MIDDLEFIELD BANC CORP
Form 10-Q
May 11, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20552

FORM 10 - Q

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

For the quarterly period ended March 31, 2016

Commission File Number 001-36613

Middlefield Banc Corp.
(Exact name of registrant as specified in its charter)

Ohio	**34 - 1585111**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

15985 East High Street, Middlefield, Ohio 44062-9263

(Address of principal executive offices)

(440) 632-1666

(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 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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 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 [ ] Small 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 [√]

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

Class: Common Stock, without par value

Outstanding at May 11, 2016: 2,033,694

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CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

	March 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$25,251	$22,421
Federal funds sold	4,969	1,329
Cash and cash equivalents	30,220	23,750
Investment securities available for sale, at fair value	142,560	146,520
Loans held for sale	176	1,107
Loans	530,356	533,710
Less allowance for loan and lease losses	6,357	6,385
Net loans	523,999	527,325
Premises and equipment, net	9,607	9,772
Goodwill	4,559	4,559
Core deposit intangibles	66	76
Bank-owned life insurance	13,240	13,141
Other real estate owned	1,447	1,412
Accrued interest and other assets	7,008	7,477
TOTAL ASSETS	$732,882	735,139
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$115,453	$116,498
Interest-bearing demand	67,082	57,219
Money market	82,143	78,856
Savings	178,292	180,653
Time	188,436	191,221
Total deposits	631,406	624,447
Short-term borrowings	26,124	35,825
Other borrowings	9,875	9,939
Accrued interest and other liabilities	1,713	2,624
TOTAL LIABILITIES	669,118	672,835
STOCKHOLDERS' EQUITY		

Common stock, no par value; 10,000,000 shares authorized, 2,268,191 and 2,263,403 shares issued; 1,882,026 and 1,877,238 shares outstanding	36,345	36,191
Retained earnings	38,216	37,236
Accumulated other comprehensive income	2,721	2,395
Treasury stock, at cost; 386,165 shares	(13,518)	(13,518)
TOTAL STOCKHOLDERS' EQUITY	63,764	62,304
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$732,882	$735,139

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
INTEREST INCOME		
Interest and fees on loans	$6,173	$5,843
Interest-bearing deposits in other institutions	12	8
Federal funds sold	4	3
Investment securities:		
Taxable interest	340	395
Tax-exempt interest	790	759
Dividends on stock	29	27
Total interest income	7,348	7,035
INTEREST EXPENSE		
Deposits	855	831
Short-term borrowings	120	37
Other borrowings	17	23
Trust preferred securities	33	(8)
Total interest expense	1,025	883
NET INTEREST INCOME	6,323	6,152
Provision for loan losses	105	105
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,218	6,047
NONINTEREST INCOME		
Service charges on deposit accounts	447	441
Investment securities gains, net	51	24
Earnings on bank-owned life insurance	99	69
Gain on sale of loans	87	53
Other income	225	209
Total noninterest income	909	796
NONINTEREST EXPENSE		

Salaries and employee benefits	2,780	2,360
Occupancy expense	335	349
Equipment expense	269	216
Data processing costs	272	250
Ohio state franchise tax	100	75
Federal deposit insurance expense	132	112
Professional fees	292	319
Loss on other real estate owned	12	88
Advertising expense	195	196
Other real estate expense	46	65
Directors fees	107	118
Core deposit intangible amortization	10	10
Appraiser fees	101	56
ATM fees	96	84
Other expense	591	513
Total noninterest expense	5,338	4,811
Income before income taxes	1,789	2,032
Income taxes	302	404
NET INCOME	$1,487	$1,628
EARNINGS PER SHARE		
Basic	$0.79	$0.79
Diluted	0.79	0.79
DIVIDENDS DECLARED PER SHARE	$0.27	$0.26

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended March 31, 2016	2015
Net income	$1,487	$1,628
Other comprehensive income:		
Net unrealized holding gain on available-for-sale securities	547	851
Tax effect	(187)	(289)
Reclassification adjustment for investment securities gains included in net income	(51)	(24)
Tax effect	17	8
Total other comprehensive income	326	546
Comprehensive income	$1,813	$2,174

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share data)

(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2015	$ 36,191	$ 37,236	$ 2,395	$ (13,518)	$ 62,304
Net income		1,487			1,487
Other comprehensive income			326		326
Common stock issuance (900 shares)	29				29
Dividend reinvestment and purchase plan (3,888 shares)	125				125
Cash dividends ($0.27 per share)		(507)			(507)
Balance, March 31, 2016	$ 36,345	$ 38,216	$ 2,721	$ (13,518)	$ 63,764

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended March 31, 2016	2015
OPERATING ACTIVITIES		
Net income	$1,487	$1,628
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	105	105
Investment securities gain, net	(51)	(24)
Depreciation and amortization	271	180
Amortization of premium and discount on investment securities	107	189
Accretion of deferred loan fees, net	(71)	(241)
Origination of loans held for sale	(3,356)	(2,664)
Proceeds from sale of loans	4,374	2,465
Gain on sale of loans	(87)	(53)
Earnings on bank-owned life insurance	(99)	(69)
Deferred income tax	(218)	(305)
(Gain) loss on other real estate owned	(12)	182
Other real estate owned writedowns	24	(94)
Increase in accrued interest receivable	(263)	(454)
Decrease in accrued interest payable	(6)	(11)
Other, net	(203)	(407)
Net cash provided by operating activities	2,002	427
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	4,822	2,224
Proceeds from sale of securities	1,322	1,590
Purchases	(1,744)	-
Decrease (increase) in loans, net	3,215	(5,497)
Proceeds from the sale of other real estate owned	30	299
Purchase of premises and equipment	(18)	(108)
Net cash provided by (used for) investing activities	7,627	(1,492)
FINANCING ACTIVITIES		
Net increase in deposits	6,959	31,031

Decrease in short-term borrowings, net	(9,701)	(9,895)
Repayment of other borrowings	(64)	(91)
Common stock issued	29	-
Stock options exercised	-	2
Proceeds from dividend reinvestment and purchase plan	125	175
Cash dividends	(507)	(534)
Net cash (used for) provided by financing activities	(3,159)	20,688
Increase in cash and cash equivalents	6,470	19,623
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	23,750	25,639
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$30,220	$45,262
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$1,031	$894
Income taxes	375	-
Noncash investing transactions:		
Transfers from loans to other real estate owned	$77	$-

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements of Middlefield Banc Corp. ("Company") include its bank subsidiary, The Middlefield Banking Company (“MB”), and a nonbank asset resolution subsidiary EMORECO, Inc. All significant inter-company items have been eliminated.

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management’s opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company’s financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2015, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U.S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with the Company’s Form 10-K for the year ended December 31, 2015. The results of the Company’s operations for any interim period are not necessarily indicative of the results of the Company’s operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (a new revenue recognition standard). The Update’s core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new accounting Update.

In June 2014, the FASB issued 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*. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015.

Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company’s financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements -Going Concern (Subtopic* 205-40). The amendments in this Update provide guidance in accounting principles generally accepted in the United States of America about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In November 2014, the FASB issued ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force).* This ASU clarifies how current U.S. GAAP should be interpreted in subjectively evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Public business entities are required to implement the new requirements in fiscal years and interim periods within those fiscal years beginning after December 15, 2015. This Update is not expected to have a significant impact on the Company’s financial statements.

In January 2015, the FASB issued ASU 2015-01, *Income Statement –Extraordinary and Unusual Items,* as part of its initiative to reduce complexity in accounting standards. This Update eliminates from GAAP the concept of extraordinary items. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. This Update is not expected to have a significant impact on the Company’s financial statements.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810)*. The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments (1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30)*, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-04, *Compensation-Retirement Benefits (Topic 715),* as part of its initiative to reduce complexity in accounting standards. For an entity with a fiscal year end that does not coincide with a month end, the amendments in this Update provide a practical expedient that permits the entity to measure defined benefit plan assets and obligations using the month end that is closest to the entity's fiscal year end and apply that practical expedient consistently from year to year. The practical expedient should be applied consistently to all plans if an entity has more than one plan. The amendments in this Update are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Earlier application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangible – Goodwill and Other Internal Use Software (Topic 350-40)*, as part of its initiative to reduce complexity in accounting standards. This guidance will help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement. The amendments in this Update 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. For public business entities, the Board decided that the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. For all other entities, the amendments will be effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted for all entities. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-06, Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions. Topic 260, Earnings Per Share, contains guidance that addresses master limited partnerships that originated from Emerging Issues Task Force (“EITF”) Issue No. 07-4, Application of the Two-Class Method Under FASB Statement No. 128 to Master Limited Partnerships. Under Topic 260, master limited partnerships apply the two-class method of calculating earnings per unit because the general partner, limited partners, and incentive distribution rights holders each participate differently in the distribution of available cash in accordance with the contractual rights contained in the partnership agreement. The amendments in this Update specify that for purposes of calculating historical earnings per unit under the two-class method, the earnings (losses) of a transferred business before the date of a dropdown transaction should be allocated entirely to the general partner. In that circumstance, the previously reported earnings per unit of the limited partners (which is typically the earnings per unit measure presented in the financial statements) would not change as a result of the dropdown transaction. Qualitative disclosures about how the rights to the earnings (losses) differ before and after the dropdown transaction occurs for purposes of computing earnings per unit under the two-class method are also required. The amendments in this Update are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In May 2015, the FASB issued ASU 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent). The Update applies to reporting entities that elect to measure the fair value of an investment using the net asset value per share (or its equivalent) practical expedient. Under the amendments in this Update, investments for which fair value is measured at net asset value per share (or its equivalent) using the practical expedient should not be categorized in the fair value hierarchy. Removing those investments from the fair value hierarchy not only eliminates the diversity in practice resulting from the way in which investments measured at net asset value per share (or its equivalent) with future redemption dates are classified, but also ensures that all investments categorized in the fair value hierarchy are classified using a consistent approach. Investments that calculate net asset value per share (or its equivalent), but for which the practical expedient is not applied will continue to be included in the fair value hierarchy. A reporting entity should continue to disclose information on investments for which fair value is measured at net asset value (or its equivalent) as a practical expedient to help users understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. A reporting entity should apply the amendments retrospectively to all periods presented. The retrospective approach requires that an investment for which fair value is measured using the net asset value per share practical expedient be removed from the fair value hierarchy in all periods presented in an entity's financial statements. Earlier application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In May 2015, the FASB issued ASU 2015-09, Financial Services – Insurance (Topic 944): Disclosure About Short-Duration Contracts. The amendments apply to all insurance entities that issue short-duration contracts as defined in Topic 944, Financial Services – Insurance. The amendments require insurance entities to disclose for annual reporting periods certain information about the liability for unpaid claims and claim adjustment expenses. The amendments also require insurance entities to disclose information about significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements. Additionally, the amendments require insurance entities to disclose for annual and interim reporting periods a rollforward of the liability for unpaid claims and claim adjustment expenses, described in Topic 944. For health insurance claims, the amendments require the disclosure of the total of incurred-but-not-reported liabilities plus expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

In June 2015, the FASB issued ASU 2015-10, Technical Corrections and Improvements. The amendments in this Update represent changes to clarify the FASB Accounting Standards Codification (“Codification”), correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Transition guidance varies based on the amendments in this Update. The amendments in this Update that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments will be effective upon the issuance of this Update. This Update is not expected to have a significant impact on the Company’s financial statements.

In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers* (Topic 606). The amendments in this Update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after

December 15, 2019. The Company is evaluating the effect of adopting this new accounting Update.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations (Topic 805).* The amendments in this Update require that an acquirer recognizes adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this Update require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The amendments in this Update require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. The amendments in this Update require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. For public business entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period. The amendments in this Update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (g) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (h) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which: (a) the lease term is 12 months or less, and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-04, *Liabilities – Extinguishments of Liabilities (Subtopic 405-20).* The standard provides that liabilities related to the sale of prepaid stored-value products within the scope of this Update are financial liabilities. The amendments in the Update provide a narrow scope exception to the guidance in Subtopic 405-20 to require that breakage for those liabilities be accounted for consistent with the breakage guidance in Topic 606. The amendments in this Update are effective for public business entities, certain not-for-profit entities, and certain employee benefit plans for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Earlier application is permitted, including adoption in an interim period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-05, *Derivatives and Hedging (Topic 815)*. The amendments in this Update apply to all reporting entities for which there is a change in the counterparty to a derivative instrument that has been designated as a heading instrument under Topic 815. The standards in this Update clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. An entity has an option to apply the amendments in this Update on either a prospective basis or a modified retrospective basis. Early adoption is permitted, including adoption in an interim period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-06, *Derivatives and Hedging (Topic 815)*. The amendments apply to all entities that are issuers of or investors in debt instruments (or hybrid financial instruments that are determined to have a debt host) with embedded call (put) options. The amendments in this update clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt host. An entity performing the assessment under the amendments in this Update is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. For entities other than public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-07, *Investments – Equity Method and Joint Ventures (Topic 323)*. The Update affects all entities that have an investment that becomes qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. The amendments in this Update eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. The amendments in this Update require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments in this Update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606).* The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services (that are an output of the entity's ordinary activities) in exchange for consideration. The amendments in this update do not change the core principle of the guidance in Topic 606; they simply clarify the implementation guidance on principal versus agent considerations. The amendments in this Update are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amendments in this Update affect the guidance in ASU 2014-09, *Revenue from Contracts with Customers (Topic 606),* which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements of Update 2014-09. ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date,* defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718).* The amendments in this Update affect all entities that issue share-based payment awards to their employees. The standards in this Update provide simplification for several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as with equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. In addition to those simplifications, the amendments eliminate the guidance in Topic 718 that was indefinitely deferred shortly after the issuance of FASB Statement No. 123 (revised 2004), *Share-Based Payment*. This should not result in a change in practice because the guidance that is being superseded was never effective. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for any entity in any interim or annual period. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606).* The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services in exchange for consideration. The amendments in this Update do not change the core principle for revenue recognition in Topic 606. Instead, the amendments provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The amendments are expected to reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the potential for diversity arising in practice and reduce the cost and complexity of applying the guidance. The amendments in this Update affect the guidance in ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)*: Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

NOTE 2 - STOCK-BASED COMPENSATION

The Company had no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of March 31, 2016 and 2015.

Stock option activity during the three months ended March 31 is as follows:

	2016	Weighted-average Exercise Price	2015	Weighted-average Exercise Price
Outstanding, January 1	31,949	$ 25.03	46,451	$ 27.90
Exercised	-	-	(375)	17.55
Outstanding, March 31	31,949	$ 25.03	46,076	$ 27.99
Exercisable, March 31	31,949	$ 25.03	46,076	$ 27.99

NOTE 3 - EARNINGS PER SHARE

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the average shares outstanding. Diluted earnings per share adds the dilutive effects of stock options to average shares outstanding.

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

	For the Three Months Ended March 31,	
	2016	2015
Weighted-average common shares outstanding	2,264,342	2,243,190
Average treasury stock shares	(386,165)	(189,530)
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	1,878,177	2,053,660
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	8,766	9,207
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	1,886,943	2,062,867

Options to purchase 31,949 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding during the three months ended March 31, 2016. Of those options, 24,700 were considered dilutive for the three month period based on the market price exceeding the strike price.

Options to purchase 46,076 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding as of the three months ended March 31, 2015. For the three months ended March 31, 2015, 27,250 were considered dilutive based on the market price exceeding the strike price.

NOTE 4 - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following levels:

Level I:	Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
Level II:	Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
Level III:	Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following tables present the assets measured on a recurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	March 31, 2016			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$ -	$18,853	$ -	$18,853
Obligations of states and political subdivisions	-	97,001	-	97,001
Mortgage-backed securities in government- sponsored entities		23,813		23,813
Private-label mortgage-backed securities	-	2,079	-	2,079
Total debt securities	-	141,746	-	141,746
Equity securities in financial institutions	5	809	-	814
Total	$ 5	$142,555	$ -	$142,560

	December 31, 2015			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$ -	$21,629	$ -	$21,629
Obligations of states and political subdivisions	-	97,290	-	97,290
Mortgage-backed securities in government- sponsored entities	-	24,524	-	24,524
Private-label mortgage-backed securities	-	2,263	-	2,263
Total debt securities	-	145,706	-	145,706
Equity securities in financial institutions	5	809	-	814
Total	$ 5	$146,515	$ -	$146,520

The Company obtains fair values from an independent pricing service which represent either quoted market prices for the identical securities (Level I inputs) or fair values determined by pricing models using a market approach that considers observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems (Level II).

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of March 31, 2016 or December 31, 2015.

The Company uses prices compiled by third party vendors due to improvements in third party pricing methodology that have narrowed the variances between third party vendor prices and actual market prices.

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs. The Company values other real estate owned at the estimated fair value of the underlying collateral less expected selling costs. Such values are estimated primarily using appraisals and reflect a market value approach. Due to the significance of the Level III inputs, other real estate owned has been classified as Level III.

(Dollar amounts in thousands)	March 31, 2016 Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$ -	$-	$14,836	$14,836
Other real estate owned	-	-	1,447	1,447

(Dollar amounts in thousands)	December 31, 2015 Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$ -	$-	$12,848	$12,848
Other real estate owned	-	-	1,412	1,412

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company uses Level III inputs to determine fair value:

(Dollar amounts in thousands)	Quantitative Information about Level III Fair Value Measurements						
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)			
March 31, 2016							
Impaired loans	$10,350	Discounted cash flow	Discount rate	3.1%	to	7.9%	(4.9%)
	4,486	Appraisal of collateral (1)	Appraisal adjustments (2)	0.0%	to	66.4%	(38.2%)
Other real estate owned	$1,447	Appraisal of collateral (1)	Appraisal adjustments (2)	0.0%	to	10.0%	(7.2%)

(Dollar amounts in thousands)	Quantitative Information about Level III Fair Value Measurements						
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)			
December 31, 2015							
Impaired loans	$6,867	Discounted cash flow	Discount rate	3.1%	to	7.9%	(5.0%)
	5,981	Appraisal of collateral (1)	Appraisal adjustments (2)	0.0%	to	87.1%	(23.3%)
Other real estate owned	$1,412	Appraisal of collateral (1)	Appraisal adjustments (2)	0%	to	10.0%	(7.3%)

(1)

Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

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The estimated fair value of the Company's financial instruments is as follows:

	March 31, 2016				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$30,220	$30,220	$-	$-	$30,220
Investment securities					
Available for sale	142,560	5	142,555	-	142,560
Loans held for sale	176	-	176	-	176
Net loans	523,999	-	-	531,917	531,917
Bank-owned life insurance	13,240	13,240	-	-	13,240
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,650	2,650	-	-	2,650
Financial liabilities:					
Deposits	$631,406	$442,970	$-	$180,127	$623,097
Short-term borrowings	26,124	26,124	-	-	26,124
Other borrowings	9,875	-	-	12,606	12,606
Accrued interest payable	389	389	-	-	389

	December 31, 2015				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$23,750	$23,750	$-	$-	$23,750
Investment securities					
Available for sale	146,520	5	146,515	-	146,520
Loans held for sale	1,107	-	1,107	-	1,107
Net loans	527,325	-	-	534,021	534,021
Bank-owned life insurance	13,141	13,141	-	-	13,141
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,387	2,387	-	-	2,387
Financial liabilities:					
Deposits	$624,447	$433,226	$-	$191,747	$624,973
Short-term borrowings	35,825	35,825	-	-	35,825
Other borrowings	9,939	-		10,063	10,063

Accrued interest payable	395	395	-	-	395

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. Since many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Federal Home Loan Bank Stock, Accrued Interest Receivable, Accrued Interest Payable, and Short-Term Borrowings

The fair value is equal to the current carrying value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the life insurance policies.

