

CENTRAL VALLEY COMMUNITY BANCORP
Form 10-Q
May 06, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED March 31, 2016

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—31977

CENTRAL VALLEY COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

California 77-0539125
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

7100 N. Financial Dr., Suite 101, Fresno, California 93720
(Address of principal executive offices) (Zip code)

Registrant's telephone number (559) 298-1775

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the past 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 preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Small reporting company

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(Do not check if a smaller reporting company)

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

As of May 5, 2016 there were 11,027,979 shares of the registrant's common stock outstanding.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

2016 QUARTERLY REPORT ON FORM 10-Q

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PART 1: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except share amounts)	March 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks	\$22,525	\$ 23,339
Interest-earning deposits in other banks	55,824	70,988
Federal funds sold	307	290
Total cash and cash equivalents	78,656	94,617
Available-for-sale investment securities (Amortized cost of \$488,425 at March 31, 2016 and \$470,080 at December 31, 2015)	501,978	477,554
Held-to-maturity investment securities (Fair value of \$35,142 at December 31, 2015)	—	31,712
Loans, less allowance for credit losses of \$10,136 at March 31, 2016 and \$9,610 at December 31, 2015	598,864	588,501
Bank premises and equipment, net	9,002	9,292
Bank owned life insurance	20,847	20,702
Federal Home Loan Bank stock	4,823	4,823
Goodwill	29,917	29,917
Core deposit intangibles	990	1,024
Accrued interest receivable and other assets	26,466	18,594
Total assets	\$1,271,543	\$ 1,276,736
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$408,080	\$ 428,773
Interest bearing	695,399	687,494
Total deposits	1,103,479	1,116,267
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	17,130	15,991
Total liabilities	1,125,764	1,137,413
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, no par value, \$1,000 per share liquidation preference; 10,000,000 shares authorized, none issued and outstanding	—	—
Common stock, no par value; 80,000,000 shares authorized; issued and outstanding: 11,026,229 at March 31, 2016 and 10,996,773 at December 31, 2015	54,624	54,424
Retained earnings	83,180	80,437
Accumulated other comprehensive income, net of tax	7,975	4,462
Total shareholders' equity	145,779	139,323
Total liabilities and shareholders' equity	\$1,271,543	\$ 1,276,736

See notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except share and per share amounts)	For the Quarter	
	Ended March 31, 2016	2015
INTEREST INCOME:		
Interest and fees on loans	\$7,733	\$ 7,286
Interest on deposits in other banks	74	46
Interest and dividends on investment securities:		
Taxable	1,523	1,107
Exempt from Federal income taxes	1,523	1,538
Total interest income	10,853	9,977
INTEREST EXPENSE:		
Interest on deposits	221	233
Interest on junior subordinated deferrable interest debentures	29	24
Total interest expense	250	257
Net interest income before provision for credit losses	10,603	9,720
(REVERSAL OF) PROVISION FOR CREDIT LOSSES	(250)	—
Net interest income after provision for credit losses	10,853	9,720
NON-INTEREST INCOME:		
Service charges	749	871
Appreciation in cash surrender value of bank owned life insurance	145	154
Interchange fees	279	278
Net realized gains on sales of investment securities	1,130	726
Other-than-temporary impairment loss on investment securities	(136)	—
Federal Home Loan Bank dividends	97	86
Loan placement fees	191	298
Other income	249	278
Total non-interest income	2,704	2,691
NON-INTEREST EXPENSES:		
Salaries and employee benefits	5,254	5,163
Occupancy and equipment	1,207	1,150
Professional services	336	481
Data processing	347	281
Regulatory assessments	143	336
ATM/Debit card expenses	122	137
License and maintenance contracts	132	138
Directors' expenses	171	128
Advertising	159	159
Internet banking expense	161	203
Amortization of core deposit intangibles	34	84
Other	910	1,028
Total non-interest expenses	8,976	9,288
Income before provision for income taxes	4,581	3,123
Provision for income taxes	1,178	657
Net income available to common shareholders	\$3,403	\$ 2,466

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Earnings per common share:

Basic earnings per share	\$0.31	\$ 0.23
Weighted average common shares used in basic computation	10,953,841	10,923,590
Diluted earnings per share	\$0.31	\$ 0.22
Weighted average common shares used in diluted computation	11,040,791	11,002,976
Cash dividend per common share	\$0.06	\$ —

See notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	For the Quarter	
	Ended March 31,	
(In thousands)	2016	2015
Net income	\$3,403	\$2,466
Other Comprehensive Income:		
Unrealized gains on securities:		
Unrealized holdings gains arising during the period	4,002	2,384
Less: reclassification for net gains included in net income	434	726
Less: reclassification for other-than-temporary impairment loss included in net income	(136)	—
Transfer of investment securities from held-to-maturity to available-for-sale	2,647	—
Amortization of net unrealized gains transferred	(64)	(1)
Other comprehensive income, before tax	6,015	1,657
Tax (expense) benefit related to items of other comprehensive income	(2,502)	(682)
Total other comprehensive income	3,513	975
Comprehensive income	\$6,916	\$3,441

See notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Quarter Ended March 31,	
	2016	2015
(In thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$3,403	\$2,466
Adjustments to reconcile net income to net cash provided by operating activities:		
Net decrease in deferred loan fees	(293)	(117)
Depreciation	349	339
Accretion	(301)	(248)
Amortization	1,995	2,054
Stock-based compensation	52	61
Excess tax benefit from exercise of stock options	(5)	—
(Reversal of) provision for credit losses	(250)	—
Other than temporary impairment losses on investment securities	136	—
Net realized gains on sales of available-for-sale investment securities	(434)	(726)
Net realized gains on sales of held-to-maturity securities	(696)	—
Net loss on disposal of premises and equipment	—	2
Increase in bank owned life insurance, net of expenses	(145)	(154)
Net decrease (increase) in accrued interest receivable and other assets	54	1,471
Net (decrease) increase in accrued interest payable and other liabilities	1,139	(108)
Provision for deferred income taxes	(723)	(33)
Net cash provided by operating activities	4,281	5,007
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investment securities	(34,357)	(45,842)
Proceeds from sales or calls of available-for-sale investment securities	15,654	38,933
Proceeds from sales or calls of held-to-maturity investment securities	9,257	—
Proceeds from maturity and principal repayments of available-for-sale investment securities	12,384	12,161
Net increase in loans	(9,821)	(4,424)
Purchases of premises and equipment	(59)	(178)
Purchases of bank owned life insurance	—	(325)
Net cash (used in) provided by investing activities	(6,942)	325
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in demand, interest bearing and savings deposits	(6,461)	4,772
Net decrease in time deposits	(6,327)	(2,061)
Proceeds from exercise of stock options	143	—
Excess tax benefit from exercise of stock options	5	—
Cash dividend payments on common stock	(660)	—
Net cash (used in) provided by financing activities	(13,300)	2,711
(Decrease) increase in cash and cash equivalents	(15,961)	8,043
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	94,617	77,328
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$78,656	\$85,371

For the
Quarter
Ended March
31,

(In thousands)	2016	2015
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Interest	\$249	\$260
Income taxes	\$690	\$—
Non-cash investing and financing activities:		
Foreclosure of loan collateral and recognition of other real estate owned	\$—	\$227
Assumption of other real estate owned liabilities	\$—	\$121
Transfer of securities from held-to-maturity to available-for-sale	\$23,131	\$—
Unrealized gain on transfer of securities from held-to-maturity to available-for-sale	\$526	\$—
Sale of available-for-sale investment securities, not yet settled	\$9,699	\$—
See notes to unaudited consolidated financial statements.		

Note 1. Basis of Presentation

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The interim unaudited condensed consolidated financial statements of Central Valley Community Bancorp and subsidiary have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). These interim condensed consolidated financial statements include the accounts of Central Valley Community Bancorp and its wholly owned subsidiary Central Valley Community Bank (the Bank) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted. The Company believes that the disclosures are adequate to make the information presented not misleading. These interim unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2015 Annual Report to Shareholders on Form 10-K. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company's financial position at March 31, 2016, and the results of its operations and its cash flows for the three month interim periods ended March 31, 2016 and 2015 have been included. Certain reclassifications have been made to prior year amounts to conform to the 2016 presentation. Reclassifications had no effect on prior period net income or shareholders' equity. The results of operations for interim periods are not necessarily indicative of results for the full year.

