FIRST NATIONAL COMMUNITY BANCORP INC
Form 10-Q
May 06, 2016

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

OR

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

For the transition period from to

Commission File No. 000-53869

FIRST NATIONAL COMMUNITY BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	**23-2900790**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
102 E. Drinker St., Dunmore, PA	**18512**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code **(570) 346-7667**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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 Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Common Stock, $1.25 par value	**16,530,432 shares**
(Title of Class)	(Outstanding at May 6, 2016)

1

Contents

Part I - Financial Information

Item 1 - Financial Statements

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(unaudited)

(in thousands, except share data)	**March 31, 2016**	**December 31, 2015**
Assets		
Cash and cash equivalents:		
Cash and due from banks	$16,367	$19,544
Interest-bearing deposits in other banks	1,847	1,539
Total cash and cash equivalents	18,214	21,083
Securities available for sale, at fair value	263,523	253,773
Stock in Federal Home Loan Bank of Pittsburgh, at cost	3,932	6,344
Loans held for sale	455	683
Loans, net of allowance for loan and lease losses of $8,635 and $8,790	719,523	724,926
Bank premises and equipment, net	10,904	11,193
Accrued interest receivable	2,854	2,475
Intangible assets	96	137
Bank-owned life insurance	29,527	29,381
Other real estate owned	1,806	3,154
Net deferred tax assets	24,995	27,807
Other assets	9,186	9,662
Total assets	$1,085,015	$1,090,618
Liabilities		
Deposits:		
Demand (non-interest-bearing)	$162,882	$154,531
Interest-bearing	720,243	667,015
Total deposits	883,125	821,546
Borrowed funds:		
Federal Home Loan Bank of Pittsburgh advances	74,511	135,802
Subordinated debentures	14,000	14,000
Junior subordinated debentures	10,310	10,310
Total borrowed funds	98,821	160,112
Accrued interest payable	333	11,165
Other liabilities	10,695	11,617
Total liabilities	992,974	1,004,440
Shareholders' equity		
Preferred shares ($1.25 par)		

Authorized: 20,000,000 shares at March 31, 2016 and December 31, 2015		
Issued and outstanding: 0 shares at March 31, 2016 and December 31, 2015	-	-
Common shares ($1.25 par)		
Authorized: 50,000,000 shares at March 31, 2016 and December 31, 2015		
Issued and outstanding: 16,530,432 shares, March 31, 2016 and 16,514,245 shares, December 31, 2015	20,663	20,643
Additional paid-in capital	62,069	62,059
Retained earnings	4,527	3,714
Accumulated other comprehensive income (loss)	4,782	(238)
Total shareholders' equity	92,041	86,178
Total liabilities and shareholders’ equity	$1,085,015	$1,090,618

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

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	Three months ended March 31,	
(in thousands, except share data)	**2016**	**2015**
Interest income		
Interest and fees on loans	$6,969	$6,472
Interest and dividends on securities:		
U.S. government agencies	930	971
State and political subdivisions, tax-free	10	50
State and political subdivisions, taxable	535	26
Other securities	96	157
Total interest and dividends on securities	1,571	1,204
Interest on interest-bearing deposits in other banks	4	21
Total interest income	8,544	7,697
Interest expense		
Interest on deposits	642	683
Interest on borrowed funds:		
Interest on Federal Home Loan Bank of Pittsburgh advances	148	120
Interest on subordinated debentures	159	563
Interest on junior subordinated debentures	57	49
Total interest on borrowed funds	364	732
Total interest expense	1,006	1,415
Net interest income before provision (credit) for loan and lease losses	7,538	6,282
Provision (credit) for loan and lease losses	696	(494)
Net interest income after provision (credit) for loan and lease losses	6,842	6,776
Non-interest income		
Deposit service charges	701	674
Net gain on the sale of securities	103	2,224
Net gain on the sale of mortgage loans held for sale	68	40
Net (loss) gain on the sale of other real estate owned	(5)	5
Loan-related fees	107	90
Income from bank-owned life insurance	146	135
Other	211	251
Total non-interest income	1,331	3,419
Non-interest expense		
Salaries and employee benefits	3,514	3,139
Occupancy expense	493	633
Equipment expense	423	384
Advertising expense	93	90
Data processing expense	523	448
Regulatory assessments	237	409
Bank shares tax	241	217
Expense of other real estate owned	46	100
Legal expense	120	163

