SOUTHERN FIRST BANCSHARES INC
Form 10-Q
October 30, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2017
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 000-27719

Southern First Bancshares, Inc.

(Exact name of registrant as specified in its charter)

South Carolina	**58-2459561**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Verdae Boulevard, Suite 100 Greenville, S.C.	**29606**
(Address of principal executive offices)	(Zip Code)

864-679-9000
(Registrant□s telephone number, including area code)
Not Applicable
(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 Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller Reporting Company
		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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 7,319,098 shares of common stock, par value $0.01 per share, were issued and outstanding as of October 25, 2017.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
September 30, 2017 Form 10-Q

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PART I. CONSOLIDATED FINANCIAL INFORMATION
Item 1. CONSOLIDATED FINANCIAL STATEMENTS

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 18,942	11,574
Federal funds sold	34,016	24,039
Interest-bearing deposits with banks	21,654	10,939
Total cash and cash equivalents	74,612	46,552
Investment securities:		
Investment securities available for sale	78,440	64,480
Other investments	3,064	5,742
Total investment securities	81,504	70,222
Mortgage loans held for sale	9,124	7,801
Loans	1,327,739	1,163,644
Less allowance for loan losses	(15,579)	(14,855)
Loans, net	1,312,160	1,148,789
Bank owned life insurance	32,911	25,471
Property and equipment, net	31,549	28,362
Deferred income taxes	9,085	6,825
Other assets	6,739	6,886
Total assets	$ 1,557,684	1,340,908
LIABILITIES		
Deposits	$ 1,342,577	1,091,151
Federal Home Loan Bank advances and other borrowings	39,200	115,200
Junior subordinated debentures	13,403	13,403
Other liabilities	15,055	11,282
Total liabilities	1,410,235	1,231,036
SHAREHOLDERS EQUITY		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, par value $.01 per share, 10,000,000 shares authorized, 7,319,098 and 6,463,789 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	73	65
Nonvested restricted stock	(500)	(600)
Additional paid-in capital	99,464	73,371
Accumulated other comprehensive income (loss)	(93)	(504)
Retained earnings	48,505	37,540
Total shareholders equity	147,449	109,872
Total liabilities and shareholders equity	$ 1,557,684	1,340,908

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(dollars in thousands, except share data)	For the three months ended September 30, 2017	2016	For the nine months ended September 30, 2017	2016
Interest income				
Loans	$ 15,282	12,486	43,089	36,280
Investment securities	443	395	1,208	1,342
Federal funds sold	230	31	548	122
Total interest income	15,955	12,912	44,845	37,744
Interest expense				
Deposits	2,084	957	5,073	2,891
Borrowings	562	1,075	2,504	3,153
Total interest expense	2,646	2,032	7,577	6,044
Net interest income	13,309	10,880	37,268	31,700
Provision for loan losses	500	825	1,500	2,025
Net interest income after provision for loan losses	12,809	10,055	35,768	29,675
Noninterest income				
Mortgage banking income	1,403	2,003	4,063	5,685
Service fees on deposit accounts	324	269	886	732
Income from bank owned life insurance	224	187	590	553
Gain on sale of investment securities	-	106	2	431
Loss on disposal of fixed assets	-	-	(50)	-
Other income	591	452	1,665	1,320
Total noninterest income	2,542	3,017	7,156	8,721
Noninterest expenses				
Compensation and benefits	5,698	4,948	16,496	14,353
Occupancy	1,043	908	3,042	2,670
Real estate owned expenses	28	81	38	725
Outside service and data processing costs	794	690	2,362	1,916
Insurance	258	227	845	678
Professional fees	334	326	1,029	864
Marketing	199	195	605	625
Other	452	425	1,512	1,339
Total noninterest expenses	8,806	7,800	25,929	23,170
Income before income tax expense	6,545	5,272	16,995	15,226
Income tax expense	2,295	1,839	6,030	5,481
Net income available to common shareholders	$ 4,250	3,433	10,965	9,745
Earnings per common share				
Basic	$ 0.58	0.54	1.59	1.55
Diluted	$ 0.55	0.51	1.50	1.45
Weighted average common shares outstanding				
Basic	7,281,594	6,322,073	6,905,017	6,299,009
Diluted	7,668,476	6,740,751	7,291,164	6,702,475

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(dollars in thousands)	For the three months ended September 30, 2017	2016	For the nine months ended September 30, 2017	2016
Net income	$ 4,250	3,433	10,965	9,745
Other comprehensive income (loss):				
Unrealized gain (loss) on securities available for sale:				
Unrealized holding gain (loss) arising during the period, pretax	130	(222)	626	1,552
Tax (expense) benefit	(43)	75	(213)	(528)
Reclassification of realized gain	-	(106)	(2)	(431)
Tax expense	-	37	-	147
Other comprehensive income (loss)	87	(216)	411	740
Comprehensive income	$ 4,337	3,217	11,376	10,485

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016
(Unaudited)

