MIDDLEFIELD BANC CORP
Form 10-Q
November 06, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)	
X	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** For the quarterly period ended September 30, 2018
or	
	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ___________ to ___________

Commission file number 001-36613

Middlefield Banc Corp.
(Exact Name of Registrant as Specified in its Charter)

Ohio	34-1585111
State or Other	I.R.S. Employer

Jurisdiction of Incorporation or Organization	Identification No.
15985 East High Street, Middlefield, Ohio	44062-0035
Address of Principal Executive Offices	Zip Code

440-632-1666
Registrant's Telephone Number, Including Area Code

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **X**   No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes **X**   No

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

Large accelerated filer Accelerated filer **X**

Non-accelerated filer	Smaller reporting company **X**
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Class: Common Stock, without par value
Outstanding at November 6, 2018: 3,238,346

MIDDLEFIELD BANC CORP.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Cash and cash equivalents	$81,951	$39,886
Equity securities, at fair value	671	-
Investment securities available for sale, at fair value	99,717	95,283
Loans held for sale	925	463
Loans	972,968	923,213
Less allowance for loan and lease losses	7,494	7,190
Net loans	965,474	916,023
Premises and equipment, net	13,002	11,853
Goodwill	15,071	15,071
Core deposit intangibles	2,484	2,749
Bank-owned life insurance	15,970	15,652
Other real estate owned	257	212
Accrued interest receivable and other assets	10,806	9,144
TOTAL ASSETS	$1,206,328	$1,106,336
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$205,357	$192,438
Interest-bearing demand	96,565	83,990
Money market	191,261	150,277
Savings	224,704	208,502
Time	295,874	242,987
Total deposits	1,013,761	878,194
Short-term borrowings	55,304	74,707
Other borrowings	8,956	29,065
Accrued interest payable and other liabilities	4,074	4,507
TOTAL LIABILITIES	1,082,095	986,473
STOCKHOLDERS' EQUITY		
Common stock, no par value; 10,000,000 shares authorized, 3,622,854 and 3,603,881 shares issued; 3,236,689 and 3,217,716 shares outstanding	85,687	84,859

Retained earnings	53,520	47,431
Accumulated other comprehensive (loss) income	(1,456)	1,091
Treasury stock, at cost; 386,165 shares	(13,518)	(13,518)
TOTAL STOCKHOLDERS' EQUITY	124,233	119,863
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,206,328	$1,106,336

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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
INTEREST AND DIVIDEND INCOME				
Interest and fees on loans	$11,821	$10,443	$34,109	$29,539
Interest-earning deposits in other institutions	178	107	412	248
Federal funds sold	8	5	29	9
Investment securities:				
Taxable interest	167	159	506	600
Tax-exempt interest	598	579	1,673	1,846
Dividends on stock	57	37	169	189
Total interest and dividend income	12,829	11,330	36,898	32,431
INTEREST EXPENSE				
Deposits	2,178	1,468	5,803	3,820
Short-term borrowings	296	202	764	652
Other borrowings	104	148	344	413
Total interest expense	2,578	1,818	6,911	4,885
NET INTEREST INCOME	10,251	9,512	29,987	27,546
Provision for loan losses	210	280	630	615
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,041	9,232	29,357	26,931
NONINTEREST INCOME				
Service charges on deposit accounts	491	479	1,416	1,397
Investment securities gains on sale, net	-	398	-	886
Gain on equity securities	15	-	46	-
Earnings on bank-owned life insurance	108	109	318	316
Gain on sale of loans	43	255	164	720
Other income	291	200	807	622
Total noninterest income	948	1,441	2,751	3,941
NONINTEREST EXPENSE				
Salaries and employee benefits	3,839	3,725	11,684	10,624

