FIRST UNITED CORP/MD/
Form 10-Q
August 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For quarterly period ended June 30, 2015

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _______________ to ________________

Commission file number 0-14237

First United Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1380770
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

19 South Second Street, Oakland, Maryland	21550-0009
(Address of principal executive offices)	(Zip Code)

(800) 470-4356

(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 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R 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 R 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 definition 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 þ

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 6,254,620 shares of common stock, par value $.01 per share, as of July 31, 2015.

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FIRST UNITED CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST UNITED CORPORATION

Consolidated Statement of Financial Condition

(In thousands, except per share and percentage data)

	June 30, 2015 (Unaudited)	December 31, 2014
Assets		
Cash and due from banks	$54,913	$ 27,554
Interest bearing deposits in banks	2,991	7,897
Cash and cash equivalents	57,904	35,451
Investment securities – available-for-sale (at fair value)	205,226	221,117
Investment securities – held to maturity (fair value $108,417 at June 30, 2015 and $110,771 at December 31, 2014)	107,816	109,449
Restricted investment in bank stock, at cost	7,180	7,524
Loans	845,090	839,991
Allowance for loan losses	(11,809)	(12,065)
Net loans	833,281	827,926
Premises and equipment, net	25,108	25,629
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	39,559	33,504
Deferred tax assets	24,006	25,907
Other real estate owned	11,587	12,932
Accrued interest receivable and other assets	20,400	21,853
Total Assets	$1,343,071	$ 1,332,296
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$211,023	$ 201,188
Interest bearing deposits	792,072	780,135
Total deposits	1,003,095	981,323
Short-term borrowings	28,252	39,801
Long-term borrowings	177,572	182,606
Accrued interest payable and other liabilities	20,998	19,567
Total Liabilities	1,229,917	1,223,297
Shareholders' Equity:		

Preferred stock – no par value; Authorized 2,000 shares of which 30 shares of Series A, $1,000 per share liquidation preference, 5% cumulative increasing to 9% cumulative on February 15, 2014, were issued and outstanding on June 30, 2015 and December 31, 2014	30,000	30,000
Common Stock – par value $.01 per share; Authorized 25,000 shares; issued and outstanding 6,255 shares at June 30, 2015 and 6,228 at December 31, 2014	63	62
Surplus	21,892	21,795
Retained earnings	78,568	77,375
Accumulated other comprehensive loss	(17,369)	(20,233)
Total Shareholders' Equity	113,154	108,999
Total Liabilities and Shareholders' Equity	$1,343,071	$ 1,332,296

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Six Months Ended June 30,	
	2015	2014
	(Unaudited)	
Interest income		
Interest and fees on loans	$18,238	$18,697
Interest on investment securities		
Taxable	3,610	3,744
Exempt from federal income tax	668	804
Total investment income	4,278	4,548
Other	175	176
Total interest income	22,691	23,421
Interest expense		
Interest on deposits	2,058	2,335
Interest on short-term borrowings	28	30
Interest on long-term borrowings	2,936	3,197
Total interest expense	5,022	5,562
Net interest income	17,669	17,859
Provision for loan losses	126	941
Net interest income after provision for loan losses	17,543	16,918
Other operating income		
Net gains – other	5	961
Total net gains	5	961
Service charges	1,385	1,466
Trust department	2,770	2,568
Debit card income	1,008	987
Bank owned life insurance	555	488
Brokerage commissions	468	406
Other	218	221
Total other income	6,404	6,136
Total other operating income	6,409	7,097
Other operating expenses		
Salaries and employee benefits	10,258	9,703
FDIC premiums	930	882
Equipment	1,271	1,306
Occupancy	1,250	1,276
Data processing	1,709	1,576
Professional Services	905	853
Other real estate owned	1,047	1,614
Other	3,282	3,455

Total other operating expenses	20,652	20,665
Income before income tax expense	3,300	3,350
Provision for income tax expense	757	752
Net Income	2,543	2,598
Accumulated preferred stock dividends and discount accretion	(1,350)	(1,250)
Net Income Available to Common Shareholders	$1,193	$1,348
Basic and diluted net income per common share	$0.19	$0.22
Weighted average number of basic and diluted shares outstanding	6,243	6,217

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Three Months Ended June 30,	
	2015	2014
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 9,109	$ 9,359
Interest on investment securities		
Taxable	1,749	1,756
Exempt from federal income tax	323	393
Total investment income	2,072	2,149
Other	87	159
Total interest income	11,268	11,667
Interest expense		
Interest on deposits	1,017	1,168
Interest on short-term borrowings	14	16
Interest on long-term borrowings	1,462	1,543
Total interest expense	2,493	2,727
Net interest income	8,775	8,940
Provision for loan losses	52	577
Net interest income after provision for loan losses	8,723	8,363
Other operating income		
Net gains– other	102	1,024
Total net gains	102	1,024
Service charges	735	757
Trust department	1,389	1,316
Debit card income	510	530
Bank owned life insurance	288	245
Brokerage commissions	232	201
Other	110	83
Total other income	3,264	3,132
Total other operating income	3,366	4,156
Other operating expenses		
Salaries and employee benefits	5,276	5,018
FDIC premiums	471	491
Equipment	653	651
Occupancy	614	621
Data processing	872	794
Professional Services	614	508
Other real estate owned	415	1,157
Other	1,701	1,701

Total other operating expenses	10,616	10,941
Income before income tax expense	1,473	1,578
Provision for income tax expense	298	338
Net Income	1,175	1,240
Accumulated preferred stock dividends and discount accretion	(675)	(803)
Net Income Available to Common Shareholders	$ 500	$ 437
Basic and diluted net income per common share	$ 0.08	$ 0.07
Weighted average number of basic and diluted shares outstanding	6,249	6,222

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

Comprehensive Income (in thousands)	Six months ended June 30, 2015	2014
	(Unaudited)	
Net Income	$2,543	$2,598
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	2,816	3,042
Net unrealized gains on all other AFS securities	667	8,342
Net unrealized gains/(losses) on HTM securities	161	(2,372)
Net unrealized gains on cash flow hedges	35	111
Net unrealized (losses)/gains on pension	(836)	37
Net unrealized gains on SERP	21	1
Other comprehensive income, net of tax	2,864	9,161
Comprehensive income	$5,407	$11,759

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

Comprehensive Income (in thousands)	Three months ended June 30, 2015	2014
	(Unaudited)	

Net Income	$ 1,175	$ 1,240
Other comprehensive income/(loss), net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	1,246	408
Net unrealized (losses)/gains on all other AFS securities	(12)	5,306
Net unrealized gains/(losses) on HTM securities	91	(2,372)
Net unrealized gains on cash flow hedges	14	56
Net unrealized (losses)/gains on pension	(746)	164
Net unrealized gains on SERP	11	0
Other comprehensive income, net of tax	604	3,562
Comprehensive income	$ 1,779	$ 4,802