(dollars in thousands, except share data)	Common stock		Preferred stock		Nonvested restricted	Additional paid-in	Accumulated other comprehensive	Retained	
	Shares	Amount	Shares	Amount	stock	capital	income (loss)	earnings	Total
December 31, 2015	**6,289,038**	**$ 63**	**-**	**-**	**$ (360)**	**$ 70,037**	**$ (4)**	**$ 24,504**	**$ 94,240**
Net income	-	-	-	-	-	-	-	9,745	9,745
Proceeds from exercise of stock options	71,628	1	-	-	-	533	-	-	534
Issuance of restricted stock	22,000	-	-	-	(526)	526	-	-	-
Amortization of deferred compensation on restricted stock	-	-	-	-	211	-	-	-	211
Compensation expense related to stock options, net of tax	-	-	-	-	-	553	-	-	553
Other comprehensive income	-	-	-	-	-	-	740	-	740
September 30, 2016	**6,382,666**	**$ 64**	**-**	**$ -**	**$ (675)**	**$ 71,649**	**$ 736**	**$ 34,249**	**$ 106,023**
December 31, 2016	**6,463,789**	**65**	**-**	**-**	**(600)**	**73,371**	**(504)**	**37,540**	**109,872**
Net income	-	-	-	-	-	-	-	10,965	10,965
Net issuance of common stock	805,000	8	-	-	-	24,750	-	-	24,758
Proceeds from exercise of stock options	47,184	-	-	-	-	454	-	-	454
Issuance of restricted stock	3,125	-	-	-	(146)	146	-	-	-
Amortization of deferred compensation on restricted stock	-	-	-	-	246	-	-	-	246
Compensation expense related to stock options, net of tax	-	-	-	-	-	743	-	-	743
Other comprehensive income	-	-	-	-	-	-	411	-	411
September 30, 2017	**7,319,098**	**$ 73**	**-**	**$ -**	**$ (500)**	**$ 99,464**	**$ (93)**	**$ 48,505**	**$ 147,449**

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(dollars in thousands)	For the nine months ended September 30, 2017	2016
Operating activities		
Net income	$ 10,965	$ 9,745
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	1,500	2,025
Depreciation and other amortization	1,053	939
Accretion and amortization of securities discounts and premium, net	422	433
Gain on sale of investment securities available for sale	(2)	(431)
Loss on sale of real estate owned	3	51
Loss on disposal of fixed assets	50	-
Write-down of real estate owned	7	389
Compensation expense related to stock options and grants	989	764
Gain on sale of loans held for sale	(4,520)	(5,704)
Loans originated and held for sale	(144,622)	(198,601)
Proceeds from sale of loans held for sale	147,819	200,122
Increase in cash surrender value of bank owned life insurance	(590)	(553)
(Increase) decrease in deferred tax asset	(2,472)	552
Increase in other assets, net	(72)	(606)
Increase in other liabilities	3,773	1,328
Net cash provided by operating activities	14,303	10,453
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(165,160)	(110,576)
Purchase of property and equipment	(4,290)	(4,079)
Purchase of investment securities:		
Available for sale	(20,675)	(16,852)
Other	(1,811)	(806)
Payments and maturities, calls and repayments of investment securities:		
Available for sale	6,918	18,448
Other	4,489	-
Proceeds from sale of investment securities available for sale	-	22,185
Purchase of life insurance policies	(6,850)	-
Proceeds from sale of real estate owned	498	395
Net cash used for investing activities	(186,881)	(91,285)
Financing activities		
Increase (decrease) in cash realized from:		
Increase in deposits, net	251,426	59,342
Decrease in Federal Home Loan Bank advances and other borrowings, net	(76,000)	-
Proceeds from issuance of common stock	24,758	-
Proceeds from the exercise of stock options and warrants	454	534
Net cash provided by financing activities	200,638	59,876
Net increase (decrease) in cash and cash equivalents	28,060	(20,956)
Cash and cash equivalents at beginning of the period	46,552	62,866
Cash and cash equivalents at end of the period	$ 74,612	$ 41,910
Supplemental information		
Cash paid for		
Interest	$ 7,404	$ 5,951
Income taxes	5,490	4,930
Schedule of non-cash transactions		
Real estate acquired in settlement of loans	289	245
Unrealized gain on securities, net of income taxes	413	1,024

See notes to consolidated financial statements that are an integral part of these consolidated statements.

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SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 Nature of Business and Basis of Presentation

Business Activity
Southern First Bancshares, Inc. (the "Company") is a South Carolina corporation that owns all of the capital stock of Southern First Bank (the "Bank") and all of the stock of Greenville First Statutory Trust I and II (collectively, the "Trusts"). The Trusts are special purpose non-consolidated entities organized for the sole purpose of issuing trust preferred securities. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions. The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the FDIC, and providing commercial, consumer and mortgage loans to the general public.

Basis of Presentation
The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three- and nine-month periods ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on March 3, 2017. The consolidated financial statements include the accounts of the Company and the Bank. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810, Consolidation, the financial statements related to the Trusts have not been consolidated.

Use of Estimates
The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, real estate acquired in the settlement of loans, fair value of financial instruments, evaluating other-than-temporary-impairment of investment securities and valuation of deferred tax assets.

Business Segments
The Company began reporting its activities as three business segments Commercial and Retail Banking, Mortgage Banking and Corporate in 2016. In determining proper segment definition, the Company considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated, relative to a resource allocation and performance assessment. The Company accounts for intersegment revenues and expenses as if the revenue/expense transactions were generated to third parties, that is, at current market prices. Please refer to Note 9 Reportable Segments for further information on the reporting for the Company s three business segments.

Reclassifications
Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis and had no effect on shareholders equity or net income.

Subsequent Events
Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management performed an evaluation to determine whether there have been any subsequent events since the balance sheet date and determined that no subsequent events occurred requiring accrual or disclosure.

NOTE 2 Investment Securities

The amortized costs and fair value of investment securities are as follows:

				September 30, 2017
	Amortized	Gross Unrealized		Fair
(dollars in thousands)	Cost	Gains	Losses	Value
Available for sale				
US government agencies	$ 8,754	14	58	8,710
SBA securities	4,357	-	18	4,339
State and political subdivisions	20,088	329	60	20,357
Mortgage-backed securities	45,381	15	362	45,034
Total investment securities available for sale	$ 78,580	358	498	78,440

				December 31, 2016
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
Available for sale				
US government agencies	$ 6,271	1	113	6,159
SBA securities	1,453	-	16	1,437
State and political subdivisions	20,625	141	292	20,474
Mortgage-backed securities	36,895	21	506	36,410
Total investment securities available for sale	$ 65,244	163	927	64,480

During the first nine months of 2017, there were $915,000 of investment securities either sold or called, resulting in a gain on sale of $2,000. During the first nine months of 2016, approximately $33.5 million of investment securities were either sold or called, subsequently resulting in a gain on sale of $431,000.

Contractual maturities and yields on the Company s investment securities at September 30, 2017 and December 31, 2016 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

										September 30, 2017
	Less than one year		One to five years		Five to ten years		Over ten years			Total
(dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										
US government agencies	$ 997	1.15%	1,517	2.04%	6,196	2.39%	-	-	8,710	2.19%
SBA securities	-	-	-	-	-	-	4,339	2.48%	4,339	2.48%
State and political subdivisions	-	-	3,668	1.64%	11,730	2.44%	4,959	2.88%	20,357	2.40%
Mortgage-backed securities	790	1.30%	-	-	12,005	1.80%	32,239	2.04%	45,034	1.97%
Total	$ 1,787	1.21%	5,185	1.59%	29,931	2.18%	41,537	2.23%	78,440	2.13%

										December 31, 2016
	Less than one year		One to five years		Five to ten years		Over ten years			Total
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										
US government agencies	$ -	-	997	1.15%	5,162	2.23%	-	-	6,159	2.06%
SBA securities	-	-	-	-	-	-	1,437	1.32%	1,437	1.32%
State and political subdivisions	-	-	2,271	1.73%	12,287	2.35%	5,916	2.77%	20,474	2.40%
Mortgage-backed securities	-	-	-	-	8,527	1.64%	27,883	1.68%	36,410	1.67%
Total	$ -	-	3,268	1.55%	25,976	2.10%	35,236	1.85%	64,480	1.93%

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities at September 30, 2017 and December 31, 2016, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

									September 30, 2017
	Less than 12 months			12 months or longer			Total		
(dollars in thousands)	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
Available for sale									
US government agencies	6	$ 5,250	$ 40	1	$ 740	$ 18	7	$ 5,990	$ 58
SBA securities	1	2,937	12	1	1,402	6	2	4,339	18
State and political subdivisions	8	3,652	12	6	2,910	48	14	6,562	60
Mortgage-backed securities	25	29,392	230	8	9,839	132	33	39,231	362
Total	40	$ 41,231	$ 294	16	$ 14,891	$ 204	56	$ 56,122	$ 498

									December 31, 2016
	Less than 12 months			12 months or longer			Total		
	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses	#	Fair value	Unrealized losses
Available for sale									
US government agencies	5	$ 5,144	$ 113	-	$ -	$ -	5	$ 5,144	$ 113
SBA securities	1	1,437	16	-	-	-	1	1,437	16
State and political subdivisions	32	13,936	292	-	-	-	32	13,936	292
Mortgage-backed securities	25	27,292	476	2	3,991	30	27	31,283	506
Total	63	$ 47,809	$ 897	2	$ 3,991	$ 30	65	$ 51,800	$ 927

At September 30, 2017, the Company had 40 individual investments with a fair market value of $41.2 million that were in an unrealized loss position for less than 12 months and 16 individual investments with a fair market value of $14.9 million that were in an unrealized loss position for 12 months or longer. The unrealized losses were primarily attributable to changes in interest rates, rather than deterioration in credit quality. The individual securities are each investment grade securities. The Company considers the length of time and extent to which the fair value of available-for-sale debt securities have been less than cost to conclude that such securities are not other-than-temporarily impaired. The Company also considers other factors such as the financial condition of the issuer, including credit ratings and specific events affecting the operations of the issuer, volatility of the security, underlying assets that collateralize the debt security, and other industry and macroeconomic conditions. As the Company has no intent to sell securities with unrealized losses and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of amortized cost, the Company has concluded that these securities are not impaired on an other-than-temporary basis.

Other investments are comprised of the following and are recorded at cost which approximates fair value.

(dollars in thousands)	September 30, 2017	December 31, 2016
Federal Home Loan Bank stock	$ 2,479	5,173
Investment in Trust Preferred securities	403	403
Other investments	182	166
Total other investments	$ 3,064	5,742

The Company has evaluated the Federal Home Loan Bank (FHLB) stock for impairment and determined that the investment in the FHLB stock is not other than temporarily impaired as of September 30, 2017 and ultimate recoverability of the par value of this investment is probable. All of the FHLB stock is used to collateralize advances with the FHLB.

At September 30, 2017, $9.8 million of securities were pledged as collateral for repurchase agreements from brokers and no securities were pledged to secure client deposits. At December 31, 2016, $21.0 million of securities were pledged as collateral for repurchase agreements from brokers, and approximately $21.1 million of securities were pledged to secure client deposits.

NOTE 3 Mortgage Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are reported as loans held for sale and carried at fair value under the fair value option, which was adopted by the Company on April 1, 2016, with changes in fair value recognized in current period earnings. At the date of funding of the mortgage loan held for sale, the funded amount of the loan, the related derivative asset or liability of the associated interest rate lock commitment, less direct loan costs becomes the initial recorded investment in the loan held for sale. Such amount approximates the fair value of the loan. At September 30, 2017, mortgage loans held for sale totaled $9.1 million compared to $7.8 million at December 31, 2016.

Mortgage loans held for sale are considered de-recognized, or sold, when the Company surrenders control over the financial assets. Control is considered to have been surrendered when the transferred assets have been isolated from the Company, beyond the reach of the Company and its creditors; the purchaser obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and the Company does not maintain effective control over the transferred assets through an agreement that both entitles and obligates the Company to repurchase or redeem the transferred assets before their maturity or the ability to unilaterally cause the holder to return specific assets.

Gains and losses from the sale of mortgage loans are recognized based upon the difference between the sales proceeds and carrying value of the related loans upon sale and are recorded in mortgage banking income in the statement of income. Mortgage banking income also includes the unrealized gains and losses associated with the loans held for sale and the realized and unrealized gains and losses from derivatives.

Mortgage loans sold by the Company to investors and which were believed to have met investor and agency underwriting guidelines at the time of sale may be subject to repurchase or indemnification in the event of specific default by the borrower or subsequent discovery that underwriting standards were not met. The Company may, upon mutual agreement, agree to repurchase the loans or indemnify the investor against future losses on such loans. In such cases, the Company bears any subsequent credit loss on the loans.

NOTE 4 Loans and Allowance for Loan Losses

The following table summarizes the composition of our loan portfolio. Total gross loans are recorded net of deferred loan fees and costs, which totaled $2.2 million as of September 30, 2017 and $2.0 million as of December 31, 2016.

	September 30, 2017		December 31, 2016	
(dollars in thousands)	Amount	% of Total	Amount	% of Total
Commercial				
Owner occupied RE	$ 317,262	23.9%	$ 285,938	24.6%
Non-owner occupied RE	301,360	22.7%	239,574	20.6%
Construction	32,332	2.4%	33,393	2.9%
Business	214,898	16.2%	202,552	17.4%
Total commercial loans	865,852	65.2%	761,457	65.5%
Consumer				
Real estate	250,483	18.9%	215,588	18.5%
Home equity	150,371	11.3%	137,105	11.8%
Construction	38,766	2.9%	31,922	2.7%
Other	22,267	1.7%	17,572	1.5%
Total consumer loans	461,887	34.8%	402,187	34.5%
Total gross loans, net of deferred fees	1,327,739	100.0%	1,163,644	100.0%
Less allowance for loan losses	(15,579)		(14,855)	
Total loans, net	$ 1,312,160		$ 1,148,789	

Maturities and Sensitivity of Loans to Changes in Interest Rates

The information in the following tables summarizes the loan maturity distribution by type and related interest rate characteristics based on the contractual maturities of individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below, because borrowers have the right to prepay obligations with or without prepayment penalties.

				September 30, 2017
(dollars in thousands)	One year or less	After one but within five years	After five years	Total
Commercial				
Owner occupied RE	$ 24,771	165,019	127,472	317,262
Non-owner occupied RE	47,778	155,987	97,595	301,360
Construction	6,908	6,492	18,932	32,332
Business	63,391	109,003	42,504	214,898
Total commercial loans	142,848	436,501	286,503	865,852
Consumer				
Real estate	23,864	62,991	163,628	250,483
Home equity	10,441	25,930	114,000	150,371
Construction	19,312	635	18,819	38,766
Other	5,875	12,082	4,310	22,267
Total consumer loans	59,492	101,638	300,757	461,887
Total gross loans, net of deferred fees	$ 202,340	538,139	587,260	1,327,739
Loans maturing after one year with:				
Fixed interest rates				$ 851,998
Floating interest rates				273,401

				December 31, 2016
	One year or less	After one but within five years	After five years	Total
Commercial				
Owner occupied RE	$ 26,062	145,419	114,457	285,938
Non-owner occupied RE	34,685	142,261	62,628	239,574
Construction	5,881	9,558	17,954	33,393
Business	66,361	99,255	36,936	202,552
Total commercial loans	132,989	396,493	231,975	761,457
Consumer				
Real estate	26,342	49,832	139,414	215,588
Home equity	7,142	29,041	100,922	137,105
Construction	14,103	627	17,192	31,922
Other	5,049	9,305	3,218	17,572
Total consumer	52,636	88,805	260,746	402,187
Total gross loan, net of deferred fees	$ 185,625	485,298	492,721	1,163,644
Loans maturing after one year with:				
Fixed interest rates				$ 733,892
Floating interest rates				244,127

Portfolio Segment Methodology

Commercial

Commercial loans are assessed for estimated losses by grading each loan using various risk factors identified through periodic reviews. The Company applies historic grade-specific loss factors to each loan class. In the development of statistically derived loan grade loss factors, the Company observes historical losses over 20 quarters for each loan grade. These loss estimates are adjusted as appropriate based on additional analysis of external loss data or other risks identified from current economic conditions and credit quality trends. The allowance also includes an amount for the estimated impairment on nonaccrual commercial loans and commercial loans modified in a troubled debt restructuring (TDR), whether on accrual or nonaccrual status.

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Consumer
For consumer loans, the Company determines the allowance on a collective basis utilizing historical losses over 20 quarters to represent its best estimate of inherent loss. The Company pools loans, generally by loan class with similar risk characteristics. The allowance also includes an amount for the estimated impairment on nonaccrual consumer loans and consumer loans modified in a TDR, whether on accrual or nonaccrual status.

Credit Quality Indicators

Commercial
We manage a consistent process for assessing commercial loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. Our risk categories include Pass, Special Mention, Substandard, and Doubtful, each of which is defined by our banking regulatory agencies. Delinquency statistics are also an important indicator of credit quality in the establishment of our allowance for credit losses.

We categorize our loans into risk categories based on relevant information about the ability of the borrower to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. A description of the general characteristics of the risk grades is as follows:

Pass These loans range from minimal credit risk to average however still acceptable credit risk.

Special mention A special mention loan has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution s credit position at some future date.

Substandard A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that may jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful A doubtful loan has all of the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

The tables below provide a breakdown of outstanding commercial loans by risk category.

					September 30, 2017
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
Pass	$ 312,878	294,934	32,332	204,694	844,838
Special mention	2,020	2,039	-	4,587	8,646
Substandard	2,364	4,387	-	5,617	12,368
Doubtful	-	-	-	-	-
	$ 317,262	301,360	32,332	214,898	865,852

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	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
					December 31, 2016
Pass	$ 282,055	234,957	33,393	193,517	743,922
Special mention	1,097	975	-	2,489	4,561
Substandard	2,786	3,642	-	6,546	12,974
Doubtful	-	-	-	-	-
	$ 285,938	239,574	33,393	202,552	761,457

The following tables provide past due information for outstanding commercial loans and include loans on nonaccrual status as well as accruing TDRs.

(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
					September 30, 2017
Current	$ 317,019	300,720	32,332	213,394	863,465
30-59 days past due	-	-	-	1,381	1,381
60-89 days past due	-	-	-	-	-
Greater than 90 Days	243	640	-	123	1,006
	$ 317,262	301,360	32,332	214,898	865,852

	Owner occupied RE	Non-owner occupied RE	Construction	Business	Total
					December 31, 2016
Current	$ 284,700	238,346	33,393	200,624	757,063
30-59 days past due	981	-	-	1,423	2,404
60-89 days past due	257	56	-	-	313
Greater than 90 Days	-	1,172	-	505	1,677
	$ 285,938	239,574	33,393	202,552	761,457

As of September 30, 2017 and December 31, 2016, loans 30 days or more past due represented 0.36% and 0.55% of the Company s total loan portfolio, respectively. Commercial loans 30 days or more past due were 0.18% and 0.38% of the Company s total loan portfolio as of September 30, 2017 and December 31, 2016, respectively.

Consumer

The Company manages a consistent process for assessing consumer loan credit quality by monitoring its loan grading trends and past due statistics. All loans are subject to individual risk assessment. The Company s categories include Pass, Special Mention, Substandard, and Doubtful, which are defined above. Delinquency statistics are also an important indicator of credit quality in the establishment of the allowance for loan losses.

The tables below provide a breakdown of outstanding consumer loans by risk category.

(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
					September 30, 2017
Pass	$ 246,962	147,570	38,766	22,172	455,470
Special mention	719	126	-	7	852
Substandard	2,802	2,675	-	88	5,565
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$ 250,483	150,371	38,766	22,267	461,887

					December 31, 2016
	Real estate	Home equity	Construction	Other	Total
Pass	$ 211,563	134,124	31,922	17,485	395,094
Special mention	1,064	2,109	-	16	3,189
Substandard	2,961	872	-	71	3,904
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
	$ 215,588	137,105	31,922	17,572	402,187

The following tables provide past due information for outstanding consumer loans and include loans on nonaccrual status as well as accruing TDRs.

					September 30, 2017
(dollars in thousands)	Real estate	Home equity	Construction	Other	Total
Current	$ 248,907	149,978	38,493	22,175	459,553
30-59 days past due	132	90	-	92	314
60-89 days past due	1,172	180	273	-	1,625
Greater than 90 Days	272	123	-	-	395
	$ 250,483	150,371	38,766	22,267	461,887

					December 31, 2016
	Real estate	Home equity	Construction	Other	Total
Current	$ 214,228	136,638	31,922	17,427	400,215
30-59 days past due	1,041	210	-	126	1,377
60-89 days past due	282	-	-	6	288
Greater than 90 Days	37	257	-	13	307
	$ 215,588	137,105	31,922	17,572	402,187

As of September 30, 2017 and December 31, 2016, consumer loans 30 days or more past due were 0.18% and 0.17% of total loans, respectively.

Nonperforming assets

The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when the Company believes, after considering economic and business conditions and collection efforts, that the borrower s financial condition is such that collection of the contractual principal or interest on the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

Following is a summary of our nonperforming assets, including nonaccruing TDRs.

(dollars in thousands)	September 30, 2017	December 31, 2016
Commercial		
Owner occupied RE	$ 244	276
Non-owner occupied RE	2,049	2,711
Construction	-	-
Business	1,116	686
Consumer		
Real estate	1,267	550
Home equity	195	256
Construction	-	-
Other	2	13
Nonaccruing troubled debt restructurings	730	990
Total nonaccrual loans, including nonaccruing TDRs	5,603	5,482
Other real estate owned	420	639
Total nonperforming assets	$ 6,023	6,121
Nonperforming assets as a percentage of:		
Total assets	0.39%	0.46%
Gross loans	0.45%	0.53%
Total loans over 90 days past due	1,401	1,984
Loans over 90 days past due and still accruing	-	-
Accruing troubled debt restructurings	$ 6,954	5,675

Impaired Loans

The table below summarizes key information for impaired loans. The Company s impaired loans include loans on nonaccrual status and loans modified in a TDR, whether on accrual or nonaccrual status. These impaired loans may have estimated impairment which is included in the allowance for loan losses. The Company s commercial and consumer impaired loans are evaluated individually to determine the related allowance for loan losses.

	September 30, 2017			
(dollars in thousands)	Unpaid Principal Balance	Impaired loans	Recorded investment Impaired loans with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$ 2,232	2,177	830	192
Non-owner occupied RE	7,854	4,299	3,704	948
Construction	-	-	-	-
Business	4,488	3,355	2,090	1,140
Total commercial	14,574	9,831	6,624	2,280
Consumer				
Real estate	2,382	2,357	2,357	1,304
Home equity	203	195	195	133
Construction	-	-	-	-
Other	175	174	174	25
Total consumer	2,760	2,726	2,726	1,462
Total	$ 17,334	12,557	9,350	3,742

				December 31, 2016
	Unpaid Principal Balance	Impaired loans	Recorded investment Impaired loans with related allowance for loan losses	Related allowance for loan losses
Commercial				
Owner occupied RE	$ 2,284	2,243	2,224	263
Non-owner occupied RE	7,238	4,031	1,638	457
Construction	-	-	-	-
Business	3,699	2,593	1,610	1,154
Total commercial	13,221	8,867	5,472	1,874
Consumer				
Real estate	1,853	1,843	1,843	682
Home equity	207	257	-	-
Construction	-	-	-	-
Other	261	190	177	88
Total consumer	2,321	2,290	2,020	770
Total	$ 15,542	11,157	7,492	2,644

The following table provides the average recorded investment in impaired loans and the amount of interest income recognized on impaired loans after impairment by portfolio segment and class.