Professional fees	287	301
Insurance expense	128	198
Other operating expenses	699	700
Total non-interest expense	6,804	6,782
Income before income taxes	1,369	3,413
Income tax expense (benefit)	226	(62)
Net income	$1,143	$3,475
Earnings per share		
Basic	$0.07	$0.21
Diluted	$0.07	$0.21
Cash Dividends Declared Per Common Share	$0.02	$-
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
Basic	16,519,759	16,490,111
Diluted	16,519,759	16,490,111

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

4

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three months ended March 31,	
(in thousands)	**2016**	**2015**
Net income	$1,143	$3,475
Other comprehensive income:		
Unrealized gains on securities available for sale	7,709	3,478
Taxes	(2,621)	(1,182)
Net of tax amount	5,088	2,296
Reclassification adjustment for gains included in net income	(103)	(2,224)
Taxes	35	756
Net of tax amount	(68)	(1,468)
Total other comprehensive income	5,020	828
Comprehensive income	$6,163	$4,303

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

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Three Months Ended March 31, 2016 and 2015
(unaudited)

(in thousands, except per share data)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated (Deficit) / Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, December 31, 2014	16,484,419	$ 20,605	$ 61,781	$ (32,126)	$ 1,138	$ 51,398
Net income for the period	-	-	-	3,475	-	3,475
Common shares issued under long-term incentive compensation plan	16,526	21	(21)	-	-	-
Restricted stock awards	-	-	41	-	-	41
Other comprehensive income, net of tax of $426	-	-	-	-	828	828
Balances, March 31, 2015	16,500,945	$ 20,626	$ 61,801	$ (28,651)	$ 1,966	$ 55,742
Balances, December 31, 2015	16,514,245	$ 20,643	$ 62,059	$ 3,714	$ (238)	$ 86,178
Net income for the period	-	-	-	1,143	-	1,143
Cash dividends paid, $0.02 per share	-	-	-	(330)	-	(330)
Common shares issued under long-term incentive compensation plan	16,187	20	(20)	-	-	-
Restricted stock awards	-	-	30	-	-	30
Other comprehensive income, net of tax of $2,586	-	-	-	-	5,020	5,020
Balances, March 31, 2016	16,530,432	$ 20,663	$ 62,069	$ 4,527	$ 4,782	$ 92,041

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

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(in thousands)	Three Months Ended March 31, 2016	2015
Operating activities:		
Net income	$1,143	$3,475
Adjustments to reconcile net income to net cash used in operating activities:		
Investment securities amortization, net	284	463
Equity in trust	(2)	(1)
Depreciation and amortization	652	360
Stock-based compensation expense	30	41
Provision (credit) for loan and lease losses	696	(494)
Valuation adjustment for off-balance sheet commitments	(51)	(21)
Gain on the sale of available-for-sale securities	(103)	(2,224)
Gain on the sale of loans held for sale	(68)	(40)
Loss (gain) on the sale of other real estate owned	5	(5)
Valuation adjustment of other real estate owned	-	12
Income from bank-owned life insurance	(146)	(135)
Proceeds from the sale of loans held for sale	1,766	1,085
Funds used to originate loans held for sale	(1,470)	(442)
Deferred income tax expense	226	-
Increase in interest receivable	(379)	(43)
Decrease (increase) in prepaid expenses and other assets	450	(324)
(Decrease) increase in interest payable	(10,832)	526
Decrease in accrued expenses and other liabilities	(883)	(2,278)
Total adjustments	(9,825)	(3,520)
Net cash used in operating activities	(8,682)	(45)
Cash flows from investing activities:		
Maturities, calls and principal payments of available-for-sale securities	1,645	2,236
Proceeds from the sale of securities available for sale	6,192	35,948
Purchases of securities available for sale	(10,162)	(19,802)
Redemption (purchase) of the stock of the Federal Home Loan Bank of Pittsburgh	2,412	(258)
Net decrease (increase) in loans to customers	4,201	(2,083)
Proceeds from the sale of other real estate owned	1,592	37
Purchases of bank premises and equipment	(25)	(518)
Net cash provided by investing activities	5,855	15,560
Cash flows from financing activities:		
Net increase (decrease) in deposits	61,579	(20,225)
Net (repayment of) proceeds from Federal Home Loan Bank of Pittsburgh advances - overnight	(56,950)	-
Proceeds from Federal Home Loan Bank of Pittsburgh advances - term	9,362	6,512
Repayment of Federal Home Loan Bank of Pittsburgh advances - term	(13,703)	(94)

