periods ended March 31, 2015 and December 31, 2014 are approximately as follows:

		March 31, 2015		December 31, 2014	
	Level	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets:					
Cash and cash equivalents	1	$254,328	$254,328	$229,052	$229,052
Other equity securities	2	3,934	3,934	3,934	3,934
Loans receivable:					
Net loans	3	536,934	533,862	537,979	535,018
Loans held-for-sale	2	4,185	4,275	491	509
Interest receivable	2	2,790	2,790	2,650	2,650
Mortgage servicing rights	3	1,824	1,960	1,862	2,068
Financial liabilities:					
Deposits	3	893,508	870,148	857,052	837,150

Interest payable	2	79	79	70	70

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9. INVESTMENT SECURITIES

The amortized cost, unrealized gains and losses and estimated fair values of investments in debt and other securities at March 31, 2015 are summarized as follows:

(in thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
Investment securities available-for-sale:				
Securities of U.S. government agencies and corporations	$33,798	$87	$(108)	$33,777
Obligations of states and political subdivisions	19,659	688	(16)	20,331
Collateralized mortgage obligations	13,857	63	(11)	13,909
Mortgage-backed securities	94,477	1,235	(142)	95,570
Total debt securities	$161,791	$2,073	$(277)	$163,587

The amortized cost, unrealized gains and losses and estimated fair values of investments in debt and other securities at December 31, 2014 are summarized as follows:

(in thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
Investment securities available-for-sale:				
Securities of U.S. government agencies and corporations	$28,787	$17	$ (375)	$28,429
Obligations of states and political subdivisions	20,236	579	(52)	20,763
Collateralized mortgage obligations	12,541	37	(25)	12,553
Mortgage-backed securities	88,491	1,144	(154)	89,481
Total debt securities	$150,055	$1,777	$ (606)	$151,226

The Company had no proceeds from sales of available-for-sale securities for the three-month periods ended March 31, 2015 and March 31, 2014. There were no gross realized gains or losses from sales or calls of available-for-sale securities for the three-month periods ended March 31, 2015 and March 31, 2014.

The amortized cost and estimated market value of debt and other securities at March 31, 2015, by contractual and expected maturity, are shown in the following table:

(in thousands)	Amortized cost	Estimated fair value
Due in one year or less	$2,651	$2,653
Due after one year through five years	138,881	140,076
Due after five years through ten years	18,324	18,762
Due after ten years	1,935	2,096
	$161,791	$163,587

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities due after one year through five years included mortgage-backed securities and collateralized mortgage obligations with expected maturities totaling $105,567,000. The maturities on these securities were based on the average lives of the securities.

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An analysis of gross unrealized losses of the available-for-sale investment securities portfolio as of March 31, 2015, follows:

	Less than 12 months		12 months or more	Total
(in thousands)	Fair Value	Unrealized losses		