	Three months ended September 30, 2017		Three months ended September 30, 2016	
(dollars in thousands)	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
Commercial				
Owner occupied RE	$ 2,182	25	2,000	30
Non-owner occupied RE	4,322	57	5,515	39
Construction	-	-	-	-
Business	3,498	58	5,072	71
Total commercial	10,002	140	12,587	140
Consumer				
Real estate	2,361	40	1,573	16
Home equity	196	2	207	-
Construction	-	-	-	-
Other	176	1	257	2
Total consumer	2,733	43	2,037	18
Total	$ 12,735	183	14,624	158

	Nine months ended September 30, 2017		Nine months ended September 30, 2016		Year ended December 31, 2016	
(dollars in thousands)	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income	Average recorded investment	Recognized interest income
Commercial						
Owner occupied RE	$ 2,198	78	2,009	72	2,263	112
Non-owner occupied RE	4,503	154	5,594	124	4,106	200
Construction	-	-	-	-	-	-
Business	3,585	165	5,134	199	2,873	135
Total commercial	10,286	397	12,737	395	9,242	447
Consumer						
Real estate	2,370	73	1,578	49	1,854	81
Home equity	196	4	257	1	257	2
Construction	-	-	-	-	-	-
Other	178	4	208	5	203	6
Total consumer	2,744	81	2,043	55	2,314	89
Total	$ 13,030	478	14,780	450	11,556	536

Allowance for Loan Losses

The allowance for loan loss is management s estimate of credit losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The Company has an established process to determine the adequacy of the allowance for loan losses that assesses the losses inherent in the portfolio. While the Company attributes portions of the allowance to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company s process involves procedures to appropriately consider the unique risk characteristics of the commercial and consumer loan portfolio segments. For each portfolio segment, impairment is measured individually for each impaired loan. The Company s allowance levels are influenced by loan volume, loan grade or delinquency status, historic loss experience and other economic conditions.

The following table summarizes the activity related to the allowance for loan losses by commercial and consumer portfolio segments:

	Three months ended September 30, 2017								
	Commercial				Consumer				
(dollars in thousands)	Owner occupied RE	Non-owner occupied RE	Construction	Business	Real Estate	Home equity	Construction	Other	Total
Balance, beginning of period	$ 2,964	2,981	350	3,857	3,061	1,608	328	295	15,444
Provision for loan losses	(141)	634	(122)	213	160	(196)	(47)	(1)	500
Loan charge-offs	-	-	-	(388)	-	-	-	(11)	(399)
Loan recoveries	-	1	-	31	1	-	-	1	34
Net loan charge-offs	-	1	-	(357)	1	-	-	(10)	(365)
Balance, end of period	$ 2,823	3,616	228	3,713	3,222	1,412	281	284	15,579
Net charge-offs to average loans (annualized)									0.11%
Allowance for loan losses to gross loans									1.17%
Allowance for loan losses to nonperforming loans									278.05%

										Three months ended September 30, 2016
			Commercial							**Consumer**
	Owner occupied RE	**Non-owner occupied RE**	**Construction**	**Business**		**Real Estate**	**Home equity**	**Construction**	**Other**	**Total**
(dollars in thousands)										
Balance, beginning of period	$2,797	3,011	350	4,019		2,302	1,296	212	330	14,317
Provision for loan losses	98	47	(53)	337		215	119	(5)	67	825
Loan charge-offs	-	(25)	-	(515)		-	(43)	-	(100)	(683)
Loan recoveries	-	5	-	13		-	-	-	1	19
Net loan charge-offs	-	(20)	-	(502)		-	(43)	-	(99)	(664)
Balance, end of period	$2,895	3,038	297	3,854		2,517	1,372	207	298	14,478
Net charge-offs to average loans (annualized)										0.24%
Allowance for loan losses to gross loans										1.30%
Allowance for loan losses to nonperforming loans										258.3%

									Nine months ended September 30, 2017
			Commercial						**Consumer**
(dollars in thousands)	**Owner occupied RE**	**Non-owner occupied RE**	**Construction**	**Business**	**Real Estate**	**Home equity**	**Construction**	**Other**	**Total**
Balance, beginning of period	$ 2,843	2,778	295	4,123	2,780	1,475	252	309	14,855
Provision for loan losses	(20)	1,257	(67)	31	359	(75)	29	(14)	1,500
Loan charge-offs	-	(433)	-	(518)	-	-	-	(11)	(962)
Loan recoveries	-	14	-	77	83	12	-	-	186
Net loan charge-offs	-	(419)	-	(441)	83	12	-	(11)	(776)
Balance, end of period	$ 2,823	3,616	228	3,713	3,222	1,412	281	284	15,579
Net charge-offs to average loans (annualized)									0.08%

									Nine months ended September 30, 2016
			Commercial						**Consumer**
(dollars in thousands)	**Owner occupied RE**	**Non-owner occupied RE**	**Construction**	**Business**	**Real Estate**	**Home equity**	**Construction**	**Other**	**Total**
Balance, beginning of period	$ 2,347	3,187	338	3,800	2,070	1,202	313	372	13,629
Provision for loan losses	553	(81)	2	666	641	236	(106)	114	2,025
Loan charge-offs	(5)	(100)	(43)	(862)	(194)	(66)	-	(192)	(1,462)
Loan recoveries	-	32	-	250	-	-	-	4	286
Net loan charge-offs	(5)	(68)	(43)	(612)	(194)	(66)	-	(188)	(1,176)
Balance, end of period	$ 2,895	3,038	297	3,854	2,517	1,372	207	298	14,478
Net charge-offs to average loans (annualized)									0.15%

The following table disaggregates the allowance for loan losses and recorded investment in loans by impairment methodology.