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
	(Unaudited)					
Balance at January 1, 2014	$29,994	$ 62	$21,661	$74,379	$ (24,213)	$ 101,883
Net income				5,597		5,597
Other comprehensive income					3,980	3,980
Stock based compensation			134			134
Preferred stock discount accretion	6			(6)		0
Preferred stock dividends paid				(2,595)		(2,595)
Balance at December 31, 2014	30,000	62	21,795	77,375	(20,233)	108,999
Net income				2,543		2,543
Other comprehensive income					2,864	2,864
Stock based compensation		1	97			98
Preferred stock dividends paid				(1,350)		(1,350)
Balance at June 30, 2015	$30,000	$ 63	$21,892	$78,568	$ (17,369)	$ 113,154

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Cash Flows

(In thousands)

	Six months ended June 30,	
	2015	2014
	(Unaudited)	
Operating activities		
Net income	$2,543	$2,598
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	126	941
Depreciation	872	994
Stock compensation	97	56
(Gain)/loss on sales of other real estate owned	(78)	970
Write-downs of other real estate owned	852	443
Gain on loan sales	(24)	(18)
Loss on disposal of fixed assets	2	3
Net amortization of investment securities discounts and premiums- AFS	296	64
Loss on sales of investment securities – available-for-sale	17	154
Gain on sales of investment securities – held for trading	0	(1,100)
Amortization of deferred loan fees	(232)	(218)
Decrease in accrued interest receivable and other assets	1,453	1,985
Decrease in deferred tax benefit	268	2
Increase/(decrease) in accrued interest payable and other liabilities	135	(5,354)
Earnings on bank owned life insurance	(555)	(488)
Net cash provided by operating activities	5,772	1,032
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	34,501	100,719
Proceeds from maturities/calls of investment securities held-to-maturity	3,949	1,509
Proceeds from sales of investment securities available-for-sale	24,667	56,222
Proceeds from sales of investment securities held for trading	0	1,100
Purchases of investment securities available-for-sale	(37,797)	(114,752)
Purchases of investment securities held-to-maturity	(2,316)	(1,256)
Proceeds from sales of other real estate owned	1,336	4,745
Proceeds from loan sales	2,769	2,104
Proceeds from disposal of fixed assets	6	0
Purchase of BOLI policy	(5,500)	0
Net decrease in FHLB stock	344	433
Net increase in loans	(8,759)	(20,253)
Purchases of premises and equipment	(359)	(404)
Net cash provided by investing activities	12,841	30,167

Financing activities		
Net increase in deposits	21,772	1,337
Preferred stock dividends paid	(1,350)	(7,745)
Common Stock Grants	1	0
Net decrease in short-term borrowings	(11,549)	(5,763)
Payments on long-term borrowings	(5,034)	(32)
Net cash provided by/(used in) financing activities	3,840	(12,203)
Increase in cash and cash equivalents	22,453	18,996
Cash and cash equivalents at beginning of the year	35,451	43,063
Cash and cash equivalents at end of period	$57,904	$62,059
Supplemental information		
Interest paid	$5,056	$12,327
Non-cash investing activities:		
Transfers from loans to other real estate owned	$765	$1,415
Transfers from securities available for sale to held-to-maturity	$0	$103,934

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

NoteS to Consolidated Financial Statements (UNAUDITED)

Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of First United Corporation and its consolidated subsidiaries, including First United Bank & Trust (the "Bank"), have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information, as required by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 270, *Interim Reporting*, and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all the information and footnotes required for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring items, have been included. Operating results for the six- and three-month periods ended June 30, 2015 are not necessarily indicative of the results that may be expected for the full year or for any future interim period. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2014. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2015 presentation. Such reclassifications had no impact on net income or equity.

First United Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of June 30, 2015 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, *Subsequent Events*.

As used in these notes to consolidated financial statements, First United Corporation and its consolidated subsidiaries are sometimes collectively referred to as the "Corporation".

Note 2 – Earnings Per Common Share

Basic earnings per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is derived by dividing net income available to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. There is no dilutive effect on earnings per share during loss periods.

The following tables set forth the calculation of basic and diluted earnings per common share for the six- and three-month periods ended June 30, 2015 and 2014:

	Six months ended June 30,					
	2015			2014		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$2,543			$2,598		
Preferred stock dividends	(1,350)			(1,244)		
Discount accretion on preferred stock	0			(6)		
Net income available to common shareholders	$1,193	6,243	$ 0.19	$1,348	6,217	$ 0.22

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	Three months ended June 30,					
	2015			2014		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$1,175			$1,240		
Preferred stock dividends deferred	(675)			(803)		
Discount accretion on preferred stock	0			0		
Net income available to common shareholders	$500	6,249	$ 0.08	$437	6,222	$ 0.07

Note 3 – Net Gains

The following table summarizes the gain/(loss) activity for the six- and three-month periods ended June 30, 2015 and 2014:

	Six months ended June 30,		Three months ended June 30,	
(in thousands)	2015	2014	2015	2014
Net gains – other:				
Available-for-sale securities:				
Realized gains	$ 156	$ 205	$ 140	$ 110
Realized losses	(173)	(359)	(60)	(196)
Held-for-trading:				
Realized gains	0	1,100	0	1,100
Gain on sale of consumer loans	24	18	22	10
Loss on disposal of fixed assets	(2)	(3)	0	0
Net gains – other	$ 5	$ 961	$ 102	$ 1,024

Note 4 – Cash and Cash Equivalents

Cash and due from banks, which represents vault cash in the retail offices and invested cash balances at the Federal Reserve and other correspondent banks, is carried at cost which approximates fair value.

(in thousands)	June 30, 2015	December 31, 2014
Cash and due from banks, weighted average interest rate of 0.09% (at June 30, 2015)	$54,913	$ 27,554

Interest bearing deposits in banks, which represent funds invested at a correspondent bank, are carried at cost which approximates fair value and, as of June 30, 2015 and December 31, 2014, consisted of daily funds invested at the Federal Home Loan Bank ("FHLB") of Atlanta, First Tennessee Bank ("FTN"), and Merchants and Traders ("M&T").