Occupancy expense	460	476	1,468	1,397
Equipment expense	262	242	696	789
Data processing costs	481	468	1,360	1,376
Ohio state franchise tax	244	186	603	558
Federal deposit insurance expense	150	165	450	368
Professional fees	346	434	1,118	1,230
Advertising expense	236	248	694	660
Software amortization expense	155	118	460	280
Core deposit intangible amortization	87	101	265	276
Merger expense	-	338	-	1,032
Other expense	832	796	2,702	2,678
Total noninterest expense	7,092	7,297	21,500	21,268
Income before income taxes	3,897	3,376	10,608	9,604
Income taxes	593	914	1,602	2,535
NET INCOME	$3,304	$2,462	$9,006	$7,069
EARNINGS PER SHARE				
Basic	$1.02	$0.77	$2.79	$2.38
Diluted	1.02	0.76	2.78	2.37
DIVIDENDS DECLARED PER SHARE	$0.28	$0.27	$0.89	$0.81

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$3,304	$2,462	$9,006	$7,069
Other comprehensive (loss) gain:				
Net unrealized holding (loss) gain on available-for-sale investment securities	(1,297)	(264)	(3,282)	1,153
Tax effect	272	89	689	(392)
Reclassification adjustment for investment securities gains included in net income	-	(398)	-	(886)
Tax effect	-	135	-	301
Total other comprehensive (loss) gain	(1,025)	(438)	(2,593)	176
Comprehensive income	$2,279	$2,024	$6,413	$7,245

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share and per share data)

(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2017	$ 84,859	$ 47,431	$ 1,091	$ (13,518)	$ 119,863
Change in accounting principle for adoption of ASU 2016-01		141	(141)		-
Change in accounting principle for adoption of ASU 2018-02		(187)	187		-
Net income		9,006			9,006
Other comprehensive loss			(2,593)		(2,593)
Dividend reinvestment and purchase plan (8,763 shares)	441				441
Stock options exercised (4,650 shares)	107				107
Stock-based compensation (5,560 shares)	280				280
Cash dividends ($0.89 per share)		(2,871)			(2,871)
Balance, September 30, 2018	$ 85,687	$ 53,520	$ (1,456)	$ (13,518)	$ 124,233

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
OPERATING ACTIVITIES		
Net income	$9,006	$7,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	630	615
Investment securities gains on sale, net	-	(886)
Gain on equity securities	(46)	-
Depreciation and amortization of premises and equipment, net	694	661
Software amortization expense	460	280
Amortization of premium and discount on investment securities, net	317	343
Accretion of deferred loan fees, net	(690)	(246)
Amortization of core deposit intangibles	265	276
Stock-based compensation expense	360	33
Origination of loans held for sale	(9,588)	(13,345)
Proceeds from sale of loans	9,290	7,811
Gain on sale of loans	(164)	(239)
Origination of student loans held for sale	-	(321,942)
Proceeds from sale of student loans	-	328,853
Gain on sale of student loans	-	(481)
Earnings on bank-owned life insurance	(318)	(316)
Deferred income tax	184	(532)
Net loss (gain) on other real estate owned	5	(211)
Increase in accrued interest receivable	(445)	(311)
Increase in accrued interest payable	126	124
Other, net	(1,721)	(2,338)
Net cash provided by operating activities	8,365	5,218
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	4,340	9,560
Proceeds from sale of securities	-	6,474
Purchases	(12,998)	(250)
Increase in loans, net	(49,467)	(75,307)
Proceeds from the sale of other real estate owned	26	1,767
Purchase of bank-owned life insurance	-	(5)

Purchase of premises and equipment	(1,843)	(1,037)
Purchase of restricted stock	(90)	(899)
Redemption of restricted stock	-	795
Acquisition, net of cash paid	-	5,431
Net cash used in investing activities	(60,032)	(53,471)
FINANCING ACTIVITIES		
Net increase in deposits	135,567	69,677
Decrease in short-term borrowings, net	(19,403)	(48,085)
Repayment of other borrowings	(20,109)	(164)
Proceeds from other borrowings	-	30,000
Proceeds from common stock issued	-	15,164
Stock options exercised	107	180
Proceeds from dividend reinvestment and purchase plan	441	407
Cash dividends	(2,871)	(2,490)
Net cash provided by financing activities	93,732	64,689
Increase in cash and cash equivalents	42,065	16,436
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	39,886	32,495
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$81,951	$48,931

See accompanying notes to unaudited consolidated financial statements.