						September 30, 2017
	Allowance for loan losses			**Recorded investment in loans**		
(dollars in thousands)	**Commercial**	**Consumer**	**Total**	**Commercial**	**Consumer**	**Total**
Individually evaluated	$ 2,280	1,462	3,742	9,831	2,726	12,557
Collectively evaluated	8,100	3,737	11,837	856,021	459,161	1,315,182
Total	$ 10,380	5,199	15,579	865,852	461,887	1,327,739

						December 31, 2016
	Allowance for loan losses			**Recorded investment in loans**		
	Commercial	**Consumer**	**Total**	**Commercial**	**Consumer**	**Total**
Individually evaluated	$ 1,874	770	2,644	8,867	2,290	11,157
Collectively evaluated	8,165	4,046	12,211	752,590	399,897	1,152,487
Total	$ 10,039	4,816	14,855	761,457	402,187	1,163,644

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NOTE 5 Troubled Debt Restructurings

At September 30, 2017, the Company had 19 loans totaling $7.7 million compared to 17 loans totaling $6.7 million at December 31, 2016, which were considered as TDRs. The Company considers a loan to be a TDR when the debtor experiences financial difficulties and the Company grants a concession to the debtor that it would not normally consider. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of the workout plan for individual loan relationships, the Company may restructure loan terms to assist borrowers facing financial challenges in the current economic environment. To date, the Company has restored four commercial loans previously classified as TDRs to accrual status.

The following table summarizes the concession at the time of modification and the recorded investment in the Company s TDRs before and after their modification during the nine months ended September 30, 2017 and 2016, respectively.

	For the nine months ended September 30, 2017						
(dollars in thousands)	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial							
Non-owner occupied RE	1	-	-	-	1	$ 976	$ 976
Business	1	1	-	-	2	378	387
Total loans	2	1	-	-	3	$ 1,354	$ 1,363

	For the nine months ended September 30, 2016						
(dollars in thousands)	Renewals deemed a concession	Reduced or deferred payments	Converted to interest only	Maturity date extensions	Total Number of loans	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial							
Owner occupied	1	-	-	-	1	$ 18	$ 22
Business	1	-	-	-	1	2,381	2,381
Consumer							
Real estate	1	-	-	-	1	188	188
Other	1	-	-	-	1	26	30
Total loans	4	-	-	-	4	$ 2,613	$ 2,621

As of September 30, 2017 there were no loans modified as TDRs for which there was a payment default (60 days past due) within 12 months of the restructuring date. There was one such loan at September 30, 2016 with a recorded investment of $30,000.

NOTE 6 Derivative Financial Instruments

The Company utilizes derivative financial instruments primarily to hedge its exposure to changes in interest rates. All derivative financial instruments are recognized as either assets or liabilities and measured at fair value. The Company accounts for all of its derivatives as free-standing derivatives and does not designate any of these instruments for hedge accounting. Therefore, the gain or loss resulting from the change in the fair value of the derivative is recognized in the Company s statement of income during the period of change.

The Company enters into commitments to originate residential mortgage loans held for sale, at specified interest rates and within a specified period of time, with clients who have applied for a loan and meet certain credit and underwriting criteria (interest rate lock commitments). These interest rate lock commitments (IRLCs) meet the definition of a derivative financial instrument and are reflected in the balance sheet at fair value with changes in fair value recognized in current period earnings. Unrealized gains and losses on the IRLCs are recorded as derivative assets and derivative liabilities, respectively, and are measured based on the value of the underlying mortgage loan, quoted mortgage-backed securities (MBS) prices and an estimate of the probability that the mortgage loan will fund within the terms of the interest rate lock commitment, net of estimated commission expenses.

The Company manages the interest rate and price risk associated with its outstanding IRLCs and mortgage loans held for sale by entering into derivative instruments such as forward sales of MBS. Management expects these derivatives will experience changes in fair value opposite to changes in fair value of the IRLCs and mortgage loans held for sale, thereby reducing earnings volatility. The Company takes into account various factors and strategies in determining the portion of the mortgage pipeline (IRLCs and mortgage loans held for sale) it wants to economically hedge.

The following table summarizes the Company s outstanding financial derivative instruments at September 30, 2017 and December 31, 2016.

(dollars in thousands)	Notional	Balance Sheet Location	September 30, 2017 Fair Value Asset/(Liability)
Mortgage loan interest rate lock commitments	$ 29,258	Other assets	$ 343
MBS forward sales commitments	18,000	Other assets	46
Total derivative financial instruments	$ 47,258		$ 389

(dollars in thousands)	Notional	Balance Sheet Location	December 31, 2016 Fair Value Asset/(Liability)
Mortgage loan interest rate lock commitments	$ 17,986	Other assets	$ 256
MBS forward sales commitments	14,250	Other assets	(3)
Total derivative financial instruments	$ 32,236		$ 253

NOTE 7 Fair Value Accounting

FASB ASC 820, Fair Value Measurement and Disclosures, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted market price in active markets
Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities that are traded in an active exchange market.

Level 2 Significant other observable inputs
Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company s available-for-sale portfolio and valued by a third-party pricing service, as well as certain impaired loans.

Level 3 Significant unobservable inputs
Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

Following is a description of valuation methodologies used for assets recorded at fair value.

Investment Securities
Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as FHLB stock, approximates fair value based on their redemption provisions.

Mortgage Loans Held for Sale
Loans held for sale include mortgage loans which are saleable into the secondary mortgage markets and their fair values are estimated using observable quoted market or contracted prices or market price equivalents, which would be used by other market participants. These saleable loans are considered Level 2.

Loans
The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, Receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with FASB ASC 820, Fair Value Measurement and Disclosures, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. The Company s current loan and appraisal policies require the Bank to obtain updated appraisals on an as is basis at renewal, or in the case of an impaired loan, on an annual basis, either through a new external appraisal or an appraisal evaluation. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3. The fair value of impaired loans may also be estimated using the present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

Other Real Estate Owned (OREO)
OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the OREO as nonrecurring Level 3.

Derivative Financial Instruments
The Company estimates the fair value of IRLCs based on the value of the underlying mortgage loan, quoted MBS prices and an estimate of the probability that the mortgage loan will fund within the terms of the IRLC, net of commission expenses (Level 2). The Company estimates the fair value of forward sales commitments based on quoted MBS prices (Level 2).

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2017 and December 31, 2016.

				September 30, 2017
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Securities available for sale				
US government agencies	$ -	8,710	-	8,710
SBA securities	-	4,339	-	4,339
State and political subdivisions	-	20,357	-	20,357
Mortgage-backed securities	-	45,034	-	45,034
Mortgage loans held for sale	-	9,124	-	9,124
Interest rate lock commitments	-	343	-	343
MBS forward sales commitments	-	46	-	46
Total assets measured at fair value on a recurring basis	$ -	87,953	-	87,953

				December 31, 2016
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Securities available for sale:				
US government agencies	$ -	6,159	-	6,159
SBA securities	-	1,437	-	1,437
State and political subdivisions	-	20,474	-	20,474
Mortgage-backed securities	-	36,410	-	36,410
Mortgage loans held for sale	-	7,801	-	7,801
Interest rate lock commitments	-	256	-	256
Total assets measured at fair value on a recurring basis	$ -	72,537	-	72,537
Liabilities				
MBS forward sales commitments	$ -	3	-	3
Total liabilities measured at fair value on a recurring basis	$ -	3	-	3

The Company has no liabilities carried at fair value or measured at fair value on a recurring basis as of September 30, 2017.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company is predominantly an asset based lender with real estate serving as collateral on more than 80% of loans as of September 30, 2017. Loans which are deemed to be impaired are valued net of the allowance for loan losses, and other real estate owned is valued at the lower of cost or net realizable value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The tables below present the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2017 and December 31, 2016.

				As of September 30, 2017
(dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Impaired loans	$ -	2,669	6,146	8,815
Other real estate owned	-	307	113	420
Total assets measured at fair value on a nonrecurring basis	$ -	2,976	6,259	9,235

				As of December 31, 2016
	Level 1	Level 2	Level 3	Total
Assets				
Impaired loans	$ -	4,075	4,438	8,513
Other real estate owned	-	526	113	639
Total assets measured at fair value on a nonrecurring basis	$ -	4,601	4,551	9,152

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis as of September 30, 2017 and December 31, 2016.

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of September 30, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

	Valuation Technique	Significant Unobservable Inputs	Range of Inputs
Impaired loans	Appraised Value/ Discounted Cash Flows	Discounts to appraisals or cash flows for estimated holding and/or selling costs or age of appraisal	0-25%
Other real estate owned	Appraised Value/ Comparable Sales	Discounts to appraisals for estimated holding or selling costs	0-25%

Fair Value of Financial Instruments

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company s common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, federal funds purchased, and securities sold under agreement to repurchase.

Deposits Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

FHLB Advances and Other Borrowings Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

Junior subordinated debentures Fair value for junior subordinated debentures are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management s best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

The estimated fair values of the Company s financial instruments at September 30, 2017 and December 31, 2016 are as follows:

					September 30, 2017
(dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Other investments, at cost	$ 3,064	3,064	-	-	3,064
Loans, net	1,312,160	1,315,125	-	2,669	1,312,456
Financial Liabilities:					
Deposits	1,342,577	1,246,252	-	1,246,252	-
FHLB and other borrowings	39,200	40,452	-	40,452	-
Junior subordinated debentures	13,403	12,595	-	12,595	-

					December 31, 2016
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Other investments, at cost	$ 5,742	5,742	-	-	5,742
Loans, net	1,148,789	1,149,527	-	4,075	1,145,452
Financial Liabilities:					
Deposits	1,091,151	1,004,923	-	1,004,923	-
FHLB and other borrowings	115,200	115,825	-	115,825	-
Junior subordinated debentures	13,403	12,026	-	12,026	-

NOTE 8 Earnings Per Common Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three and nine months ended September 30, 2017 and 2016. Dilutive common shares arise from the potentially dilutive effect of the Company s stock options that were outstanding at September 30, 2017. The assumed conversion of stock options can create a difference between basic and dilutive net income per common share. At September 30, 2017 and 2016, there were 109,450 and 108,457 options, respectively, that were not considered in computing diluted earnings per common share because they were anti-dilutive.

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands, except share data)	2017	2016	2017	2016
Numerator:				
Net income available to common shareholders	$ 4,250	3,433	10,965	9,745
Denominator:				
Weighted-average common shares outstanding basic	7,281,594	6,322,073	6,905,017	6,299,009
Common stock equivalents	386,882	418,678	386,147	403,466
Weighted-average common shares outstanding diluted	7,668,476	6,740,751	7,291,164	6,702,475
Earnings per common share:				
Basic	$ 0.58	0.54	1.59	1.55
Diluted	$ 0.55	0.51	1.50	1.45

NOTE 9 Reportable Segments

The Company s reportable segments represent the distinct product lines the Company offers and are viewed separately for strategic planning purposes by management. The three segments include Commercial and Retail Banking, Mortgage Banking, and Corporate. The following schedule presents financial information for each reportable segment.

			Three months ended September 30, 2017		Three months ended September 30, 2016
Commercial				Commercial	
and Retail	Mortgage	Elimin-			