(in thousands)	June 30, 2015	December 31, 2014
FHLB daily investments, interest rate of 0.005% (at June 30, 2015)	$ 1,130	$ 983
FTN daily investments, interest rate of 0.08% (at June 30, 2015)	850	850
M&T daily investments, interest rate of 0.15% (at June 30, 2015)	1,011	6,064
	$ 2,991	$ 7,897

Note 5 – Investments

The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The amortized cost of debt securities classified as available-for-sale is adjusted for the amortization of premiums to the first call date, if applicable, or to maturity, and for the accretion of discounts to maturity, or, in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from investments. Interest and dividends are included in interest income from investments. Gains and losses on the sale of securities are recorded using the specific identification method.

The following table shows a comparison of amortized cost and fair values of investment securities at June 30, 2015 and December 31, 2014:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCI
June 30, 2015					
Available for Sale:					
U.S. treasuries	$ 10,059	$ 16	$ 0	$ 10,075	$ 0
U.S. government agencies	44,056	182	143	44,095	0
Residential mortgage-backed agencies	20,073	158	268	19,963	0
Commercial mortgage-backed agencies	42,795	171	100	42,866	0
Collateralized mortgage obligations	13,170	100	91	13,179	0
Obligations of states and political subdivisions	44,343	1,103	444	45,002	0
Collateralized debt obligations	35,563	3,298	8,815	30,046	1,460
Total available for sale	$ 210,059	$ 5,028	$ 9,861	$ 205,226	$ 1,460
Held to Maturity:					
U.S. government agencies	$ 24,611	$ 306	$ 33	$ 24,884	$ 0
Residential mortgage-backed agencies	55,616	195	121	55,690	0
Commercial mortgage-backed agencies	18,215	287	0	18,502	0
Collateralized mortgage obligations	6,749	0	140	6,609	0
Obligations of states and political subdivisions	2,625	107	0	2,732	0
Total held to maturity	$ 107,816	$ 895	$ 294	$ 108,417	$ 0
December 31, 2014					
Available for Sale:					
U.S. treasuries	$ 29,607	$ 0	$ 11	$ 29,596	$ 0
U.S. government agencies	39,077	117	253	38,941	0

Residential mortgage-backed agencies	45,175	510	412	45,273	0
Commercial mortgage-backed agencies	26,007	53	103	25,957	0
Collateralized mortgage obligations	8,611	96	0	8,707	0
Obligations of states and political subdivisions	46,151	1,413	260	47,304	0
Collateralized debt obligations	37,117	1,155	12,933	25,339	6,143
Total available for sale	$ 231,745	$ 3,344	$ 13,972	$ 221,117	$ 6,143
Held to Maturity:					
U.S. government agencies	$ 24,520	$ 514	$ 0	$ 25,034	$ 0
Residential mortgage-backed agencies	58,400	613	5	59,008	0
Commercial mortgage-backed agencies	16,425	312	0	16,737	0
Collateralized mortgage obligations	7,379	5	0	7,384	0
Obligations of states and political subdivisions	2,725	0	117	2,608	0
Total held to maturity	$ 109,449	$ 1,444	$ 122	$ 110,771	$ 0

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Proceeds from sales of available for sale securities and the realized gains and losses are as follows:

(in thousands)	Six months ended June 30, 2015	2014	Three months ended June 30, 2015	2014
Proceeds	$24,667	$56,222	$ 9,578	$ 47,637
Realized gains	156	1,305	140	1,210
Realized losses	173	359	60	196

The following table shows the Corporation's investment securities with gross unrealized losses and fair values at June 30, 2015 and December 31, 2014, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months		12 months or more	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2015				
Available for Sale:				
U.S. treasuries	$ 0	$ 0	$0	$ 0
U.S. government agencies	13,963	102	9,959	41
Residential mortgage-backed agencies	0	0	8,437	268
Commercial mortgage-backed agencies	23,311	100	0	0
Collateralized mortgage obligations	5,701	91	0	0
Obligations of states and political subdivisions	14,531	290	4,860	154
Collateralized debt obligations	0	0	22,641	8,815
Total available for sale	$ 57,506	$ 583	$45,897	$ 9,278
Held to Maturity:				
U.S. government agencies	$ 6,985	$ 33	$0	$ 0
Residential mortgage-backed agencies	23,233	121	0	0
Collateralized mortgage obligations	6,609	140	0	0
Total held to maturity	$ 36,827	$ 294	$0	$ 0
December 31, 2014				
Available for Sale:				
U.S. treasuries	$ 27,096	$ 11	$0	$ 0
U.S. government agencies	0	$ 0	$18,819	$ 253
Residential mortgage-backed agencies	0	0	17,918	412
Commercial mortgage-backed agencies	12,298	97	973	6
Obligations of states and political subdivisions	0	0	8,981	260
Collateralized debt obligations	0	0	20,290	12,933
Total available for sale	$ 39,394	$ 108	$66,981	$ 13,864
Held to Maturity:				

U.S. government agencies	$ 0	$ 0	$0	$ 0
Residential mortgage-backed agencies	3,850	5	0	0
Obligations of states and political subdivisions	0	0	2,608	117
Total held to maturity	$ 3,850	$ 5	$2,608	$ 117

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Management systematically evaluates securities for impairment on a quarterly basis. Management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other-than-temporary impairment ("OTTI") losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). Further discussion about the evaluation of securities for impairment can be found in Item 2 of Part I of this report under the heading "*Investment Securities*".

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of the Corporation's consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for the Corporation's collateralized debt obligation ("CDO") portfolio consisting of pooled trust preferred securities. Based on management's review of the assumptions and results of the third-party review, it does not believe that there were any material differences in the valuations between December 31, 2014 and June 30, 2015.

U.S. Treasuries – Available for Sale – As of June 30, 2015, there were no securities issued by the U.S. Treasury that were in a loss position.

U.S. Government Agencies – Available for Sale – There were three U.S. government agencies in an unrealized loss position for less than 12 months as of June 30, 2015. There was one U.S. government agency in an unrealized loss position for 12 months or more. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell it before recovery of its amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at June 30, 2015.

Residential Mortgage-Backed Agencies – Available for Sale - There were no residential mortgage-backed agencies in an unrealized loss position for less than 12 months as of June 30, 2015. There was one residential mortgage-backed agency security in an unrealized loss position for 12 months or more. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, which may be at maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at June 30, 2015.

Commercial Mortgage-Backed Agencies – Available for Sale – There were five commercial mortgage-backed agencies in an unrealized loss position for less than 12 months as of June 30, 2015. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2015. There were no commercial mortgage-backed agency securities in an unrealized loss position for 12 months or more.

Collateralized Mortgage Obligations – Available for Sale – There was one collateralized mortgage obligations in an unrealized loss position for less than 12 months as of June 30, 2015. The security is of the highest investment grade and the Corporation does not intend to sell it, and it is not more likely than not that the Corporation will be required to sell it before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2015. There were no collateralized mortgage obligations in an unrealized loss position for 12 months or more.

Obligations of State and Political Subdivisions – Available for Sale – There were ten obligations of state and political subdivisions that have been in an unrealized loss position for less than 12 months at June 30, 2015. There was one security that had been in an unrealized loss position for 12 months or more. These investments are of investment grade as determined by the major rating agencies and management reviews the ratings of the underlying issuers and performs an in-depth credit analysis on the securities. Management believes that this portfolio is well-diversified throughout the United States, and all bonds continue to perform according to their contractual terms. The Corporation does not intend to sell these investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2015.

Collateralized Debt Obligations – Available for Sale - The $8.8 million in unrealized losses greater than 12 months at June 30, 2015 relates to 13 pooled trust preferred securities that are included in the CDO portfolio. See Note 9 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during the first six months of 2015. The unrealized losses on the remaining securities in the portfolio are primarily attributable to continued depression in market interest rates, marketability, liquidity and the current economic environment.

U.S. Government Agencies – Held to Maturity – There was one security issued by government agencies in an unrealized loss position for less than 12 months as of June 30, 2015. The Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at June 30, 2015. There were no securities issued by government agencies in an unrealized loss position for 12 months or more.

Residential Mortgage-Backed Agencies – Held to Maturity - Twelve residential mortgage-backed agencies have been in an unrealized loss position for less than 12 months as of June 30, 2015. The Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2015. There were no residential mortgage-backed agencies in an unrealized loss position for 12 months or more.

Commercial Mortgage-Backed Agencies – Held to Maturity - There were no commercial mortgage-backed agencies in the Held to Maturity portfolio as of June 30, 2015 in a loss position.

Collateralized Mortgage Obligations – Held to Maturity – There was one collateralized mortgage obligations in an unrealized loss position for less than 12 months as of June 30, 2015. The Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at June 30, 2015. There were no collateralized mortgage obligations in an unrealized loss position for 12 months or more.

Obligations of State and Political Subdivisions – Held to Maturity – There were no obligations of state and political subdivisions in the Held to Maturity portfolio as of June 30, 2015 in a loss position.

The following tables present a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the six- and three-month periods ended June 30, 2015 and 2014:

	Six months ended June 30,	
(in thousands)	2015	2014
Balance of credit-related OTTI at January 1	$ 12,583	$ 13,422
Reduction for increases in cash flows expected to be collected	(340)	(331)
Balance of credit-related OTTI at June 30	$ 12,243	$ 13,091

	Three months ended June 30,	
(in thousands)	2015	2014
Balance of credit-related OTTI at April 1	$ 12,416	$ 13,262
Reduction for increases in cash flows expected to be collected	(173)	(171)
Balance of credit-related OTTI at June 30	$ 12,243	$ 13,091

The amortized cost and estimated fair value of securities by contractual maturity at June 30, 2015 are shown in the following table. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2015	
(in thousands)	Amortized Cost	Fair Value
Contractual Maturity		
Available for sale:		
Due in one year or less	$0	$0
Due after one year through five years	53,470	53,689
Due after five years through ten years	20,615	21,236
Due after ten years	59,936	54,293
	134,021	129,218
Residential mortgage-backed agencies	20,073	19,963
Commercial mortgage-backed agencies	42,795	42,866
Collateralized mortgage obligations	13,170	13,179
	$210,059	$205,226
Held to Maturity:		
Due after five years through ten years	$15,538	$15,799
Due after ten years	11,698	11,817
	27,236	27,616
Residential mortgage-backed agencies	55,616	55,690
Commercial mortgage-backed agencies	18,215	18,502
Collateralized mortgage obligations	6,749	6,609

$107,816	$108,417

Note 6 - Restricted Investment in Bank Stock

Restricted stock, which represents required investments in the common stock of the FHLB of Atlanta, Atlantic Community Bankers Bank ("ACBB") and Community Bankers Bank ("CBB"), is carried at cost and is considered a long-term investment.

Management evaluates the restricted stock for impairment in accordance with ASC Industry Topic 942, *Financial Services – Depository and Lending*, (ASC Section 942-325-35). Management's evaluation of potential impairment is based on management's assessment of the ultimate recoverability of the cost of the restricted stock rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (a) the significance of the decline in net assets of the issuing bank as compared to the capital stock amount for that bank and the length of time this situation has persisted, (b) commitments by the issuing bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of that bank, and (c) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuing bank. Management has evaluated the restricted stock for impairment and believes that no impairment charge is necessary as of June 30, 2015.

The Corporation recognizes dividends received on its restricted stock investments on a cash basis. For the six months ended June 30, 2015, dividends of $155,668 were recognized in earnings. For the comparable period of 2014, dividends of $144,336 were recognized in earnings. For the three months ended June 30, 2015 and 2014, dividends of $76,511 and $71,338, respectively, were recognized in earnings.

Note 7 – Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio as of June 30, 2015 and December 31, 2014:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
June 30, 2015						
Individually evaluated for impairment	$ 12,598	$ 5,892	$ 1,474	$ 4,620	$ 0	$ 24,584
Collectively evaluated for impairment	$ 248,577	$ 88,981	$ 92,057	$ 366,335	$ 24,556	$ 820,506
Total loans	$ 261,175	$ 94,873	$ 93,531	$ 370,955	$ 24,556	$ 845,090
December 31, 2014						
Individually evaluated for impairment	$ 11,949	$ 6,553	$ 1,861	$ 4,418	$ 0	$ 24,781
Collectively evaluated for impairment	$ 244,115	$ 92,748	$ 91,394	$ 363,223	$ 23,730	$ 815,210
Total loans	$ 256,064	$ 99,301	$ 93,255	$ 367,641	$ 23,730	$ 839,991

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate ("CRE") loan segment is then segregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied, non-farm, and nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The acquisition and development ("A&D") loan segment is segregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. A&D loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan is made. The commercial and industrial ("C&I") loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is segregated into two classes. Amortizing term loans are primarily first lien loans. Home equity lines of credit are generally second lien loans. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

Management uses a 10-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of a specific allocation of the allowance for loan losses that management believes is associated with a pending event that could trigger loss in the short-term will be classified in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in the commercial segments at origination and on an ongoing basis. The Bank's experienced Credit Quality and Loan Review Department performs an annual review of all commercial relationships of $500,000 or greater. Confirmation of the appropriate risk grade is included as part of the review process on an ongoing basis. The Credit Quality and Loan Review Department continually reviews and assesses loans within the portfolio. In addition, the Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than $1,000,000 and/or criticized non-consumer loans greater than $500,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard within the internal risk rating system as of June 30, 2015 and December 31, 2014:

(in thousands)	Pass	Special Mention	Substandard	Total
June 30, 2015				
Commercial real estate				
Non owner-occupied	$118,276	$ 11,754	$ 11,002	$141,032
All other CRE	92,069	9,397	18,677	120,143
Acquisition and development				
1-4 family residential construction	15,232	0	700	15,932
All other A&D	72,030	78	6,833	78,941
Commercial and industrial	89,473	688	3,370	93,531
Residential mortgage				
Residential mortgage - term	285,546	246	10,378	296,170
Residential mortgage - home equity	73,438	49	1,298	74,785
Consumer	24,519	0	37	24,556
Total	$770,583	$ 22,212	$ 52,295	$845,090
December 31, 2014				
Commercial real estate				
Non owner-occupied	$115,276	$ 10,884	$ 11,273	$137,433
All other CRE	90,740	8,618	19,273	118,631
Acquisition and development				
1-4 family residential construction	12,920	0	790	13,710
All other A&D	72,323	1,356	11,912	85,591
Commercial and industrial	88,579	884	3,792	93,255
Residential mortgage				
Residential mortgage - term	280,113	379	10,934	291,426

Residential mortgage - home equity	74,698	90	1,427	76,215
Consumer	23,658	0	72	23,730
Total	$758,307	$ 22,211	$ 59,473	$839,991

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Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment remains unpaid 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans as of June 30, 2015 and December 31, 2014:

(in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and Accruing	Non-Accrual	Total Loans
June 30, 2015							
Commercial real estate							
Non owner-occupied	$136,368	$ 199	$ 2,820	$ 0	$3,019	$ 1,645	$ 141,032
All other CRE	115,151	47	0	0	47	4,945	120,143
Acquisition and development							
1-4 family residential construction	15,932	0	0	0	0	0	15,932
All other A&D	75,799	0	110	20	130	3,012	78,941
Commercial and industrial	93,242	120	0	0	120	169	93,531
Residential mortgage							
Residential mortgage - term	291,279	512	2,240	392	3,144	1,747	296,170
Residential mortgage - home equity	73,855	441	125	0	566	364	74,785
Consumer	24,291	208	54	3	265	0	24,556
Total	$825,917	$ 1,527	$ 5,349	$ 415	$7,291	$ 11,882	$ 845,090
December 31, 2014							
Commercial real estate							
Non owner-occupied	$135,994	$ 104	$ 183	$ 0	$287	$ 1,152	$ 137,433
All other CRE	112,825	1,196	0	0	1,196	4,610	118,631
Acquisition and development							
1-4 family residential construction	13,710	0	0	0	0	0	13,710
All other A&D	81,702	239	40	1	280	3,609	85,591
Commercial and industrial	93,060	0	20	4	24	171	93,255
Residential mortgage							
Residential mortgage - term	279,340	8,654	1,350	416	10,420	1,666	291,426
	74,913	577	313	69	959	343	76,215

Residential mortgage - home equity							
Consumer	23,316	287	88	39	414	0	23,730
Total	$814,860	$ 11,057	$ 1,994	$ 529	$ 13,580	$ 11,551	$ 839,991

Non-accrual loans which have been subject to a partial charge-off totaled $5.0 million as of June 30, 2015, compared to $4.6 million as of December 31, 2014. Loans secured by 1-4 family residential real estate properties in the process of foreclosure were $2.1 million at June 30, 2015 and $1.9 million at December 31, 2014.

An allowance for loan losses ("ALL") is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the allocated portion of the Bank's ALL. In the second quarter of 2015, management determined that it would be prudent to establish an unallocated portion of the ALL to protect the Bank from other risks associated with the loan portfolio that may not be specifically identifiable.

The following table summarizes the primary segments of the ALL, segregated by the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of June 30, 2015 and December 31, 2014:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
June 30, 2015							
Individually evaluated for impairment	$ 30	$ 1,052	$ 0	$ 84	$ 0	$ 0	$1,166
Collectively evaluated for impairment	$ 2,536	$ 2,754	$ 1,007	$ 3,623	$ 223	$ 500	$10,643
Total ALL	$ 2,566	$ 3,806	$ 1,007	$ 3,707	$ 223	$ 500	$11,809
December 31, 2014							
Individually evaluated for impairment	$ 36	$ 1,141	$ 0	$ 59	$ 0	$ 0	$1,236
Collectively evaluated for impairment	$ 2,388	$ 2,771	$ 1,680	$ 3,803	$ 187	$ 0	$10,829
Total ALL	$ 2,424	$ 3,912	$ 1,680	$ 3,862	$ 187	$ 0	$12,065

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan (a) is greater than $500,000 or (b) is part of a relationship that is greater than $750,000 and is either (i) in nonaccrual status or (ii) risk-rated Substandard and greater than 60 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Bank does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired; otherwise, loans in these segments are considered impaired when they are classified as non-accrual.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan’s effective interest rate; (b) the loan’s observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. If the fair value of the collateral less selling costs method is utilized for collateral securing loans in the commercial segments, then an updated external appraisal is ordered on the collateral supporting the loan if the loan balance is greater than $500,000 and the existing appraisal is greater than 18 months old. If an updated appraisal has not been received and reviewed in time for the determination of estimated fair value at quarter (or year) end, or if the appraisal is found to be deficient following the Corporation’s internal appraisal review process and re-ordered, then the estimated fair value of the collateral is determined by adjusting the existing appraisal by the appropriate percentage from an internally prepared appraisal discount grid. This grid considers the age of a third party appraisal and the geographic region where the collateral is located. The discount rates in the appraisal discount grid are updated periodically to reflect the most current knowledge that management has available, including the results of current appraisals. A specific allocation of the ALL is recorded if there is any deficiency in collateral value determined by comparing the estimated fair value to the recorded investment of the loan. When updated appraisals are received and reviewed, adjustments are made to the specific allocation as needed.

The evaluation of the need and amount of a specific allocation of the ALL and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of June 30, 2015 and December 31, 2014:

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
(in thousands)	Recorded Investment	Related Allowances	Recorded Investment	Recorded Investment	Unpaid Principal Balance
June 30, 2015					
Commercial real estate					
Non owner-occupied	$ 138	$ 30	$ 4,492	$ 4,630	$ 4,640
All other CRE	0	0	7,968	7,968	8,459
Acquisition and development					
1-4 family residential construction	700	68	0	700	746
All other A&D	4,472	984	720	5,192	8,933
Commercial and industrial	0	0	1,474	1,474	2,336
Residential mortgage					
Residential mortgage - term	298	84	3,958	4,256	4,622
Residential mortgage – home equity	0	0	364	364	385
Consumer	0	0	0	0	0
Total impaired loans	$ 5,608	$ 1,166	$ 18,976	$ 24,584	$ 30,121
December 31, 2014					
Commercial real estate					
Non owner-occupied	$ 143	$ 35	$ 4,353	$ 4,496	$ 4,543
All other CRE	0	0	7,453	7,453	7,944
Acquisition and development					
1-4 family residential construction	790	105	0	790	836
All other A&D	3,615	1,037	2,148	5,763	9,590
Commercial and industrial	0	0	1,861	1,861	2,723
Residential mortgage					
Residential mortgage – term	296	59	3,779	4,075	4,485
Residential mortgage – home equity	0	0	343	343	363
Consumer	0	0	0	0	0
Total impaired loans	$ 4,844	$ 1,236	$ 19,937	$ 24,781	$ 30,484

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity (full and partial charge-offs, net of full and partial recoveries) at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. Consumer pools currently utilize a rolling 12 quarters, while Commercial pools currently utilize a rolling eight quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. “Pass” pools for commercial and residential real estate are further segmented based upon the geographic location of the underlying collateral. There are seven geographic regions utilized – six that represent the Bank’s lending footprint and a seventh for all out-of-market credits. Different economic environments and resultant credit risks exist in each region that are acknowledged in the assignment of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Management supplements the historical charge-off factor with a number of additional qualitative factors that are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors, which are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources, are: (a) national and local economic trends and conditions; (b) levels of and trends in delinquency rates and non-accrual loans; (c) trends in volumes and terms of loans; (d) effects of changes in lending policies; (e) experience, ability, and depth of lending staff; (f) value of underlying collateral; and (g) concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Residential mortgage and consumer loans are charged off after they are 120 days contractually past due. All other loans are charged off based on an evaluation of the facts and circumstances of each individual loan. When the Bank believes that its ability to collect is solely dependent on the liquidation of the collateral, a full or partial charge-off is recorded promptly to bring the recorded investment to an amount that the Bank believes is supported by an ability to collect on the collateral. The circumstances that may impact the Bank’s decision to charge-off all or a portion of a loan include default or non-payment by the borrower, scheduled foreclosure actions, and/or prioritization of the Bank’s claim in bankruptcy. There may be circumstances where, due to pending events, the Bank will place a specific allocation of the ALL on a loan for which a partial charge-off has been previously recognized. This specific allocation may be either charged off or removed depending upon the outcome of the pending event. Full or partial charge-offs are not recovered until full principal and interest on the loan have been collected, even if a subsequent appraisal supports a higher value. Loans with partial charge-offs generally remain in non-accrual status. Both full and partial charge-offs reduce the recorded investment of the loan and the ALL and are considered to be charge-offs for purposes of all credit loss metrics and trends, including the historical rolling charge-off rates used in the determination of the ALL. At June 30, 2015, $.5 million of the ALL was considered to be unallocated.

The following tables present the activity in the ALL for the six- and three-month periods ended June 30, 2015 and 2014:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at January 1, 2015	$ 2,424	$ 3,912	$ 1,680	$ 3,862	$ 187	$ 0	$ 12,065
Charge-offs	(287)	(256)	0	(36)	(174)	0	(753)
Recoveries	65	41	20	133	112	0	371
Provision	364	109	(693)	(252)	98	500	126
ALL balance at June 30, 2015	$ 2,566	$ 3,806	$ 1,007	$ 3,707	$ 223	$ 500	$ 11,809
ALL balance at January 1, 2014	$ 4,052	$ 4,172	$ 766	$ 4,320	$ 284	$ 0	$ 13,594
Charge-offs	(21)	(1,520)	(208)	(566)	(263)	0	(2,578)
Recoveries	10	71	7	156	262	0	506
Provision	(1,202)	919	988	268	(32)	0	941
ALL balance at June 30, 2014	$ 2,839	$ 3,642	$ 1,553	$ 4,178	$ 251	$ 0	$ 12,463

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at April 1, 2015	$ 2,576	$ 3,692	$ 1,477	$ 3,790	$ 216	$ 0	$ 11,751
Charge-offs	0	(25)	0	(73)	(78)	0	(176)
Recoveries	62	26	13	28	53	0	182
Provision	(72)	113	(483)	(38)	32	500	52
ALL balance at June 30, 2015	$ 2,566	$ 3,806	$ 1,007	$ 3,707	$ 223	$ 500	$ 11,809
ALL balance at April 1, 2014	$ 3,399	$ 3,896	$ 1,070	$ 3,962	$ 245	$ 0	$ 12,572
Charge-offs	0	(701)	(56)	(98)	(84)	0	(939)
Recoveries	0	59	4	107	83	0	253
Provision	(560)	388	535	207	7	0	577
ALL balance at June 30, 2014	$ 2,839	$ 3,642	$ 1,553	$ 4,178	$ 251	$ 0	$ 12,463

The ALL is based on estimates, and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following tables present the average recorded investment in impaired loans by class and related interest income recognized for the periods indicated:

(in thousands)	Six Months Ended June 30, 2015 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Six Months Ended June 30, 2014 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$4,224	$ 78	$ 0	$1,105	$ 11	$ 0
All other CRE	7,533	55	8	9,936	81	44
Acquisition and development						
1-4 family residential construction	760	18	0	1,919	25	0
All other A&D	5,417	63	0	8,567	96	0
Commercial and industrial	1,617	47	18	2,126	49	2
Residential mortgage						
Residential mortgage - term	4,146	82	2	6,648	107	52
Residential mortgage – home equity	373	0	2	686	4	1
Consumer	7	0	0	11	0	0
Total	$24,077	$ 343	$ 30	$30,998	$ 373	$ 99

(in thousands)	Three months ended June 30, 2015 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Three months ended June 30, 2014 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$4,088	$ 38	$ 0	$1,068	$ 4	$ 0
All other CRE	7,574	28	7	9,624	40	43
Acquisition and development						
1-4 family residential construction	746	9	0	1,549	11	0
All other A&D	5,245	31	0	8,329	35	0
Commercial and industrial	1,495	24	18	2,040	23	0
Residential mortgage						
Residential mortgage - term	4,181	42	2	6,489	53	43
Residential mortgage – home equity	388	0	2	739	1	0
Consumer	7	0	0	0	0	0

Total	$23,724	$ 172	$ 29	$29,838	$ 167	$ 86

In the normal course of business, the Bank modifies loan terms for various reasons. These reasons may include as a retention strategy, remaining competitive in the current interest rate environment, and re-amortizing or extending a loan term to better match the loan's payment stream with the borrower's cash flows. A modified loan is considered to be a troubled debt restructuring ("TDR") when the Bank has determined that the borrower is troubled (i.e., experiencing financial difficulties). The Bank evaluates the probability that the borrower will be in payment default on any of its debt obligations in the foreseeable future without modification. To make this determination, the Bank performs a global financial review of the borrower and loan guarantors to assess their current ability to meet their financial obligations.