Cash dividends paid	(330)	-
Net cash used in financing activities	(42)	(13,807)
Net (decrease) increase in cash and cash equivalents	(2,869)	1,708
Cash and cash equivalents at beginning of period	21,083	35,667
Cash and cash equivalents at end of period	$18,214	$37,375
Supplemental cash flow information		
Cash paid during the period for:		
Interest	$11,838	$889
Income taxes	-	-
Other transactions:		
Available-for-sale securities purchased, not settled	-	(1,013)
Principal balance of loans transferred to other real estate owned	237	149
Change in deferred gain on sale of other real estate owned	12	(9)

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

FIRST NATIONAL COMMUNITY BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Basis of Presentation

The consolidated financial statements are comprised of the accounts of First National Community Bancorp, Inc., and its wholly owned subsidiary, First National Community Bank (the “Bank”), as well as the Bank’s wholly owned subsidiaries (collectively, “FNCB”). The accounting and reporting policies of FNCB conform to accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all of the information and accompanying notes required by GAAP for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included in the consolidated financial statements. All intercompany balances and transactions have been eliminated in consolidation. Prior period amounts have been reclassified when necessary to conform to the current period’s presentation. These reclassifications did not have an impact on the operating results or financial position of FNCB. The operating results and financial position of FNCB for the three months ended March 31, 2016, may not be indicative of future results of operations and financial position.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change in the near term are the allowance for loan and lease losses (“ALLL”), investment security valuations, the evaluation of investment securities and other real estate owned (“OREO”) for impairment, and the evaluation of deferred income taxes.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in FNCB’s audited financial statements, included in the Annual Report filed on Form 10-K as of and for the year ended December 31, 2015.

Note 2. New Authoritative Accounting Guidance

ASU 2014-12, Compensation – Stock Compensation (Topic 718): "Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could be Achieved after the Requisite Service Period," requires a performance target that affects vesting and that can be achieved after the requisite service period to be treated as a performance condition. To account for such awards, an entity should apply existing guidance as it relates to awards with performance conditions that affect vesting. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent compensation cost attributable to the period(s) for which the requisite service already has been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service periods. The total amount of compensation cost should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. The adoption of this guidance on January 1, 2016 did not have a material effect on the operating results or financial position of FNCB.

ASU 2015-01, Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): "Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items," will alleviate uncertainty for preparers, auditors and regulators because auditors and regulators will no longer be required to evaluate whether a preparer presented an unusual and/or infrequent item appropriately. Although ASU 2015-01 eliminates the concept of extraordinary items, the presentation and disclosure guidance for items that are unusual in nature or infrequent in occurrence has been retained and has been expanded to include items that are both unusual in nature or infrequent in occurrence. The nature and financial effects of each event or transaction is required to be presented as a separate component of income from continuing operations or, alternatively, in the notes to the financial statements. ASU 2015-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption of this guidance is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The adoption of this guidance on January 1, 2016 did not have a material effect on the operating results or financial position of FNCB.

ASU 2015-02, Consolidation (Topic 810): "Amendments to the Consolidation Analysis," improves targeted areas of the consolidation guidance and reduces the number of consolidation models. The new consolidation standard changes the way reporting enterprises evaluate whether (a) they should consolidate limited partnerships and similar entities, (b) fees paid to a decision maker or service provider are variable interests in a variable interest entity ("VIE"), and (c) variable interests in a VIE held by related parties of the reporting enterprise require the reporting enterprise to consolidate the VIE. It also eliminates the VIE consolidation model based on majority exposure to variability that applied to certain investment companies and similar entities. ASU 2015-02 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this guidance on January 1, 2016 did not have a material effect on the operating results or financial position of FNCB.

ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): “Simplifying the Presentation of Debt Issuance Costs,” more closely aligns the presentation of debt issuance costs under U.S. GAAP with the presentation under comparable IFRS standards. Under ASU 2015-03 debt issuance costs related to a recognized debt liability will no longer be recorded as a separate asset, but will be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. The costs will continue to be amortized to interest expense using the effective interest method. ASU 2015-03 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, and requires retrospective application to all prior periods presented in the financial statements. Early adoption of this guidance is permitted. The adoption of this guidance on January 1, 2016 did not have a material effect on the operating results or financial position of FNCB.