The preparation of these interim unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Management has determined that since all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment, and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

The Company terminated its interest in Central Valley Community Insurance Service, LLC (CVCIS) at the beginning of the third quarter of 2015. The Bank's interest in CVCIS was originally established in 2006 for the purpose of providing health, commercial property and casualty insurance products and services primarily to business customers. The termination of this entity did not have a material impact on the Company's financial statements.

Impact of New Financial Accounting Standards:

FASB Accounting Standards Update (ASU) 2015-03 - Interest-Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs: ASU 2015-03 requires the debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by the amendments in ASU 2015-03. ASU 2015-03 was effective for the Company on January 1, 2016, and did not have a significant impact on the Company's consolidated financial statements, results of operations, cash flows, or disclosures.

FASB Accounting Standards Update (ASU) 2015-16 - Business Combinations (Subtopic 805) - Simplifying the Accounting for Measurement-Period Adjustments: ASU 2015-16 requires that adjustments to provisional amounts that are identified during the measurement period of a business combination be recognized in the reporting period in which the adjustment amounts are determined. Furthermore, the income statement effects of such adjustments, if any, must be calculated as if the accounting had been completed at the acquisition date. The portion of the amount recorded in current-period earnings that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date is required to be reported separately on the face of the income statement, or disclosed within the footnotes to the financial statements. Under previous guidance, adjustments to provisional amounts identified during the measurement period are to be recognized retrospectively.

ASU 2015-16 was effective for the Company on January 1, 2016, and did not have a significant impact on the Company's consolidated financial statements, results of operations, cash flows, or disclosures.

FASB Accounting Standards Update (ASU) 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, was issued January 2016. ASU 2016-01 addresses certain aspects of recognition, measurement presentation, and disclosure of financial instruments. Most notably the ASU changes the income statement impact of equity investments held by the Company and the requirement for the Company to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company will be required to adopt the provisions of ASU 2016-01 on January 1, 2018. Management is evaluating the impact that this ASU will have on the Company's financial statements.

FASB Accounting Standards Update (ASU) 2016-02 - Leases - Overall (Subtopic 845): was issued February 2016. ASU 2016-02 requires the lessee to recognize most leases on the balance sheet thereby resulting in the recognition of lease assets and

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liabilities for those leases currently classified as operating leases. The accounting for lessors is largely unchanged. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted. Management is evaluating the impact that this ASU will have on the Company's financial statements.

FASB Accounting Standards Update (ASU) 2016-09 - Compensation - Stock Compensation (Subtopic 718): Improvements to Employee Share-Based Payment Accounting, was issued March 2016. ASU 2016-09 addresses simplification of several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 is effective for annual reporting periods beginning after December 15, 2016 with early adoption permitted. Management is evaluating the impact that this ASU will have on the Company's financial statements.

Note 2. Fair Value Measurements

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. In accordance with applicable guidance, the Company groups its assets and liabilities measured 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. Valuations within these levels are based upon:

Level 1 — Quoted market prices (unadjusted) for identical instruments traded in active exchange markets that the Company has the ability to access as of the measurement date.

Level 2 — 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 — Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, we report the transfer at the beginning of the reporting period. The estimated carrying and fair values of the Company's financial instruments are as follows (in thousands):

(In thousands)	March 31, 2016				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	\$22,525	\$22,525	\$ —	—	—\$ 22,525
Interest-earning deposits in other banks	55,824	55,824	—	—	55,824
Federal funds sold	307	307	—	—	307
Available-for-sale investment securities	501,978	7,648	494,330	—	501,978
Loans, net	598,864	—	—	594,624	594,624
Federal Home Loan Bank stock	4,823	N/A	N/A	N/A	N/A
Accrued interest receivable	5,634	23	3,047	2,564	5,634

Financial liabilities:

Deposits	1,103,479	971,439	134,236	—	1,105,675
Junior subordinated deferrable interest debentures	5,155	—	—	3,100	3,100
Accrued interest payable	102	—	73	29	102