	Nine Months Ended September 30,	
	2018	2017
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$6,785	$4,761
Income taxes	1,675	4,455
Noncash investing transactions:		
Transfers from loans to other real estate owned	$76	$1,179
Common stock issued in business acquisition	-	20,995
Transfer of equity securities from investment securities available for sale, at fair value	(625)	-

Acquisition of Liberty Bank, N.A.	
Noncash assets acquired	
Loans	$195,388
Loans held for sale	5,953
Premises and equipment, net	325
Accrued interest receivable	440
Bank-owned life insurance	1,681
Core deposit intangible	3,087
Other assets	997
Goodwill	10,740
Total noncash assets acquired	218,611
Liabilities assumed	
Time deposits	(30,744)
Deposits other than time deposits	(167,300)
Accrued interest payable	(47)
Deferred taxes	(1,134)
Other liabilities	(2,754)
Total liabilities assumed	(201,979)
Liberty stock acquired in business combination	(1,068)
Net noncash assets acquired	$15,564
Cash and cash equivalents acquired, net	$5,431

See accompanying notes to unaudited consolidated financial statements.

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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 ("MBC" or "Middlefield Bank"), and a nonbank asset resolution subsidiary EMORECO, Inc. All significant inter-company items have been eliminated.

The unaudited condensed consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2017. The interim consolidated financial statements include all adjustments (consisting of only normal recurring items) that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year.

Recently Adopted Accounting Pronouncements –

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 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 (g) 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. In February 2018, the FASB issued ASU No. 2018-03 which includes technical corrections and improvements to clarify the guidance in ASU No. 2016-01. On January 1, 2018, the Company adopted ASU 2016-01 which resulted in a reclassification of $141,000 between accumulated other comprehensive income and retained earnings on the Consolidated Balance Sheet and Consolidated Statement of Changes in Stockholders' Equity.

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220)*, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this Update is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this Update should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. On January 1, 2018, the Company adopted this standard which resulted in a reclassification of $187,000 between accumulated other comprehensive income and retained earnings on the Consolidated Balance Sheet and Consolidated Statement of Changes in Stockholders' Equity.

In February 2018, the FASB issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10)*, to clarify certain aspects of the guidance issued in ASU 2016-01. (1) An entity measuring an equity security using the measurement alternative may change its measurement approach to a fair value method in accordance with Topic 820, Fair Value Measurement, through an irrevocable election that would apply to that security and all identical or similar investments of the same issuer. Once an entity makes this election, the entity should measure all future purchases of identical or similar investments of the same issuer using a fair value method in accordance with Topic 820. (2) Adjustments made under the measurement alternative are intended to reflect the fair value of the security as of the date that the observable transaction for a similar security took place. (3) Remeasuring the entire value of forward contracts and purchased options is required when observable transactions occur on the underlying equity securities. (4) When the fair value option is elected for a financial liability, the guidance in paragraph 825-10- 45-5 should be applied, regardless of whether the fair value option was elected under either Subtopic 815-15, *Derivatives and Hedging—Embedded Derivatives, or 825-10, Financial Instruments—Overall.* (5) Financial liabilities for which the fair value option is elected, the amount of change in fair value that relates to the instrument specific credit risk should first be measured in the currency of denomination when presented separately from the total change in fair value of the financial liability. Then, both components of the change in the fair value of the liability should be remeasured into the functional currency of the reporting entity using end-of-period spot rates. (6) The prospective transition approach for equity securities without a readily determinable fair value in the amendments in Update 2016-01 is meant only for instances in which the measurement alternative is applied. An insurance entity subject to the guidance in Topic 944, *Financial Services— Insurance*, should apply a prospective transition method when applying the amendments related to equity securities without readily determinable fair values. An insurance entity should apply the selected prospective transition method consistently to the entity's entire population of equity securities for which the measurement alternative is elected. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Public business entities with fiscal years beginning between December 15, 2017, and June 15, 2018, are not required to adopt these amendments until the interim period beginning after June 15, 2018, and public business entities with fiscal years beginning between June 15, 2018, and December 15, 2018, are not required to adopt these amendments before adopting the amendments in Update 2016-01. For all other entities, the effective date is the same as the effective date in Update 2016-01. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted Update 2016-01. The adoption of this standard has not had a significant impact on the Company's financial position or results of operations.