ASU 2015-05, Intangibles – Goodwill and Other Internal-Use Software (Subtopic 350-40): “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” provides explicit guidance on a customer’s accounting for fees paid in a cloud computing environment. Specifically, the amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this guidance on January 1, 2016 did not have a material effect on the operating results or financial position of FNCB.

Accounting Guidance to be Adopted in Future Periods

ASU 2016-09, Compensation – Stock Compensation (Topic 718): “Improvements to Employee Share-Based Payment Accounting” simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, forfeitures, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016 for public entities. The adoption of this guidance on January 1, 2017 is not expected to have a material effect on the operating results of financial position of FNCB.

Refer to Note 2 to FNCB's consolidated financial statements included in the 2015 Annual Report on Form 10-K for a discussion of additional guidance applicable to FNCB that will be adopted in future periods.

Note 3. Securities

The following tables present the amortized cost, gross unrealized gains and losses, and the fair value of FNCB’s securities at March 31, 2016 and December 31, 2015:

	March 31, 2016			
		Gross Unrealized	Gross Unrealized	
(in thousands)	**Amortized Cost**	**Holding Gains**	**Holding Losses**	**Fair Value**
Available-for-sale:				
Obligations of U.S. government agencies	$37,698	$ 1,218	$ -	$38,916
Obligations of state and political subdivisions	84,891	2,678	11	87,558
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	21,312	548	1	21,859
Collateralized mortgage obligations - commercial	89,617	2,453	-	92,070
Residential mortgage-backed securities	18,077	475	-	18,552
Corporate debt securities	500	-	113	387
Negotiable certificates of deposit	3,173	49	-	3,222
Equity securities	1,010	-	51	959
Total available-for-sale securities	$256,278	$ 7,421	$ 176	$263,523

	December 31, 2015			
(in thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale:				
Obligations of U.S. government agencies	$43,787	$ 256	$ -	$44,043
Obligations of state and political subdivisions	75,401	428	422	75,407
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	22,162	116	9	22,269
Collateralized mortgage obligations - commercial	89,900	124	601	89,423
Residential mortgage-backed securities	18,201	58	161	18,098
Corporate debt securities	500	-	77	423
Negotiable certificates of deposit	3,173	-	11	3,162
Equity securities	1,010	-	62	948
Total available-for-sale securities	$254,134	$ 982	$ 1,343	$253,773

At March 31, 2016 and December 31, 2015, securities with a carrying amount of $262.2 million and $252.4 million, respectively, were pledged as collateral to secure public deposits and for other purposes.

The following table shows the amortized cost and approximate fair value of FNCB's available-for-sale debt securities at March 31, 2016 using contractual maturities. Expected maturities will differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Because collateralized mortgage obligations and residential mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	March 31, 2016	
(in thousands)	Amortized Cost	Fair Value
Amounts maturing in:		
One year or less	$-	$-
After one year through five years	25,061	25,737
After five years through ten years	98,485	101,668
After ten years	2,716	2,678
Collateralized mortgage obligations	110,929	113,929
Residential mortgage-backed securities	18,077	18,552
Total	$255,268	$262,564

Gross proceeds from the sale of available-for-sale securities were $6.2 million and $35.9 million for the three months ended March 31, 2016 and March 31, 2015, respectively, with gross gains of $103 thousand and $2.2 million, respectively realized upon the sales. There were no losses realized upon the sales for the three months ended March 31, 2016 and 2015.

10

The following tables present the number of, fair value and gross unrealized losses of available-for-sale securities with unrealized losses at March 31, 2016 and December 31, 2015:

	March 31, 2016								
	Less than 12 Months			**12 Months or Greater**			**Total**		
(dollars in thousands)	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**
Obligations of US government agencies	-	$ -	$ -	-	$-	$ -	-	$-	$ -
Obligations of state and policitical subdivisions	-	-	-	1	1,507	11	1	1,507	11
U.S. government/government-sponsored agencies:									
Collateralized mortgage obligations - residential	-	-	-	2	488	1	2	488	1
Collateralized mortgage obligations - commercial	-	-	-	-	-	-	-	-	-
Residential mortgage-backed securities	-	-	-	-	-	-	-	-	-
Corporate debt securities	-	-	-	1	387	113	1	387	113
Negotiable certificates of deposit	-	-	-	-	-	-	-	-	-
Equity securities	-	-	-	1	949	51	1	949	51
Total	-	$ -	$ -	5	$3,331	$ 176	5	$3,331	$ 176