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(In thousands)	December 31, 2015				
	Amount	Level 1	Level 2	Level 3	Total
Carrying Fair Value					
Financial assets:					
Cash and due from banks	\$23,339	\$23,339	\$ —	—\$	—\$ 23,339
Interest-earning deposits in other banks	70,988	70,988	—	—	70,988
Federal funds sold	290	290	—	—	290
Available-for-sale investment securities	477,554	7,536	470,018	—	477,554
Held-to-maturity investment securities	31,712	—	35,142	—	35,142
Loans, net	588,501	—	—	585,737	585,737
Federal Home Loan Bank stock	4,823	N/A	N/A	N/A	N/A
Accrued interest receivable	6,355	27	3,414	2,914	6,355
Financial liabilities:					
Deposits	1,116,267	76,433	139,353	—	1,115,786
Junior subordinated deferrable interest debentures	5,155	—	—	3,200	3,200
Accrued interest payable	101	—	76	25	101

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding 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 fair values presented.

The methods and assumptions used to estimate fair values are described as follows:

(a) Cash and Cash Equivalents — The carrying amounts of cash and due from banks, interest-earning deposits in other banks, and Federal funds sold approximate fair values and are classified as Level 1.

(b) Investment Securities — Investment securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for investment securities classified in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

(c) Loans — Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Purchased credit impaired (PCI) loans are measured at estimated fair value on the date of acquisition. Carrying value is calculated as the present value of expected cash flows and approximates fair value. Fair values for other 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 resulting in a Level 3 classification. Impaired loans are initially valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such

adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(d) FHLB Stock — It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

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(e) Other real estate owned — OREO is measured at fair value less estimated costs to sell when acquired, establishing a new cost basis. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process to adjust for differences between the comparable sales and income data available. The Company records OREO as non-recurring with level 3 measurement inputs.

(f) Deposits — Fair value of demand deposit, savings, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount), resulting in a Level 1 classification. Fair value for fixed and variable rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for certificates with similar remaining maturities resulting in a Level 2 classification.

(g) Short-Term Borrowings — The fair values of the Company's federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, are based on the market rates for similar types of borrowing arrangements resulting in a Level 2 classification.

(h) Other Borrowings — The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

(i) Accrued Interest Receivable/Payable — The fair value of accrued interest receivable and payable is based on the fair value hierarchy of the related asset or liability.

(j) Off-Balance Sheet Instruments — Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not considered significant for financial reporting purposes.

Assets Recorded at Fair Value

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of March 31, 2016:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of March 31, 2016 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	\$ 51,558	\$—	\$ 51,558	\$ —
Obligations of states and political subdivisions	214,757	—	214,757	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	224,641	—	224,641	—
Private label residential mortgage backed securities	3,374	—	3,374	—

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Other equity securities	7,648	7,648	—	—
Total assets measured at fair value on a recurring basis	\$ 501,978	\$ 7,648	\$ 494,330	\$ —

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale investment securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the three months ended March 31, 2016, no transfers between levels occurred.

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There were no Level 3 assets measured at fair value on a recurring basis at or during the three months ended March 31, 2016. Also there were no liabilities measured at fair value on a recurring basis at March 31, 2016.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at March 31, 2016 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Assets:				
Impaired loans:				
Commercial:				
Commercial and industrial	\$ 482	\$ —	—	—\$ 482
Total commercial	482	—	—	482
Consumer:				
Equity loans and lines of credit	\$ 120	\$ —	—	—\$ 120
Total impaired loans	602	—	—	602
Other real estate owned	—	—	—	—
Total assets measured at fair value on a non-recurring basis	\$ 602	\$ —	—	—\$ 602

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow methods as prescribed by ASC Topic 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the three month period ended March 31, 2016.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$1,270,000 with a valuation allowance of \$668,000 at March 31, 2016, resulting in fair value of \$602,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

During the three months ended March 31, 2016, specific allocation for the allowance for credit losses related to loans carried at fair value was \$635,000 compared to none during 2015 related to loans carried at fair value.. There were no

charge-offs related to loans carried at fair value at March 31, 2016 and 2015

There were no liabilities measured at fair value on a non-recurring basis at March 31, 2016.

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The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at March 31, 2016 (dollars in thousands):

Description	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
Commercial and industrial	\$ 482	Sales comparison	Appraiser adjustments on sales comparable data	0%-20%
		Management estimates	Management adjustments for depreciation in values depending on property types	65%
Equity loans and lines of credit	\$ 120	Sales comparison	Appraiser adjustments on sales comparable data	3%-22%
		Management estimates	Management adjustments for depreciation in values depending on property types	58%

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2015:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of December 31, 2015 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale securities				
Debt Securities:				
U.S. Government agencies	\$ 52,901	\$—	\$52,901	\$ —
Obligations of states and political subdivisions	188,268	—	188,268	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	225,259	—	225,259	—
Private label residential mortgage backed securities	3,590	—	3,590	—
Other equity securities	7,536	7,536	—	—
Total assets measured at fair value on a recurring basis	\$ 477,554	\$ 7,536	\$ 470,018	\$ —

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale investment securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the year ended December 31, 2015, no transfers between levels occurred.

There were no Level 3 assets measured at fair value on a recurring basis at or during the year ended December 31, 2015. Also there were no liabilities measured at fair value on a recurring basis at December 31, 2015.

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Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at December 31, 2015 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Impaired loans:				
Commercial:				
Commercial and industrial	\$ —	\$ —	—\$ —	—\$ —
Total commercial	—	—	—	—
Consumer:				
Equity loans and lines of credit	\$ 132	\$ —	—\$ —	—\$ 132
Total consumer	132	—	—	132
Total impaired loans	132	—	—	132
Total assets measured at fair value on a non-recurring basis	\$ 132	\$ —	—\$ —	—\$ 132

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method as prescribed by ASC Topic 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the year ended December 31, 2015.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$166,000 with a valuation allowance of \$34,000 at December 31, 2015, resulting in fair value of \$132,000. The valuation allowance represents specific allocations for the allowance for credit losses for impaired loans.

During the year ended December 31, 2015, there was no provision for credit losses related to loans carried at fair value. During the year ended December 31, 2015, there was no net charge-offs related to loans carried at fair value. There were no liabilities measured at fair value on a non-recurring basis at December 31, 2015.

Note 3. Investments

The investment portfolio consists primarily of U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations, private label residential mortgage backed securities (PLRMBS), and obligations of states and political subdivisions securities. As of March 31, 2016, \$114,784,000 of these securities were held as collateral for borrowing arrangements, public funds, and for other purposes.

The fair value of the available-for-sale investment portfolio reflected a net unrealized gain of \$13,553,000 at March 31, 2016 compared to an unrealized gain of \$7,474,000 at December 31, 2015. The unrealized gain recorded is net of \$5,578,000 and \$3,076,000 in tax liabilities as accumulated other comprehensive income within shareholders' equity at March 31, 2016 and December 31, 2015, respectively.

The following table sets forth the carrying values and estimated fair values of our investment securities portfolio at the dates indicated (in thousands):

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	March 31, 2016			
Available-for-Sale Securities	Amortized Cost	Gross Realized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$51,194	\$ 499	\$ (135)	\$ 51,558
Obligations of states and political subdivisions	204,242	10,611	(96)	214,757
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	223,234	1,990	(583)	224,641
Private label residential mortgage backed securities	2,255	1,119	—	3,374
Other equity securities	7,500	148	—	7,648
Total available-for-sale	\$488,425	\$ 14,367	\$ (814)	\$ 501,978

	December 31, 2015			
Available-for-Sale Securities	Amortized Cost	Gross Realized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government agencies	\$52,803	\$ 315	\$ (217)	\$ 52,901
Obligations of states and political subdivisions	181,785	6,779	(296)	188,268
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	225,636	1,042	(1,419)	225,259
Private label residential mortgage backed securities	2,356	1,234	—	3,590
Other equity securities	7,500	36	—	7,536
Total available-for-sale	\$470,080	\$ 9,406	\$ (1,932)	\$ 477,554

	December 31, 2015			
Held-to-Maturity Securities	Amortized Cost	Gross Realized Gains	Gross Unrecognized Losses	Estimated Fair Value
Debt securities:				
Obligations of states and political subdivisions	\$31,712	\$ 3,431	\$ (1)	\$ 35,142

Proceeds and gross realized gains (losses) from the sales or calls of investment securities for the periods ended