When the Bank restructures a loan to a troubled borrower, the loan terms (i.e., interest rate, payment amount, amortization period, and/or maturity date) are modified in such a way as to enable the borrower to cover the modified debt service payments based on current financials and cash flow adequacy. If a borrower's hardship is thought to be temporary, then modified terms are only offered for that time period. Where possible, the Bank obtains additional collateral and/or secondary payment sources at the time of the restructure in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. To date, the Bank has not forgiven any principal as a restructuring concession. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default.

All loans designated as TDRs are considered impaired loans and may be in either accruing or non-accruing status. The Bank's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition. Accordingly, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. If the loan was accruing at the time of the modification, then it continues to be in accruing status subsequent to the modification. Non-accrual TDRs may return to accruing status when there has been sufficient payment performance for a period of at least six months. TDRs are considered to be in payment default if, subsequent to modification, the loans are transferred to non-accrual status or to foreclosure. Loans may be removed from being reported as a TDR in the calendar year following the modification if the interest rate at the time of modification was consistent with the interest rate for a loan with comparable credit risk and the loan has performed according to its modified terms for at least six months.

The volume and type of TDR activity is considered in the assessment of the local economic trends' qualitative factor used in the determination of the ALL for loans that are evaluated collectively for impairment.

The following tables present the volume and recorded investment at the time of modification of TDRs by class and type of modification that occurred during the periods indicated:

(in thousands)	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Six Months Ended June 30, 2015						
Commercial real estate						
Non owner-occupied	0	$ 0	1	$ 3,097	1	$ 136
All other CRE	0	0	1	237	5	3,847
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	3	372	0	0
Commercial and industrial	0	0	1	930	0	0
Residential mortgage						
Residential mortgage – term	0	0	2	599	1	116
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	8	$ 5,235	7	$ 4,099

(in thousands)	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Three months ended June 30, 2015						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	0	$ 0
All other CRE	0	0	1	237	0	0
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	0	0	0	0
Commercial and industrial	0	0	1	930	0	0
Residential mortgage						
Residential mortgage – term	0	0	0	0	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	2	$ 1,167	0	$ 0

During the six months ended June 30, 2015, there were seven new TDRs. In addition, eight existing TDRs which had reached their original modification maturity were re-modified. A $4,324 reduction of the ALL resulted from a change to the impairment evaluation of one loan from evaluated collectively to being evaluated individually. The remaining six new TDRs were impaired at the time of modification, resulting in no impact to the ALL as a result of the modifications and there was no impact to the recorded investment relating to the transfer of these loans.

During the quarter ended June 30, 2015, one residential mortgage loan totaling $70,000 that was modified as a TDR within the previous 12 months was transferred to non-accrual, and is considered a payment default. There were no payment defaults in the quarter ended March 31, 2015.

(in thousands)	Temporary Rate Modification Number of Contracts	Temporary Rate Modification Recorded Investment	Extension of Maturity Number of Contracts	Extension of Maturity Recorded Investment	Modification of Payment and Other Terms Number of Contracts	Modification of Payment and Other Terms Recorded Investment
Six Months Ended June 30, 2014						
Commercial real estate						
Non owner-occupied	0	$ 0	2	$ 277	0	$ 0
All other CRE	0	0	0	0	4	2,627
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	0	0	0	0
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	1	90	0	0	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	1	$ 90	2	$ 277	4	$ 2,627

(in thousands)	Temporary Rate Modification Number of Contracts	Temporary Rate Modification Recorded Investment	Extension of Maturity Number of Contracts	Extension of Maturity Recorded Investment	Modification of Payment and Other Terms Number of Contracts	Modification of Payment and Other Terms Recorded Investment
Three Months Ended June 30, 2014						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	0	$ 0
All other CRE	0	0	0	0	3	2,173
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	0	0	0	0
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	0	0	0	0	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	0	$ 0	3	$ 2,173

During the six months ended June 30, 2014, there were two new TDRs. In addition, five existing TDRs which had reached their original modification maturity were re-modified. A $1,055 reduction of the ALL resulted from a change to the impairment evaluation of one loan, from evaluated collectively to being evaluated individually. The remaining new TDR was impaired at the time of modification, resulting in no impact to the ALL as a result of the modifications and there was no impact to the recorded investment relating to the transfer of these loans.

During the quarter ended March 31, 2014, one A&D loan totaling $1.4 million that was modified as a TDR within the previous 12 months was transferred to non-accrual, and is considered a payment default. There were no payment defaults in the quarter ended June 30, 2014.

Note 8 - Other Real Estate Owned

The following table presents the components of Other Real Estate Owned ("OREO") as of June 30, 2015 and December 31, 2014:

(in thousands)	June 30, 2015	December 31, 2014
Commercial real estate	$ 1,957	$ 1,772
Acquisition and development	7,792	9,263
Residential mortgage	1,838	1,897
Total OREO	$ 11,587	$ 12,932

The following table presents the activity in the OREO valuation allowance for the six- and three-month periods ended June 30, 2015 and 2014:

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
(in thousands)	2015	2014	2015	2014
Balance January 1	$ 3,440	$ 4,047	$ 3,765	$ 3,670
Fair value write-down	852	443	346	72
Sales of OREO	(449)	(748)	(268)	0
Balance at end of period	$ 3,843	$ 3,742	$ 3,843	$ 3,742

The following table presents the components of OREO expenses, net for the six- and three-month periods ended June 30, 2015 and 2014:

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
(in thousands)	2015	2014	2015	2014
Gains on real estate, net	$ (78)	$ 970	$ (51)	$ 995
Fair value write-down, net	852	443	346	72
Expenses, net	456	357	249	169
Rental and other income	(183)	(156)	(129)	(79)
Total OREO expense, net	$ 1,047	$ 1,614	$ 415	$ 1,157

Note 9 – Fair Value of Financial Instruments

The Corporation complies with the guidance of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. The Corporation also follows the guidance on matters relating to all financial instruments found in ASC Subtopic 825-10, *Financial Instruments – Overall*.

Fair value is defined as the price to sell an asset or to transfer a liability in an orderly transaction between willing market participants as of the measurement date. Fair value is best determined by values quoted through active trading markets. Active trading markets are characterized by numerous transactions of similar financial instruments between willing buyers and willing sellers. Because no active trading market exists for various types of financial instruments, many of the fair values disclosed were derived using present value discounted cash flows or other valuation techniques described below. As a result, the Corporation's ability to actually realize these derived values cannot be assumed.