	December 31, 2015								
	Less than 12 Months			**12 Months or Greater**			**Total**		
(dollars in thousands)	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**
Obligantions of U.S. government agencies	-	$-	$ -	-	$-	$ -	-	$-	$ -
Obligations of state and policitical subdivisions	31	33,022	419	1	264	3	32	33,286	422
U.S. government/government-sponsored agencies:									
Collateralized mortgage obligations - residential	4	5,738	9	-	-	-	4	5,738	9
Collateralized mortgage obligations - commercial	16	67,969	601	-	-	-	16	67,969	601
Residential mortgage-backed securities	7	16,779	161	-	-	-	7	16,779	161
Corporate debt securities	-	-	-	1	423	77	1	423	77
Negotiable certificates of deposit	12	2,913	11	-	-	-	12	2,913	11

Equity securities	-	-	-	1	938	62	1	938	62
Total	70	$126,421	$ 1,201	3	$1,625	$ 142	73	$128,046	$ 1,343

Management evaluates individual securities in an unrealized loss position quarterly for other than temporary impairment ("OTTI"). As part of its evaluation, management considers, among other things, the length of time a security's fair value is less than its amortized cost, the severity of decline, any credit deterioration of the issuer, whether or not management intends to sell the security, and whether it is more likely than not that FNCB will be required to sell the security prior to recovery of its amortized cost.

There were five securities in an unrealized loss position at March 31, 2016, including two securities issued by a U.S. government or government-sponsored agency, one obligation of a state and political subdivision, one corporate bond, and one equity security. All five securities were in an unrealized loss position for greater than 12 months. Management performed a review of the fair values of all securities in an unrealized loss position as of March 31, 2016 and determined that movements in the fair values of the securities were consistent with the change in market interest rates. In addition, as part of its review, management noted that there was no material change in the credit quality of any of the issuers or other events or circumstances that may cause a significant adverse effect on the fair value of these securities. Moreover, to date, FNCB has received all scheduled principal and interest payments and expects to fully collect all future contractual principal and interest payments on all securities in an unrealized loss position at March 31, 2016. FNCB does not intend to sell the securities nor is it more likely than not that it will be required to sell the securities prior to recovery of their amortized cost. Based on the results of its review and considering the attributes of these debt and equity securities, management concluded that the individual unrealized losses were temporary and OTTI did not exist at March 31, 2016.

Investments in FHLB of Pittsburgh and FRB stock, which have limited marketability, are carried at cost and totaled $5.3 million and $7.7 million at March 31, 2016 and December 31, 2015, respectively. FRB stock of $1.3 million is included in Other Assets at March 31, 2016 and December 31, 2015. Management noted no indicators of impairment for the FHLB of Pittsburgh and FRB of Philadelphia stock at March 31, 2016.

Note 4. Loans

The following table summarizes loans receivable, net, by category at March 31, 2016 and December 31, 2015:

(in thousands)	March 31, 2016	December 31, 2015
Residential real estate	$136,254	$130,696
Commercial real estate	247,867	245,198
Construction, land acquisition and development	20,432	30,843
Commercial and industrial	142,511	149,826
Consumer	128,825	128,533
State and political subdivisions	49,759	46,056
Total loans, gross	725,648	731,152
Unearned income	(93)	(98)
Net deferred loan costs	2,603	2,662
Allowance for loan and lease losses	(8,635)	(8,790)
Loans, net	$719,523	$724,926

FNCB has granted loans, letters of credit and lines of credit to certain of its executive officers and directors as well as to certain related parties of executive officers and directors. For more information about related party transactions, refer to Note 7 – "Related Party Transactions" to these consolidated financial statements.

FNCB originates one- to four-family mortgage loans for sale in the secondary market. During the quarter ended March 31, 2016, one-to four-family mortgages sold on the secondary market were $1.7 million. FNCB retains servicing rights on these mortgages. At March 31, 2016 and December 31, 2015, there were $455 thousand and $683 thousand in one-to four-family residential mortgage loans held for sale, respectively.

FNCB does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, and bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios.

There were no material changes to the risk characteristics of FNCB's loan segments, loan classification and credit grading systems and methodology for determining the adequacy of the ALLL during the three months ended March 31, 2016. Refer to Note 2 to FNCB's consolidated financial statements included in the 2015 Annual Report on Form 10-K for information about the risk characteristics related to FNCB's loan segments, loan classification and credit grading systems and methodology for determing the adequacy of the ALLL.