Investment Securities Available for Sale

The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans Held for Sale

Loans held for sale are carried at lower of cost or fair value. The fair value of loans held for sale is based on secondary market pricing on portfolios with similar characteristics. The changes in fair value of the assets are largely driven by changes in interest rates subsequent to loan funding and changes in the fair value of servicing associated with the mortgage loan held for sale.

Net Loans

The fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were used as estimates for fair value.

Deposits and Other Borrowings

The fair values of certificates of deposit and other borrowings are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposits are valued at the amount payable on demand as of period end.

Commitments to Extend Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure.

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables present the changes in accumulated other comprehensive income by component net of tax for the three months ended March 31, 2016 and 2015, respectively:

(Dollars in thousands)	Unrealized gains on available-for-sale securities
Balance as of December 31, 2015	$ 2,395
Other comprehensive income before reclassification	360
Amount reclassified from accumulated other comprehensive income	(34)
Period change	326
Balance at March 31, 2016	$ 2,721

(Dollars in thousands)	Unrealized gains on available-for-sale securities
Balance as of December 31, 2014	$ 2,548
Other comprehensive income before reclassification	562
Amount reclassified from accumulated other comprehensive income	(16)
Period change	546
Balance at March 31, 2015	3,094

The following tables present significant amounts reclassified out of each component of accumulated other comprehensive income for the three months ended March 31, 2016 and 2015, respectively:

(Dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive Income (a) For the Three Months Ended	Affected Line Item in the Statement Where Net Income is

Details about other comprehensive income	March 31, 2016	March 31, 2015	Presented
Unrealized gains on available-for-sale securities			
	$ 51	$ 24	Investment securities gains, net
	(17)	(8)	Income taxes
	$ 34	$ 16	Net of tax

(a) Amounts in parentheses indicate debits to net income

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NOTE 6 - INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and fair values of securities available for sale are as follows:

	March 31, 2016			
(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$18,616	$ 313	$ (76)	$18,853
Obligations of states and political subdivisions:				
Taxable	1,989	187	(1)	2,175
Tax-exempt	91,605	3,394	(173)	94,826
Mortgage-backed securities in government-sponsored entities	23,550	380	(117)	23,813
Private-label mortgage-backed securities	1,927	153	(1)	2,079
Total debt securities	137,687	4,427	(368)	141,746
Equity securities in financial institutions	750	64	-	814
Total	$138,437	$ 4,491	$ (368)	$142,560

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$21,655	$ 245	$ (271)	$21,629
Obligations of states and political subdivisions:				
Taxable	1,989	134	-	2,123
Tax-exempt	91,940	3,402	(175)	95,167
Mortgage-backed securities in government-sponsored entities	24,480	316	(272)	24,524
Private-label mortgage-backed securities	2,079	184	-	2,263
Total debt securities	142,143	4,281	(718)	145,706
Equity securities in financial institutions	750	64	-	814
Total	$142,893	$ 4,345	$ (718)	$146,520

The amortized cost and fair value of debt securities at March 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 1,224	$ 1,237
Due after one year through five years	11,171	11,380
Due after five years through ten years	18,523	19,327
Due after ten years	106,769	109,802
Total	$ 137,687	$ 141,746

Proceeds from the sales of securities available for sale and the gross realized gains and losses for the three months ended March 31 are as follows:

(Dollar amounts in thousands)	For the Three Months Ended March 31,	
	2016	2015
Proceeds from sales	$ 1,322	$ 1,590
Gross realized gains	51	48
Gross realized losses	-	(24)

Investment securities with an approximate carrying value of $63.0 million and $68.8 million at March 31, 2016 and December 31, 2015, respectively, were pledged to secure deposits and other purposes as required by law.

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position.

	March 31, 2016					
	Less than Twelve Months		Twelve Months or Greater		Total	
(Dollar amounts in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	$ 4,565	$ (9)	$ 7,612	$ (67)	$ 12,177	$ (76)
Obligations of states and political subdivisions	8,999	(122)	1,426	(52)	10,425	(174)
Mortgage-backed securities in government-sponsored entities	4,000	(7)	6,675	(110)	10,675	(117)

Private-label mortgage-backed securities	109	(1)	-	-	109	(1)
Total	$17,673	$ (139)	$15,713	$ (229)	$33,386	$ (368)

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	December 31, 2015					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	$3,818	$ (57)	$10,872	$ (214)	$14,690	$ (271)
Obligations of states and political subdivisions						
Tax-exempt	1,268	(9)	9,394	(166)	10,662	(175)
Mortgage-backed securities in government-sponsored entities	8,725	(86)	6,685	(186)	15,410	(272)
Total	$13,811	$ (152)	$26,951	$ (566)	$40,762	$ (718)

There were 38 securities considered temporarily impaired at March 31, 2016.

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment ("OTTI"). A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The Company assesses whether the unrealized loss is other than temporary.

OTTI losses are recognized in earnings when the Company has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Company does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other than temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. As a result the credit loss component of an OTTI is recorded as a component of investment securities gains (losses) in the accompanying Consolidated Statement of Income, while the remaining portion of the impairment loss is recognized in other comprehensive income, provided the Company does not intend to sell the underlying debt security and it is "more likely than not" that the Company will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, U.S. government-sponsored enterprises, and state and political subdivisions accounted for more than 98% of the total available-for-sale portfolio as of March 31, 2016 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of prolonged unrealized loss positions within the obligations of state and political subdivisions security portfolio. The Company considers the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.
- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions;
- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer’s industry and actions taken by the issuer to deal with the present economic climate.

For the three months ended March 31, 2016 and 2015, there were no available-for-sale debt securities with an unrealized loss that suffered OTTI. Management does not believe any individual unrealized loss as of March 31, 2016 or December 31, 2015 represented an other-than-temporary impairment. The unrealized losses on debt securities are primarily the result of interest rate changes. These conditions will not prohibit the Company from receiving its contractual principal and interest payments on these debt securities. The fair value of these debt securities is expected to recover as payments are received on these securities and they approach maturity. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

NOTE 7 - LOANS AND RELATED ALLOWANCE FOR LOAN AND LEASE LOSSES

Major classifications of loans are summarized as follows (in thousands):

	March 31, 2016	December 31, 2015
Commercial and industrial	$47,436	$42,536
Real estate - construction	21,005	22,137
Real estate - mortgage:		
Residential	238,489	232,478
Commercial	218,363	231,701
Consumer installment	5,063	4,858
	530,356	533,710
Less: Allowance for loan and lease losses	6,357	6,385
Net loans	$523,999	$527,325

The Company's primary business activity is with customers located within its local Northeastern Ohio trade area, eastern Geauga County, and contiguous counties to the north, east, and south. The Company also serves the central Ohio market with offices in Dublin and Westerville, Ohio. Commercial, residential, consumer, and agricultural loans are granted. Although the Company has a diversified loan portfolio, loans outstanding to individuals and businesses are dependent upon the local economic conditions in the Company's immediate trade area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are reported at their outstanding unpaid principal balances net of the allowance for loan and lease losses. Interest income is recognized as income when earned on the accrual method. The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of interest is doubtful. Interest received on nonaccrual loans is recorded as income or applied against principal according to management's judgment as to the collectability of such principal.