The Corporation measures fair values based on the fair value hierarchy established in ASC Paragraph 820-10-35-37. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of inputs that may be used to measure fair value under the hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities. This level is the most reliable source of valuation.

Level 2: Quoted prices that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability. Level 2 inputs include inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates). It also includes inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs). Several sources are utilized for valuing these assets, including a contracted valuation service, Standard & Poor's ("S&P") evaluations and pricing services, and other valuation matrices.

Level 3: Prices or valuation techniques that require inputs that are both significant to the valuation assumptions and not readily observable in the market (i.e. supported with little or no market activity). Level 3 instruments are valued based on the best available data, some of which is internally developed, and consider risk premiums that a market participant would require.

The level established within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Transfers in and out of Level 1, 2 or 3 are recorded at fair value at the beginning of the reporting period.

Management believes that the Corporation's valuation techniques are appropriate and consistent with the techniques used by other market participants. However, the use of different methodologies and assumptions could result in a different estimate of fair values at the reporting date. The valuation techniques used by the Corporation to measure, on a recurring and non-recurring basis, the fair value of assets as of June 30, 2015 are discussed in the paragraphs that follow.

Investments – The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The fair value of investments is determined using a market approach. As of June 30, 2015, the U.S. Treasuries, U.S. Government agencies, residential and commercial mortgage-backed securities, collateralized mortgage obligations, and state and political subdivisions bonds segments are classified as Level 2 within the valuation hierarchy. Their fair values were determined based upon market-corroborated inputs and valuation matrices, which were obtained through third party data service providers or securities brokers through which the Corporation has historically transacted both purchases and sales of investment securities.

The CDO segment, which consists of pooled trust preferred securities issued by banks, thrifts and insurance companies, is classified as Level 3 within the valuation hierarchy. At June 30, 2015, the Corporation owned 16 pooled trust preferred securities with an amortized cost of $35.6 million and a fair value of $30.0 million. The market for these securities at June 30, 2015 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as few CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities or any securities other than those issued or guaranteed by the U.S. Department of the Treasury (the “Treasury”) are depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (a) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at June 30, 2015, (b) an income valuation approach technique (i.e. present value) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than a market approach, and (c) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management relies on an independent third party to prepare both the evaluations of OTTI as well as the fair value determinations for its CDO portfolio. Management does not believe that there were any material differences in the OTTI evaluations and pricing between June 30, 2015 and December 31, 2014.

The approach used by the third party to determine fair value involves several steps, including detailed credit and structural evaluation of each piece of collateral in each bond, default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

Derivative financial instruments (Cash flow hedge) – The Corporation's open derivative positions are interest rate swaps that are classified as Level 3 within the valuation hierarchy. Open derivative positions are valued using externally developed pricing models based on observable market inputs provided by a third party and validated by management. The Corporation has considered counterparty credit risk in the valuation of its interest rate swap assets.

Impaired loans – Loans included in the table below are those that are considered impaired with a specific allocation or with a partial charge-off, based upon the guidance of the loan impairment subsection of the *Receivables* Topic, ASC Section 310-10-35, under which the Corporation has measured impairment generally based on the fair value of the loan's collateral. Fair value consists of the loan balance less its valuation allowance and is generally determined based on independent third-party appraisals of the collateral or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values based upon the lowest level of input that is significant to the fair value measurements.

Other real estate owned – OREO included in the table below are considered impaired with specific write-downs. Fair value of other real estate owned is based on independent third-party appraisals of the properties. These values were determined based on the sales prices of similar properties in the approximate geographic area. These assets are included as Level 3 fair values based upon the lowest level of input that is significant to the fair value measurements.

For Level 3 assets and liabilities measured at fair value on a recurring and non-recurring basis as of June 30, 2015 and December 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

(in thousands)	Fair Value at June 30, 2015	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Recurring:				
Investment Securities – available for sale	$ 30,046	Discounted Cash Flow	Discount Rate	Range of Libor+ 5.50% to 9.50%
Cash Flow Hedge	$ (140)	Discounted Cash Flow	Reuters Third Party Market Quote	99.9% (weighted avg 99.9%)
Non-recurring:				
Impaired Loans	$ 6,592	Market Comparable Properties	Marketability Discount	3% -15% (1) (weighted avg 12.0%)
Other Real Estate Owned	$ 2,444	Market Comparable Properties	Marketability Discount	6.7% -15.9% (1) (weighted avg 12.9%)

(in thousands)	Fair Value at December 31, 2014	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Recurring:				
Investment Securities – available for sale	$ 25,339	Discounted Cash Flow	Discount Rate	Range of Libor+ 5% to 12%
Cash Flow Hedge	$ (199)	Discounted Cash Flow	Reuters Third Party Market Quote	99.9% (weighted avg 99.9%)
Non-recurring:				
Impaired Loans	$ 9,122	Market Comparable Properties	Marketability Discount	10% (1) (weighted avg 10%)
Other Real Estate Owned	$ 2,511	Market Comparable Properties	Marketability Discount	10% -15% (1) (weighted avg 11%)

NOTE:

(1) Range would include discounts taken since appraisal and estimated values

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For assets measured at fair value on a recurring and non-recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2015 and December 31, 2014 are as follows:

		Fair Value Measurements at June 30, 2015 Using		
	Assets Measured at Fair Value	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
(in thousands)	**6/30/2015**	**(Level 1)**	**(Level 2)**	**(Level 3)**
Recurring:				
Investment securities available-for-sale:				
U.S. treasuries	$ 10,075		$ 10,075	
U.S. government agencies	$ 44,095		$ 44,095	
Residential mortgage-backed agencies	$ 19,963		$ 19,963	
Commercial mortgage-backed agencies	$ 42,866		$ 42,866	
Collateralized mortgage obligations	$ 13,179		$ 13,179	
Obligations of states and political subdivisions	$ 45,002		$ 45,002	
Collateralized debt obligations	$ 30,046			$ 30,046
Financial Derivative	$ (140)			$ (140)
Non-recurring:				
Impaired loans	$ 6,592			$ 6,592
Other real estate owned	$ 2,444			$ 2,444

		Fair Value Measurements at December 31, 2014 Using		
	Assets Measured at Fair Value	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
(in thousands)	**12/31/2014**	**(Level 1)**	**(Level 2)**	**(Level 3)**
Recurring:				
Investment securities available-for-sale:				
U.S. treasuries	$ 29,596		$ 29,596	

U.S. government agencies	$ 38,941	$ 38,941
Residential mortgage-backed agencies	$ 45,273	