Each quarter, management evaluates the ALLL and adjusts the ALLL as appropriate through a provision or credit for loan losses. While management uses the best information available to make evaluations, future adjustments to the ALLL may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of its examination process, bank regulators periodically review the ALLL. These regulators may require FNCB to adjust the ALLL based on their analysis of information available at the time of examination.

The following table summarizes activity in the ALLL by loan category for the three months ended March 31, 2016 and 2015:

(in thousands)	Real Estate Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition and Development	Commercial and Industrial	Consumer	State and Political Subdivisions	Unallocated	Total
Three months ended March 31, 2016: Allowance for loan losses:								
Beginning balance, January 1, 2016	$1,333	$ 3,346	$ 853	$ 1,205	$ 1,494	$ 485	$ 74	$8,790
Charge-offs	(24)	(251)	-	(568)	(305)	-	-	(1,148)
Recoveries	1	1	-	94	201	-	-	297
Provisions (credits)	(100)	195	(200)	591	(11)	295	(74)	696
Ending balance, March 31, 2016	$1,210	$ 3,291	$ 653	$ 1,322	$ 1,379	$ 780	$ -	$8,635
Three months ended March 31, 2015: Allowance for loan losses:								
Beginning balance, January 1, 2015	$1,772	$ 4,663	$ 665	$ 2,104	$ 1,673	$ 598	$ 45	$11,520
Charge-offs	(68)	-	-	(70)	(139)	-	-	(277)
Recoveries	6	2	-	65	122	-	-	195
Provisions (credits)	(179)	(334)	99	(101)	42	(15)	(6)	(494)
Ending balance, March 31, 2015	$1,531	$ 4,331	$ 764	$ 1,998	$ 1,698	$ 583	$ 39	$10,944

The following table represents the allocation of the ALLL and the related loan balance, by loan category, disaggregated based on the impairment methodology at March 31, 2016 and December 31, 2015:

(in thousands)	Real Estate Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition and Development	Commercial and Industrial	Consumer	State and Political Subdivisions	Unallocated	Total
March 31, 2016								

Allowance for loan losses:								
Individually evaluated for impairment	$54	$ 279	$ -	$ -	$ 1	$ -	$ -	$ 334
Collectively evaluated for impairment	1,156	3,012	653	1,322	1,378	780	-	8,301
Total	$ 1,210	$ 3,291	$ 653	$ 1,322	$ 1,379	$ 780	$ -	$ 8,635
Loans receivable:								
Individually evaluated for impairment	$ 2,741	$ 3,749	$ 443	$ 199	$ 301	$ -	$ -	$ 7,433
Collectively evaluated for impairment	133,513	244,118	19,989	142,312	128,524	49,759	-	718,215
Total	$ 136,254	$ 247,867	$ 20,432	$ 142,511	$ 128,825	$ 49,759	$ -	$ 725,648
December 31, 2015								
Allowance for loan losses:								
Individually evaluated for impairment	$92	$ 287	$ 1	$ -	$ 1	$ -	$ -	$ 381
Collectively evaluated for impairment	1,241	3,059	852	1,205	1,493	485	74	8,409
Total	$ 1,333	$ 3,346	$ 853	$ 1,205	$ 1,494	$ 485	$ 74	$ 8,790
Loans receivable:								
Individually evaluated for impairment	$ 2,930	$ 3,831	$ 646	$ 203	$ 351	$ -	$ -	$ 7,961
Collectively evaluated for impairment	127,766	241,367	30,197	149,623	128,182	46,056	-	723,191
Total	$ 130,696	$ 245,198	$ 30,843	$ 149,826	$ 128,533	$ 46,056	$ -	$ 731,152

Credit Quality Indicators – Commercial Loans

Management continuously monitors the credit quality of FNCB's commercial loans by regularly reviewing certain credit quality indicators. Management utilizes credit risk ratings as the key credit quality indicator for evaluating the credit quality of FNCB's loan receivables.