Loan origination fees and certain direct loan origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. Management is amortizing these amounts over the contractual life of the related loans.

The following tables summarize the primary segments of the loan portfolio and allowance for loan and lease losses (in thousands):

			Real Estate- Mortgage			
March 31, 2016	Commercial and industrial	Real estate- construction	Residential	Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 865	$ 1,453	$4,085	$ 9,239	$ 5	$15,647
Collectively evaluated for impairment	46,571	19,552	234,404	209,124	5,058	514,709
Total loans	$ 47,436	$ 21,005	$238,489	$ 218,363	$ 5,063	$530,356

			Real estate- Mortgage			
December 31, 2015	Commercial and industrial	Real estate- construction	Residential	Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 1,808	$ 1,787	$3,881	$ 6,199	$ 6	$13,681
Collectively evaluated for impairment	40,728	20,350	228,597	225,502	4,852	520,029
Total loans	$ 42,536	$ 22,137	$232,478	$ 231,701	$ 4,858	$533,710

March 31, 2016	Commercial and industrial	Real estate-construction	Real Estate-Mortgage Residential	Real Estate-Mortgage Commercial	Consumer installment	Total
Allowance for loan and lease losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 323	$ 118	$269	$ 101	$ -	$811
Collectively evaluated for impairment	260	129	2,447	2,682	28	5,546
Total ending allowance balance	$ 583	$ 247	$2,716	$ 2,783	$ 28	$6,357

December 31, 2015	Commercial and industrial	Real estate-construction	Real Estate-Mortgage Residential	Real Estate-Mortgage Commercial	Consumer installment	Total
Allowance for loan and lease losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 388	$ 130	$276	$ 39	$ -	$833
Collectively evaluated for impairment	479	146	2,863	2,039	25	5,552
Total ending allowance balance	$ 867	$ 276	$3,139	$ 2,078	$ 25	$6,385

The Company’s loan portfolio is segmented to a level that allows management to monitor risk and performance. The portfolio is segmented into Commercial and Industrial (“C&I”), Real Estate Construction, Real Estate - Mortgage which is further segmented into Residential and Commercial real estate (“CRE”), and Consumer Installment Loans. The C&I loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment consists of loans made for the purpose of financing the activities of residential homeowners. The commercial mortgage loan segment consists of loans made for the purpose of financing the activities of commercial real estate owners and operators. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

The decrease in C&I collectively evaluated loans during the three month period ended March 31, 2016 is due primarily to reclassification of loans to CRE in the first quarter of 2016. The impact on CRE collective evaluation, outside of reclassification, as well as residential real estate, is due to updates to the qualitative factors in the ALLL calculation. These factors were increased based on economic conditions, loan volume, and external factors.

Management evaluates individual loans in all of the commercial segments for possible impairment based on guidance established by the Board of Directors. Loans are considered to be impaired when, based on current information and events, it is probable that the Company 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 Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired.

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 the following 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. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company’s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands):

March 31, 2016
Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 477	$ 477	$ -
Real estate - construction	1,335	1,330	-
Real estate - mortgage:			
Residential	2,928	2,926	-
Commercial	2,319	2,315	-
Consumer installment	5	5	-
Total	$ 7,064	$ 7,053	$ -
With an allowance recorded:			
Commercial and industrial	$ 388	$ 388	$ 323
Real estate - construction	118	118	118
Real estate - mortgage:			
Residential	1,157	1,155	269
Commercial	6,920	6,906	101
Total	$ 8,583	$ 8,567	$ 811
Total:			
Commercial and industrial	$ 865	$ 865	$ 323
Real estate - construction	1,453	1,448	118
Real estate - mortgage:			
Residential	4,085	4,081	269
Commercial	9,239	9,221	101
Consumer installment	5	5	-
Total	$ 15,647	$ 15,620	$ 811

December 31, 2015
Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 1,027	$ 1,025	$ -
Real estate - construction	1,657	1,651	-
Real estate - mortgage:			
Residential	2,445	2,443	-
Commercial	2,337	2,335	-
Total	$ 7,466	$ 7,454	$ -
With an allowance recorded:			
Commercial and industrial	$ 781	$ 781	$ 388
Real estate - construction	130	130	130
Real estate - mortgage:			
Residential	1,436	1,436	276
Commercial	3,862	3,846	39
Consumer installment	6	6	-
Total	$ 6,215	$ 6,199	$ 833
Total:			
Commercial and industrial	$ 1,808	$ 1,806	$ 388
Real estate - construction	1,787	1,781	130
Real estate - mortgage:			
Residential	3,881	3,879	276
Commercial	6,199	6,181	39
Consumer installment	6	6	-
Total	$ 13,681	$ 13,653	$ 833

The following tables present interest income by class, recognized on impaired loans (in thousands):

	For the Three Months Ended March 31, 2016	
	Average Recorded Investment	Interest Income Recognized
Total:		
Commercial and industrial	$ 1,337	$ 13
Real estate - construction	1,620	25
Real estate - mortgage:		
Residential	3,983	36

Commercial	7,719	123
Consumer installment	6	-
	$14,665	$ 197

	For the Three Months Ended March 31, 2015	
	Average Recorded Investment	Interest Income Recognized
Total:		
Commercial and industrial	$1,227	$ 14
Real estate - construction	2,882	20
Real estate - mortgage:		
Residential	4,833	38
Commercial	4,266	39
Consumer installment	6	-
	$13,214	$ 111

Management uses a nine-point internal risk-rating system to monitor the credit quality of the overall loan portfolio. The first five 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. 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 Company 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 Company’s Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis with the Chief Credit Officer ultimately responsible for accurate and timely risk ratings. The Credit Department performs an annual review of all commercial relationships with loan balances of $1,000,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Company engages an external consultant to conduct loan reviews on a semiannual basis. Generally, the external consultant reviews commercial relationships greater than $250,000 and/or criticized relationships greater than $125,000. 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 primary risk of commercial and industrial loans is the current economic uncertainties. C&I loans are, by nature, secured by less substantial collateral than real estate-secured loans. The primary risk of real estate construction loans is potential delays and /or disputes during the completion process. The primary risk of residential real estate loans is current economic uncertainties along with the slow recovery in the housing market. The primary risk of commercial real estate loans is loss of income of the owner or occupier of the property and the inability of the market to sustain rent levels. Consumer installment loans historically have experienced higher delinquency rates. Consumer installments are typically secured by less substantial collateral than other types of credits.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk-rating system (in thousands):

March 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total Loans
Commercial and industrial	$ 45,742	$ 485	$ 1,209	$ -	$ 47,436
Real estate - construction	20,886	-	-	119	21,005
Real estate - mortgage:					
Residential	231,785	493	6,211	-	238,489
Commercial	208,808	1,223	8,332	-	218,363
Consumer installment	5,060	-	3	-	5,063
Total	$ 512,281	$ 2,201	$ 15,755	$ 119	$ 530,356

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total Loans
Commercial and industrial	$ 40,560	$ 242	$ 1,734	$ -	$ 42,536
Real estate - construction	22,007	-	-	130	22,137
Real estate - mortgage:					
Residential	225,945	728	5,805	-	232,478
Commercial	219,331	4,327	8,043	-	231,701
Consumer installment	4,854	-	4	-	4,858
Total	$ 512,697	$ 5,297	$ 15,586	$ 130	$ 533,710

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.

Nonperforming assets include nonaccrual loans, troubled debt restructurings (TDRs), loans 90 days or more past due, EMORECO assets, other real estate owned, and repossessed assets. A loan is classified as nonaccrual when, in the opinion of management, there are serious doubts about collectability of interest and principal. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower’s financial condition is such that collection of principal and interest is doubtful. Payments received on nonaccrual loans are applied against the principal balance.

The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans (in thousands):

March 31, 2016	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due	Total Loans
Commercial and industrial	$47,080	$2	$9	$345	$356	$47,436
Real estate - construction	21,005	-	-	-	-	21,005
Real estate - mortgage:						
Residential	236,114	1,261	91	1,023	2,375	238,489
Commercial	217,625	21	112	605	738	218,363
Consumer installment	5,063	-	-	-	-	5,063
Total	$526,887	$1,284	$212	$1,973	$3,469	$530,356

December 31, 2015	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due	Total Loans
Commercial and industrial	$41,544	$225	$26	$741	$992	$42,536
Real estate - construction	22,137	-	-	-	-	22,137
Real estate - mortgage:						
Residential	229,725	1,482	92	1,179	2,753	232,478
Commercial	230,903	189	-	609	798	231,701
Consumer installment	4,837	16	3	2	21	4,858
Total	$529,146	$1,912	$121	$2,531	$4,564	$533,710

The following tables present the classes of the loan portfolio summarized by nonaccrual loans (in thousands):

March 31, 2016	Nonaccrual	90+ Days Past Due and Accruing
Commercial and industrial	$ 1,058	$ -
Real estate - construction	118	-
Real estate - mortgage:		
Residential	4,435	67
Commercial	1,922	-
Consumer installment	1	-
Total	$ 7,534	$ 67

December 31, 2015	December 31, 2015 Nonaccrual	90+ Days Past Due and Accruing
Commercial and industrial	$ 1,450	$ -
Real estate - construction	130	-
Real estate - mortgage:		
Residential	4,122	-
Commercial	1,842	-
Consumer installment	1	2

Total	$ 7,545	$ 2

An allowance for loan and lease losses ("ALLL") is maintained to absorb losses from the loan portfolio. The ALLL 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 nonperforming loans.

The Company's methodology for determining the ALLL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Company's ALLL. Management also performs impairment analyses on TDRs, which may result in specific reserves.

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 purpose code assigned to each loan, provide the starting point for the ALLL analysis. Management tracks the historical net charge-off activity at the purpose code level. A historical charge-off factor is calculated using the last four consecutive historical quarters.

Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and nonaccrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and 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 ALLL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALLL.

The following tables summarize the primary segments of the loan portfolio (in thousands):

	Commercial and industrial	Real estate- construction	Real estate- residential mortgage	Real estate- commercial mortgage	Consumer installment	Total
ALLL balance at December 31, 2015	$ 867	$ 276	$ 3,139	$ 2,078	$ 25	$ 6,385
Charge-offs	(120)	-	(42)	-	(15)	(177)
Recoveries	37	-	4	-	3	44
Provision	(201)	(29)	(385)	705	15	105
ALLL balance at March 31, 2016	$ 583	$ 247	$ 2,716	$ 2,783	$ 28	$ 6,357

	Commercial and industrial	Real estate- construction	Real estate- residential mortgage	Real estate- commercial mortgage	Consumer installment	Total
ALLL balance at December 31, 2014	$ 642	$ 868	$ 3,703	$ 1,576	$ 57	$ 6,846

Charge-offs	(100)	(385)	(191)	-	(3)	(679)
Recoveries	162	-	12	-	1	175
Provision	(211)	11	(65)	382	(12)	105
ALLL balance at March 31, 2015	$ 493	$ 494	$ 3,459	$ 1,958	$ 43	$ 6,447

The following tables summarize troubled debt restructurings (in thousands):

	For the Three Months Ended March 31, 2016				
	Number of Contracts			Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings	Term Modification	Other	Total		
Commercial and industrial	2	-	2	$ 33	$ 33
Residential real estate	2	-	2	74	74
Commercial real estate	2	-	2	581	581

	For the Three Months Ended March 31, 2015				
	Number of Contracts			Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings	Term Modification	Other	Total		
Commercial and industrial	1	-	1	$ 48	$ 48
Residential real estate	1	-	1	175	195

No TDRs, modified in the twelve months prior to March 31, 2016 and March 31, 2015, subsequently defaulted in the three months ended March 31, 2016 and March 31, 2015.

NOTE 8 – OTHER REAL ESTATE OWNED ("OREO")

OREO comprises foreclosed assets acquired in settlement of loans and is carried at fair value less estimated cost to sell and is included in other assets on the Consolidated Balance Sheet. At March 31, 2016 and December 31, 2015, there was $1.4 million of OREO. As of March 31, 2016, the Company has initiated formal foreclosure proceedings on $2.0 million of real estate.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis provides further detail to the financial condition and results of operations of the Company. The MD&A should be read in conjunction with the notes and financial statements presented in this report.

CHANGES IN FINANCIAL CONDITION

General. The Company's total assets ended the March 31, 2016 quarter at $732.9 million, a decrease of $2.3 million or 0.3% from December 31, 2015. For the same time period, cash and cash equivalents increased $6.5 million, or 27.2% while net loans decreased $3.3 million, or 0.6%. Total liabilities decreased $3.7 million, or 0.6% while stockholders' equity increased $1.5 million, or 2.3%.

Cash and cash equivalents. Cash and due from banks and Federal funds sold represent cash and cash equivalents. Cash and cash equivalents increased $6.5 million at March 31, 2016 from $23.8 million at December 31, 2015. Deposits from customers into savings and checking accounts, loan and securities repayments and proceeds from borrowed funds typically increase these accounts. Decreases result from customer withdrawals, new loan originations, purchases of investment securities and repayments of borrowed funds.

Investment securities. Investment securities available for sale on March 31, 2016 totaled $142.6 million, a decrease of $4.0 million or 2.7% from $146.5 million at December 31, 2015. During this period the Company recorded repayments, calls, and maturities of $4.8 million. Sales of securities were $1.3 million with a net realized gain of $51,000. Securities purchases were $1.7 million during this period.

Loans receivable. The loans receivable category consists primarily of single-family mortgage loans used to purchase or refinance personal residences located within the Company's market area and commercial real estate loans used to finance properties that are used in the borrowers' businesses or to finance investor-owned rental properties, and to a lesser extent, construction and consumer loans. Net loans receivable decreased $3.3 million or 0.6% to $524.0 million as of March 31, 2016 from $527.3 million at December 31, 2015. Included in this amount were increases in the residential real estate and commercial and industrial portfolios of $6.0 million, or 2.6% and $4.9 million, or 11.5%, respectively. The commercial real estate and construction portfolios decreased by $13.3 million and $1.1 million, respectively.

The Company's Mortgage Banking operation generates loans for sale to FHLMC. Loans held for sale on March 31, 2016 totaled $0.2 million, a decrease of $0.9 million, or 84.1%, from December 31, 2015. This decrease is the result of fewer funded loans being held in the warehouse at quarter end.

Allowance for loan and lease losses and Asset Quality. The Company maintained the allowance for loan and lease losses at $6.4 million, or 1.2% of total loans, at March 31, 2016. For the three months ended March 31, 2016, net loan charge-offs totaled $133,000, or 0.10% of average loans, compared to net charge-offs of $504,000, or 0.43%, for the same period in 2015. To maintain the allowance for loan and lease losses, the Company recorded a provision for loan loss of $105,000 in the three month periods ending March 31, 2016 and 2015.

Management analyzes the adequacy of the allowance for loan and lease losses regularly through reviews of the performance of the loan portfolio considering economic conditions, changes in interest rates and the effect of such changes on real estate values and changes in the amount and composition of the loan portfolio. The allowance for loan and lease losses is a significant estimate that is particularly susceptible to changes in the near term. Such evaluation includes a review of all loans designated as impaired, historical loan loss experience, the estimated fair value of the underlying collateral, economic conditions, current interest rates, trends in the borrower’s industry and other factors that management believes warrant recognition in providing for an appropriate allowance for loan and lease losses. Future additions or reductions to the allowance for loan and lease losses will be dependent on these factors. Additionally, the Company uses an outside party to conduct an independent review of commercial and commercial real estate loans that is designed to test management conclusions of risk ratings and the appropriateness of the allowance allocated to these loans. The Company uses the results of this review to help determine the effectiveness of policies and procedures and to assess the adequacy of the allowance for loan and lease losses allocated to these types of loans. Management believes the allowance for loan and lease losses is appropriately stated at March 31, 2016. Based on the variables involved and management’s judgments about uncertain outcomes, the determination of the allowance for loan and lease losses is considered a critical accounting policy.

Nonperforming assets. Nonperforming assets includes nonaccrual loans, troubled debt restructurings (TDRs), loans 90 days or more past due, EMORECO assets, other real estate, and repossessed assets. Real estate owned is written down to fair value at its initial recording and continually monitored for changes in fair value. A loan is classified as nonaccrual when, in the opinion of management, there are serious doubts about collectability of interest and principal. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower’s financial condition is such that collection of principal and interest is doubtful. Payments received on nonaccrual loans are applied against principal until doubt about collectability ceases. TDRs are those loans which the Company, for economic or legal reasons related to a borrower’s financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. The Company has 33 TDRs with a total balance of $3.3 million as of March 31, 2016. A TDR that yields market interest rate at the time of restructuring and is in compliance with its modified terms is no longer reported as TDR in calendar years after the year in which the restructuring took place. To be in compliance with its modified terms, a loan that is a TDR must not be in nonaccrual status and must be current or less than 30 days past due on its contractual principal and interest payments under the modified repayment terms. Nonperforming loans secured by real estate totaled $9.3 million as of March 31, 2016, an increase of $1.0 million from $8.3 million at December 31, 2015.

Asset Quality History

(Dollar amounts in thousands)	3/31/2016	12/31/2015	9/30/2015	6/30/2015	3/31/2015
Nonperforming loans	$ 10,508	$ 10,263	$ 8,921	$ 7,777	$ 8,262
Real estate owned	1,447	1,412	2,006	2,308	2,203
Nonperforming assets	$ 11,955	$ 11,675	$ 10,927	$ 10,085	$ 10,465
Allowance for loan and lease losses	6,357	6,385	6,320	6,346	6,447
Ratios					
Nonperforming loans to total loans	1.98 %	1.92 %	1.75 %	1.58 %	1.74 %
Nonperforming assets to total assets	1.63 %	1.59 %	1.54 %	1.43 %	1.50 %
Allowance for loan and lease losses to total loans	1.20 %	1.20 %	1.24 %	1.29 %	1.35 %
Allowance for loan and lease losses to nonperforming loans	60.50 %	62.21 %	70.84 %	81.60 %	78.03 %

The increase in nonperforming loans is due to an effort to be more aggressive in moving accounts to nonaccrual. Specifically, five loans averaging $0.4 million were added. These loans were either charged down to a reliable carrying amount or specific reserves were taken. Total ALLL is sufficient to absorb any expected losses.

A major factor in determining the appropriateness of the allowance for loan and lease losses is the type of collateral which secures the loans. Of the total nonperforming loans at March 31, 2016, 88.6% were secured by real estate. Although this does not insure against all losses, the real estate typically provides for at least partial recovery, even in a distressed-sale and declining-value environment. The Company’s objective is to minimize the future loss exposure to the Company.

Deposits. The Company considers various sources when evaluating funding needs, including but not limited to deposits, which are a significant source of funds totaling $631.4 million or 94.6% of the Company’s total funding sources at March 31, 2016. Total deposits increased $7.0 million or 1.1% at March 31, 2016 from $624.4 million at December 31, 2015. The increase in deposits is primarily related to the increase in interest-bearing demand and money market accounts of $9.9 million or 17.2%, and $3.3 million or 4.2%, respectively, at March 31, 2016. These increases were partially offset by decreases in time, savings, and noninterest-bearing demand accounts of $2.8 million, $2.4 million, and $1.0 million, respectively.

Borrowed funds. The Company uses short and long-term borrowings as another source of funding used for asset growth and liquidity needs. These borrowings primarily include FHLB advances, junior subordinated debt, short-term borrowings from other banks, federal funds purchased, and repurchase agreements. Short-term borrowings decreased $9.7 million, or 27.1%, to $26.1 million as of March 31, 2016.

Stockholders' equity. Stockholders' equity increased $1.5 million, or 2.3%, to $63.8 million at March 31, 2016 from $62.3 million at December 31, 2015. This growth was the result of increases in retained earnings and accumulated other comprehensive income ("AOCI") of $1.0 million and $0.3 million, respectively. The change to AOCI is due to available-for-sale securities fair value adjustments and the change in retained earnings is due to the year to date net income offset by dividends paid.

RESULTS OF OPERATIONS

General. Net income for the three months ended March 31, 2016, was $1.5 million, a $141,000, or 8.7% decrease from the amount earned during the same period in 2015. Diluted earnings per share for the quarter was unchanged from the same period in 2015 at $0.79.

The Company's annualized return on average assets (ROA) and return on average equity (ROE) for the quarter were 0.81% and 9.34%, respectively, compared with 0.96% and 10.23% for the same period in 2015.

Net interest income. Net interest income, the primary source of revenue for the Company, is determined by the Company's interest rate spread, which is defined as the difference between income on earning assets and the cost of funds supporting those assets, and the relative amounts of interest-earning assets and interest-bearing liabilities. Management periodically adjusts the mix of assets and liabilities, as well as the rates earned or paid on those assets and liabilities in order to manage and improve net interest income. The level of interest rates and changes in the amount and composition of interest-earning assets and liabilities affect the Company's net interest income. Historically from an interest rate risk perspective, it has been management's goal to maintain a balance between steady net interest income growth and the risks associated with interest rate fluctuations.

Net interest income for the three months ended March 31, 2016 totaled $6.3 million, an increase of 2.8% from that reported in the comparable period of 2015. The net interest margin was 3.87% for the first quarter of 2015, down from the 4.02% reported for the same quarter of 2015. The decrease is attributable to lower interest-earning asset yields, which decreased 10 basis points to 4.46%, on average interest-earning assets that increased by $37.7 million, or 5.7%. The decrease is also the result of a 5 basis point increase to 0.75% in the cost of interest-bearing liabilities on average interest-earning assets that increased by $39.6 million, or 7.7%.

Interest income. Interest income increased $313,000, or 4.4%, for the three months ended March 31, 2016, compared to the same period in the prior year. This is attributable to an increase in interest and fees on loans, partially offset by a decrease in interest earned on taxable investment securities.

Interest earned on loans receivable increased $330,000, or 5.6%, for the three months ended March 31, 2016, compared to the same period in the prior year. This is attributable to an increase in average loan balances of $58.6 million, partially offset by a 10 basis point decrease in the average yield, to 4.46%.

Interest earned on securities was unchanged for the three months ended March 31, 2016 when compared to the same period in the prior year. The average balance decreased $6.3 million, or 4.2% while the 4.23% yield on the investment portfolio was an increase of 12 basis points, from 4.11%, for the same period in the prior year.

Interest expense. Interest expense increased $142,000, or 16.1%, for the three months ended March 31, 2016, compared to the same period in the prior year. The increase is attributable to average balance increases to borrowings, time deposits, and money market deposits of $23.3 million, or 116.2%, $9.5 million, or 5.2%, and $4.1 million, or 5.4%, respectively. The increase was also the result of a 5 basis point increase in the cost of interest-bearing liabilities from the same period in 2015.

Provision for loan losses. The provision for loan losses represents the charge to income necessary to adjust the allowance for loan and lease losses to an amount that represents management’s assessment of the estimated probable incurred credit losses inherent in the loan portfolio. Each quarter management performs a review of estimated probable incurred credit losses in the loan portfolio. Based on this review, a provision for loan losses of $105,000 was recorded for the quarter ended March 31, 2016 unchanged from the quarter ended March 31, 2015. Nonperforming loans were $10.5 million, or 2.0% of total loans at March 31, 2016 compared with $8.3 million, or 1.7% at March 31, 2015. For the three months ended March 31, 2016, net loan charge-offs totaled $133,000, or 0.10% of average loans, compared to net charge-offs of $504,000, or 0.43%, for the first quarter of 2015.

Noninterest income. Noninterest income increased $113,000 for the three months ended March 31, 2016 over the comparable 2015 period. This increase was largely the result of increases in gain on sale of loans, earnings on bank-owned life insurance, and net investment security gains of $34,000, $30,000, and $27,000, respectively.

Noninterest expense. Noninterest expense of $5.3 million for the first quarter of 2016 was 11.0% or $527,000 more than the first quarter of 2015. Salaries and benefits and other expense increased $420,000, or 17.8%, and $78,000, or 20.7%, respectively. The salary increase is mostly due to an additional pay cycle in the first three months of 2016.

Provision for income taxes. The Company recognized $302,000 in income tax expense, which reflected an effective tax rate of 16.9% for the three months ended March 31, 2016, as compared to $404,000 with an effective tax rate of 19.9% for the comparable 2015 period.

CRITICAL ACCOUNTING ESTIMATES

The Company's critical accounting estimates involving the more significant judgments and assumptions used in the preparation of the consolidated financial statements as of March 31, 2016, have remained unchanged from December 31, 2015.

Average Balance Sheet and Yield/Rate Analysis. The following tables set forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resultant average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resultant average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average balances are calculated using monthly averages and the average loan balances include nonaccrual loans and exclude the allowance for loan and lease losses, and interest income includes accretion of net deferred loan fees. Interest and yields on tax-exempt securities (tax exempt for federal income tax purposes) are shown on a fully tax-equivalent basis utilizing a federal tax rate of 34%. Yields and rates have been calculated on an annualized basis utilizing monthly interest amounts.

	For the Three Months Ended March 31,					
	2016			2015		
(Dollars in thousands)	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Interest-earning assets:						
Loans receivable	$531,196	$6,173	4.67 %	$472,569	$5,843	5.01 %
Investment securities (3)	146,245	1,130	4.23 %	152,584	1,154	4.11 %
Interest-bearing deposits with other banks	21,134	45	0.86 %	35,702	38	0.43 %
Total interest-earning assets	698,575	7,348	4.46 %	660,855	7,035	4.56 %
Noninterest-earning assets	36,695			24,338		
Total assets	$735,270			$685,193		
Interest-bearing liabilities:						
Interest-bearing demand deposits	$59,931	$42	0.28 %	$57,931	$44	0.31 %
Money market deposits	79,964	83	0.42 %	75,853	75	0.40 %
Savings deposits	178,827	128	0.29 %	178,044	137	0.31 %
Certificates of deposit	191,016	602	1.27 %	181,558	575	1.28 %
Borrowings	43,331	170	1.58 %	20,038	52	1.05 %
Total interest-bearing liabilities	553,069	1,025	0.75 %	513,424	883	0.70 %
Noninterest-bearing liabilities						
Other liabilities	118,313			107,227		
Stockholders' equity	63,888			64,542		
Total liabilities and stockholders' equity	$735,270			$685,193		