Recently Issued Accounting Pronouncements –

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. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a 1 percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments ("CECL"),* which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. Management is currently evaluating the impact of the adoption of this guidance on the Company's consolidated financial statements. Management will oversee the implementation of CECL and is currently in the process of implementing a software solution to assist in the adoption of this ASU. Management plans to run the current incurred loss model and the CECL model concurrently for 12 months prior to the adoption of this guidance on January 1, 2020.

ASU 2018-04, *Investments – Debt Securities (Topic 320)* and *Regulated Operations (Topic 980) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273*, ASU 2018-04 supersedes various SEC paragraphs and adds an SEC paragraph pursuant to the issuance of Staff Accounting Bulletin No. 117. This Update is not expected to have a significant impact on the Company's financial statements.

In June 2018, the FASB issued ASU 2018-07, *Compensation – Stock Compensation (Topic 718)*, which simplified the accounting for nonemployee share-based payment transactions. The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments in this Update improve the following areas of nonemployee share-based payment accounting: (a) the overall measurement objective, (b) the measurement date, (c) awards with performance conditions, (d) classification reassessment of certain equity-classified awards, (e) calculated value (nonpublic entities only), and (f) intrinsic value (nonpublic entities only). The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. 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 July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. This Update provides another transition method which allows entities to initially apply ASC 842 at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Entities that elect this approach should report comparative periods in accordance with ASC 840, *Leases*. In addition, this Update provides a practical expedient under which lessors may elect, by class of underlying assets, to not separate nonlease components from the associated lease component, similar to the expedient provided for lessees. However, the lessor practical expedient is limited to circumstances in which the nonlease component or components otherwise would be accounted for under the new revenue guidance and both (a) the timing and pattern of transfer are the same for the nonlease component(s) and associated lease component and (b) the lease component, if accounted for separately, would be classified as an operating lease. If the nonlease component or components associated with the lease component are the predominant component of the combined component, an entity should account for the combined component in accordance with ASC 606, *Revenue from Contracts with Customers*. Otherwise, the entity should account for the combined component as an operating lease in accordance with ASC 842. If a lessor elects the practical expedient, certain disclosures are required. This Update is effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. 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 August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes the Disclosure Requirements for Fair Value Measurements*. The Update removes the requirement to disclose the amount of, and reasons for, transfers between Level I and Level II of the fair value hierarchy; the policy for timing of transfers between levels; and the valuation processes for Level III fair value measurements. The Update requires disclosure of changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level III fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level III fair value measurements. This Update is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. 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 – REVENUE RECOGNITION

Effective January 1, 2017, the Company adopted ASU 2014-09 *Revenue from Contracts with Customers-(Topic 606)* and all subsequent ASUs that modified ASC 606. The implementation of the new standard had no material impact on the measurement or recognition of revenue for prior periods and did not require any cumulative effect adjustment for adoption.

Management determined that the primary sources of revenue, which emanate from interest income on loans and investments, along with noninterest revenue resulting from investment security gains, gains on the sale of loans, and BOLI income, are not within the scope of ASC 606. As a result, no changes were made during the period related to these sources of revenue, which cumulatively comprise 92.9% of the total revenue of the Company.

The main types of noninterest income within the scope of the standard are as follows:

Service charges on deposit accounts – The Company has contracts with its deposit customers where fees are charged if the account balance falls below predetermined levels defined as compensating balances. These agreements can be cancelled at any time by either the Company or the deposit customer. Revenue from these transactions is recognized on a monthly basis as the Company has an unconditional right to the fee consideration. The Company also has transaction fees related to specific customer requests or activities that include overdraft fees, online banking fees, and other transaction fees. All of these fees are attributable to specific performance obligations of the Company where the revenue is recognized at a defined point in time, which is completion of the requested service/transaction.

Gains (losses) on sale of other real estate owned – Gains and losses are recognized at the completion of the property sale when the buyer obtains control of the real estate and all of the performance obligations of the Company have been satisfied. Evidence of the buyer obtaining control of the asset include transfer of the property title, physical possession of the asset, and the buyer obtaining control of the risks and rewards related to the asset. In situations where the Company agrees to provide financing to facilitate the sale, additional analysis is performed to ensure that the contract for sale identifies the buyer and seller, the asset to be transferred and the payment terms, that the contract has a true commercial substance and that amounts due from the buyer are reasonable. In situations where financing terms are not reflective of current market terms, the transaction price is discounted impacting the gain/loss and the carrying value of the asset.

The following table depicts the disaggregation of revenue derived from contracts with customers to depict the nature, amount, timing, and uncertainty of revenue and cash flows:

Noninterest Income (Dollar amounts in thousands)	For the Three Months Ended September 30, 2018	 2017	For the Nine Months Ended September 30, 2018	 2017
Service charges on deposit accounts:				
Overdraft fees	$207	$209	$597	$583
ATM banking fees	219	209	634	528
Service charges and other fees	65	61	185	286
Investment securities gains on sale, net [(a)]	-	398	-	886
Equity securities, unrealized gains [(a)]	15	-	46	-
Earnings on bank-owned life insurance [(a)]	108	109	318	316
Gain on sale of loans [(a)]	43	255	164	720
Other income	291	200	807	622

Total noninterest income	$948	$1,441	$2,751	$3,941

(a) Not within scope of ASC 606

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NOTE 3 - STOCK-BASED COMPENSATION

The Company had no unvested stock options outstanding as of September 30, 2018 and 2017.

Stock option activity during the nine months ended September 30 is as follows:

	Shares	Weighted-average Exercise Price Per Share
Outstanding, January 1, 2018	19,750	$ 20.94
Exercised	(6,150)	23.00
Outstanding, September 30, 2018	13,600	$ 20.01
Exercisable, September 30, 2018	13,600	$ 20.01

The following table presents the activity during the nine months ended September 30, 2018 related to awards of restricted stock:

	Shares	Weighted-average Grant Date Fair Value Per Share
Nonvested at January 1, 2018	14,601	$ 35.14
Granted	9,952	48.20
Forfeited	(223)	35.31
Vested	(3,905)	33.61
Nonvested at September 30, 2018	20,425	$ 41.80
Expected to vest at September 30, 2018	10,473	$ 35.71

The Company recognizes restricted stock forfeitures in the period they occur.

Share-based compensation expense of $90,000 and $45,000 was recognized for the three-month periods ended September 30, 2018 and 2017, respectively. Share-based compensation expense of $226,000 and $135,000 was recognized for the nine-month periods ended September 30, 2018 and 2017, respectively.

The expected remaining compensation expense that will be recognized on restricted stock totals $102,000, of which $31,000 will be recognized in 2018 and $71,000 will be recognized in 2019.

NOTE 4 - 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 and restricted stock 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 September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted-average common shares issued	3,620,558	3,598,500	3,613,010	3,352,316
Average treasury stock shares	(386,165)	(386,165)	(386,165)	(386,165)
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	3,234,393	3,212,335	3,226,845	2,966,151
Additional common stock equivalents (stock options and restricted stock) used to calculate diluted earnings per share	13,933	11,418	15,454	12,592
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	3,248,326	3,223,753	3,242,299	2,978,743

Options to purchase 13,600 shares of common stock, at prices ranging from $17.55 to $23.00, were outstanding during the three and nine months ended September 30, 2018. Also outstanding were 20,425 shares of restricted stock. None of the outstanding options or restricted stock were anti-dilutive.

Options to purchase 21,375 shares of common stock, at prices ranging from $17.55 to $37.00, were outstanding during the three and nine months ended September 30, 2017. Also outstanding were 12,811 shares of restricted stock. None of the outstanding options or restricted stock were anti-dilutive.

NOTE 5 - 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 establishes 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.

	September 30, 2018			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$-	$7,594	$ -	$7,594
Obligations of states and political subdivisions	-	74,130	-	74,130
Mortgage-backed securities in government-sponsored entities	-	17,993	-	17,993
Total debt securities	-	99,717	-	99,717
Equity securities in financial institutions [(a)]	421	-	-	421
Total	$421	$99,717	$ -	$100,138

	December 31, 2017			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$-	$8,719	$ -	$8,719
Obligations of states and political subdivisions	-	67,429	-	67,429
Mortgage-backed securities in government-sponsored entities	-	18,510	-	18,510
Total debt securities	-	94,658	-	94,658
Equity securities in financial institutions [(a)]	375	-	-	375
Total	$375	$94,658	$ -	$95,033

[(a)] The Company held one equity investment not included in this total because it is held at amortized cost of $250,000.

Investment Securities Available for Sale - The Company obtains fair values from an independent pricing service which represent quoted prices for similar assets, 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).

Equity Securities - Equity securities that are traded on a national securities exchange are valued at their last reported sales price as of the measurement date. Equity securities traded in the over-the-counter ("OTC") markets and listed securities for which no sale was reported on that date are generally valued at their last reported "bid" price if held long, and last reported "ask" price if sold short. To the extent equity securities are actively traded and valuation adjustments are not applied, they are categorized in Level I of the fair value hierarchy. Equity securities traded on inactive markets or valued by reference to similar instruments are generally categorized in Level II of the fair value hierarchy. Equity securities are carried at fair value through net income at September 30, 2018.

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. Collateral-dependent impaired loans are carried at fair value if they have been charged down to fair value or if a specific valuation allowance has been established. A new cost basis is established at the time a property is initially recorded in OREO. OREO properties are carried at fair value if a devaluation has been taken to the property's value subsequent to the initial measurement. No such devaluation occurred in the nine months ended September 30, 2018.

	September 30, 2018			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	$ -	$ -	$ 851	$ 851

	December 31, 2017			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	$ -	$ -	$ 3,072	$ 3,072
Other real estate owned	-	-	32	32

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Impaired Loans – The Company has measured impairment on collateral-dependent impaired loans generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties. In some cases, management may adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. Additionally, management makes estimates about expected costs to sell the property which are also included in the net realizable value. If the fair value of the collateral-dependent loan is less than the carrying amount of the loan, a specific reserve for the loan is made in the allowance for loan losses or a charge-off is taken to reduce the loan to the fair value of the collateral (less estimated selling costs) and the loan is included in the above table as a Level III measurement. If the fair value of the collateral exceeds the carrying amount of the loan, then the loan is not included in the above table as it is not currently being carried at its fair value. The fair values in the above table exclude estimated selling costs of $379,000 at September 30, 2018.

Other Real Estate Owned (OREO) – OREO is carried at the lower of cost or fair value, which is measured at the date of foreclosure. If the fair value of the collateral exceeds the carrying amount of the loan, no charge-off or adjustment is necessary, the loan is not considered to be carried at fair value, and is therefore not included in the above table. If the fair value of the collateral is less than the carrying amount of the loan, management will charge the loan down to its estimated realizable value. The fair value of OREO is based on the appraised value of the property, which is generally unadjusted by management and is based on comparable sales for similar properties in the same geographic region as the subject property, and is included in the above table as a Level II measurement. In some cases, management may adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. In these cases, the loans are categorized in the above table as a Level III measurement since these adjustments are considered to be unobservable inputs. Income and expenses from operations and further declines in the fair value of the collateral subsequent to foreclosure are included in net expenses from OREO.

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)
September 30, 2018				
Impaired loans	$851	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 100.0% (52.19%)

Quantitative Information about Level III Fair Value Measurements

(Dollar amounts in thousands)

December 31, 2017	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Impaired loans	$ 3,072	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 86.1% (13.8%)
Other real estate owned	$ 32	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 10.0%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level III inputs which are not identifiable, less any associated allowance.

(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.

The estimated fair value of the Company’s financial instruments not recorded at fair value on a recurring basis is as follows:

	September 30, 2018				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents (1)	$81,951	$81,951	$-	$-	$81,951
Loans held for sale	925	-	925	-	925
Net loans	965,474	-	-	951,818	951,818
Bank-owned life insurance (1)	15,970	15,970	-	-	15,970
Federal Home Loan Bank stock (1)	3,679	3,679	-	-	3,679
Accrued interest receivable (1)	3,733	3,733	-	-	3,733
Financial liabilities:					
Deposits	$1,013,761	$717,887	$-	$292,362	$1,010,249
Short-term borrowings (1)	55,304	55,304	-	-	55,304
Other borrowings	8,956	-	-	8,949	8,949
Accrued interest payable (1)	704	704	-	-	704

(1) This financial instrument is carried at cost at September 30, 2018, which approximates the fair value of the instrument.

	December 31, 2017				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$39,886	$39,886	$-	$-	$39,886
Loans held for sale	463	-	463	-	463
Net loans	916,023	-	-	913,323	913,323
Bank-owned life insurance	15,652	15,652	-	-	15,652
Federal Home Loan Bank stock	3,589	3,589	-	-	3,589
Accrued interest receivable	3,288	3,288	-	-	3,288
Financial liabilities:					
Deposits	$878,194	$635,207	$-	$242,020	$877,227
Short-term borrowings	74,707	74,707	-	-	74,707
Other borrowings	29,065	-	-	29,069	29,069

Accrued interest payable	578	578	-	-	578

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NOTE 6 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables present the changes in accumulated other comprehensive income ("AOCI") by component net of tax for the three and nine months ended September 30, 2018 and 2017, respectively:

(Dollars in thousands)	Unrealized gains on available-for-sale securities (a)
Balance as of June 30, 2018	$ (431)
Other comprehensive loss	(1,025)
Balance at September 30, 2018	$ (1,456)
Balance as of December 31, 2017	$ 1,091
Other comprehensive loss	(2,593)
Change in accounting principle, ASC 2016-01 [(b)]	(141)
Change in accounting principle, ASC 2018-02 [(b)]	187
Period change	(2,547)
Balance at September 30, 2018	$ (1,456)

(Dollars in thousands)	Unrealized gains on available-for-sale securities (a)
Balance as of June 30, 2017	$ 1,815
Other comprehensive loss before reclassification	(175)
Amount reclassified from accumulated other comprehensive income	(263)
Period change	(438)
Balance at September 30, 2017	$ 1,377
Balance as of December 31, 2016	$ 1,201
Other comprehensive income before reclassification	761
Amount reclassified from accumulated other comprehensive income	(585)
Period change	176

Balance at September 30, 2017	$ 1,377

(a) All amounts are net of tax. Amounts in parentheses indicate debits to AOCI.

(b) Reclassifications are the result of the adoption of ASUs 2016-01 and 2018-02 effective for the Company beginning January 1, 2018. The reclassifications are presented within the Consolidated Statement of Changes in Stockholders' Equity for the affected transitional periods.

The following tables present significant amounts reclassified from or to each component of AOCI:

(Dollars in thousands)	Amounts Reclassified from Accumulated Other Comprehensive Income For the Three Months Ended		Affected Line Item in the Statement Where Net Income is
Details about other comprehensive income	September 30, 2018	September 30, 2017	Presented
Unrealized gains on available-for-sale securities (a)			
	$ -	$ 398	Investment securities gains on sale, net
	-	(135)	Income taxes
	$ -	$ 263	

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(Dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive Income For the Nine Months Ended		Affected Line Item in the Statement Where Net Income is
Details about other comprehensive income	September 30, 2018	September 30, 2017	Presented
Unrealized gains on available-for-sale securities (a)			
	$ -	$ 886	Investment securities gains on sale, net
	-	(301)	Income taxes
	$ -	$ 585	

(a) For unrealized gains on available-for-sale securities, amounts in parentheses indicate expenses and other amounts indicate income.

NOTE 7 – INVESTMENT AND EQUITY SECURITIES

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

	September 30, 2018			
(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$7,703	$ 24	$ (133)	$7,594
Obligations of states and political subdivisions:				
Taxable	502	10	-	512
Tax-exempt	74,592	500	(1,474)	73,618
Mortgage-backed securities in government-sponsored entities	18,760	26	(793)	17,993
Total	$101,557	$ 560	$ (2,400)	$99,717

December 31, 2017
Gross Gross

(Dollar amounts in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agency securities	$8,664	$ 126	$ (71)	$8,719
Obligations of states and political subdivisions:				
Taxable	504	8	-	512
Tax-exempt	65,408	1,547	(38)	66,917
Mortgage-backed securities in government-sponsored entities	18,640	157	(287)	18,510
Total debt securities	93,216	1,838	(396)	94,658
Equity securities in financial institutions	415	210	-	625
Total	$93,631	$ 2,048	$ (396)	$95,283

The Company held one equity investment without a readily determinable fair value at September 30, 2018. For both year-to-date and life-to-date, the equity had an amortized cost of $250,000, with no impairment or observable price changes.

The Company recognized net gains on equity investments of $15,000 and $46,000, respectively, for the three and nine months ended September 30, 2018. No net gains on sold equity securities were realized during those periods.

The amortized cost and fair value of debt securities at September 30, 2018, 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.

(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 4,484	$ 4,516
Due after one year through five years	6,358	6,407
Due after five years through ten years	12,126	11,955
Due after ten years	78,589	76,839
Total	$ 101,557	$ 99,717

Proceeds from the sales of investment securities and the gross realized gains and losses are as follows:

(Dollar amounts in thousands)	For the Three Months Ended September 30, 2018	2017	For the Nine Months Ended September 30, 2018	2017
Proceeds from sales	$ -	$ 3,787	$ -	$ 6,474
Gross realized gains	-	430	-	918 (1)
Gross realized losses	-	(32)	-	(32)

(1) Prior to the acquisition of Liberty Bank, N.A., the Company held an equity interest in Liberty which was remeasured at fair value on the acquisition date and resulted in a gain of $488,000. This gain was recorded in Equity Securities, Unrealized Gains on the consolidated Income Statement for the nine months ended September 30, 2017.

Investment securities with an approximate carrying value of $66.2 million and $57.9 million at September 30, 2018 and December 31, 2017, respectively, were pledged to secure deposits and for 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.

	September 30, 2018					
	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	$1,733	$(6)	$4,186	$(127)	$5,919	$(133)
Obligations of states and political subdivisions:						
Tax-exempt	38,810	(1,323)	3,375	(151)	42,185	(1,474)
Mortgage-backed securities in government-sponsored entities	6,186	(213)	9,832	(580)	16,018	(793)
Total	$46,729	$(1,542)	$17,393	$(858)	$64,122	$(2,400)

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	December 31, 2017					
	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	$557	$ (4)	$4,036	$ (67)	$4,593	$ (71)
Obligations of states and political subdivisions:						
Tax-exempt	1,009	(6)	2,784	(32)	3,793	(38)
Mortgage-backed securities in government-sponsored entities	5,698	(71)	8,734	(216)	14,432	(287)
Total	$7,264	$ (81)	$15,554	$ (315)	$22,818	$ (396)

There were 114 securities considered temporarily impaired at September 30, 2018.

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 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 100% of the total available-for-sale portfolio as of September 30, 2018 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 the 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 nine months ended September 30, 2018 and 2017, 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 September 30, 2018 or December 31, 2017 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 8 - LOANS AND RELATED ALLOWANCE FOR LOAN AND LEASE LOSSES

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

	September 30, 2018	December 31, 2017
Commercial and industrial	$ 93,144	$ 101,346
Real estate - construction	48,901	47,017
Real estate - mortgage:		
Residential	329,609	318,157
Commercial	483,675	437,947
Consumer installment	17,639	18,746
	972,968	923,213
Less: Allowance for loan and lease losses	(7,494)	(7,190)
Net loans	$ 965,474	$ 916,023

The amounts above include deferred loan origination costs of $1.5 million at both September 30, 2018 and December 31, 2017.

The Company's primary business activity is with customers located within its local Northeastern Ohio trade area, Geauga County, and contiguous counties. The Company also serves the central Ohio market with offices in Dublin, Sunbury, Westerville, and Powell, 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 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 payments received on nonaccrual loans are applied against the unpaid principal balance until accrual status is restored.

Loan origination fees and certain direct loan origination costs are deferred with the net amount amortized over the contractual life of the loan as an adjustment of the related loan's yield.

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

September 30, 2018	Commercial and industrial	Real estate- construction	Real Estate - Mortgage Residential	Real Estate - Mortgage Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 3,045	$ -	$2,495	$ 6,055	$ 3	$11,598
Collectively evaluated for impairment	90,099	48,901	327,114	477,620	17,636	961,370
Total loans	$ 93,144	$ 48,901	$329,609	$ 483,675	$ 17,639	$972,968