FNCB's loan rating system assigns a degree of risk to commercial loans based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. Management analyzes these non-homogeneous loans individually by grading the loans as to credit risk and probability of collection for each type of loan. Commercial and industrial loans include commercial indirect auto loans which are not individually risk rated, and construction, land acquisition and development loans include residential construction loans which are also not individually risk rated. These loans are monitored on a pool basis due to their homogeneous nature as described in "Credit Quality Indicators – Other Loans" below. FNCB risk rates certain residential real estate loans and consumer loans that are part of a larger commercial relationship using its credit grading system as described in "Credit Quality Indicators – Commercial Loans." The grading system contains the following basic risk categories:

1. Minimal Risk

2. Above Average Credit Quality

3. Average Risk

4. Acceptable Risk

5. Pass - Watch

6. Special Mention

7. Substandard - Accruing

8. Substandard - Non-Accrual

9. Doubtful

10. Loss

This analysis is performed on a quarterly basis using the following definitions for risk ratings:

Pass - Assets rated 1 through 5 are considered pass ratings. These assets show no current or potential problems and are considered fully collectible. All such loans are considered collectively for ALLL calculation purposes. However, accruing TDRs that have been performing for an extended period of time, do not represent a higher risk of loss, and have been upgraded to a pass rating are evaluated individually for impairment.

Special Mention – Assets classified as special mention do not currently expose FNCB to a sufficient degree of risk to warrant an adverse classification but do possess credit deficiencies or potential weaknesses deserving close attention.

Special Mention assets have a potential weakness or pose an unwarranted financial risk which, if not corrected, could weaken the asset and increase risk in the future.

Substandard - Assets classified as substandard have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that FNCB will sustain some loss if the deficiencies are not corrected.

Doubtful - Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable based on current circumstances.

Loss - Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted.

Credit Quality Indicators – Other Loans

Certain residential real estate loans, consumer loans, and commercial indirect auto loans are monitored on a pool basis due to their homogeneous nature. Loans that are delinquent 90 days or more are placed on non-accrual status unless collection of the loan is in process and reasonably assured. FNCB utilizes accruing versus non-accrual status as the credit quality indicator for these loan pools.

The following tables present the recorded investment in loans receivable by loan category and credit quality indicator at March 31, 2016 and December 31, 2015:

	Credit Quality Indicators March 31, 2016									
	Commercial Loans						**Other Loans**			
	Pass	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Subtotal Commercial**	**Accruing Loans**	**Non-accrual Loans**	**Subtotal Other**	**Total Loans**
Residential real estate	$24,378	$390	$ 1,015	$ -	$ -	$ 25,783	$109,545	$ 926	$110,471	$136,254
Commercial real estate	229,731	9,989	8,147	-	-	247,867	-	-	-	247,867
Construction, land acquisition and development	13,496	355	4,799	-	-	18,650	1,782	-	1,782	20,432
	134,559	998	2,025	-	-	137,582	4,924	5	4,929	142,511

Commercial and industrial										
Consumer	4,904	5	39	-	-	4,948	123,580	297	123,877	128,825
State and political subdivisions	43,374	5,947	438	-	-	49,759	-	-	-	49,759
Total	$450,442	$17,684	$ 16,463	$ -	$ -	$484,589	$239,831	$ 1,228	$241,059	$725,648

14

Credit Quality Indicators
December 31, 2015

	Commercial Loans						Other Loans			
	Pass	Special Mention	Substandard	Doubtful	Loss	Subtotal Commercial	Accruing Loans	Non-accrual Loans	Subtotal Other	Total Loans
Residential real estate	$21,018	$449	$ 984	$ -	$ -	$ 22,451	$107,204	$ 1,041	$108,245	$130,696
Commercial real estate	225,850	11,356	7,992	-	-	245,198	-	-	-	245,198
Construction, land acquisition and development	23,946	358	5,137	-	-	29,441	1,402	-	1,402	30,843
Commercial and industrial	142,242	595	2,209	-	-	145,046	4,775	5	4,780	149,826
Consumer	2,747	9	39	-	-	2,795	125,392	346	125,738	128,533
State and political subdivisions	45,464	120	472	-	-	46,056	-	-	-	46,056
Total	$461,267	$12,887	$ 16,833	$ -	$ -	$ 490,987	$238,773	$ 1,392	$240,165	$731,152

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded investment in these non-accrual loans was $3.6 million and $3.8 million at March 31, 2016 and December 31, 2015, respectively. Generally, loans are placed on non-accrual status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accrual status. There were no loans past due 90 days or more and still accruing at March 31, 2016 and December 31, 2015.

The following tables present the delinquency status of past due and non-accrual loans at March 31, 2016 and December 31, 2015: