First Federal of Northern Michigan Bancorp, Inc.
Form 10-Q
August 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from____________________ to____________________

Commission File Number 000-31957

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland	**32-0135202**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 S. Second Avenue, Alpena, Michigan	**49707**
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: **(989) 356-9041**

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

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

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

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

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

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

Common Stock, Par Value $0.01	Outstanding at August 7, 2014
(Title of Class)	2,884,049 shares

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

FORM 10-Q

Quarter Ended June 30, 2014

INDEX

101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

When used in this Form 10-Q or future filings by First Federal of Northern Michigan Bancorp, Inc. (the “Company”) with the Securities and Exchange Commission (“SEC”), in the Company’s press releases or other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases “would be,” “will allow,” “intends to,” “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “pro similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors, could affect the Company’s financial performance and could cause the Company’s actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheet

	June 30, 2014	December 31, 2013
	(Unaudited)	
ASSETS		
Cash and cash equivalents:		
Cash on hand and due from banks	$3,235,034	$2,760,010
Overnight deposits with FHLB	2,066	5,823
Total cash and cash equivalents	3,237,100	2,765,833
Securities AFS	61,466,330	50,358,175
Securities HTM	2,215,000	2,255,000
Loans held for sale	380,405	175,400
Loans receivable, net of allowance for loan losses of $1,486,809 and $1,471,622 as of June 30, 2014 and December 31, 2013, respectively	135,068,805	136,314,964
Foreclosed real estate and other repossessed assets	1,723,024	1,780,058
Federal Home Loan Bank stock, at cost	3,266,100	3,266,100
Premises and equipment	5,122,666	5,203,301
Accrued interest receivable	714,126	744,730
Intangible assets	—	39,732
Deferred tax asset	574,768	798,163
Originated mortgage servicing rights	773,413	860,024
Bank owned life insurance	4,667,787	4,610,070
Other assets	580,782	485,234
Total assets	$219,790,306	$209,656,784
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$168,999,329	$160,029,115
Advances from borrowers for taxes and insurance	383,311	151,254
Federal Home Loan Bank Advances	25,157,152	24,813,409
Accrued expenses and other liabilities	1,091,910	1,138,324
Total liabilities	195,631,702	186,132,102

Stockholders’ equity:		
Common stock ($0.01 par value 20,000,000 shares authorized 3,191,799 shares issued and outstanding) at June 30, 2014 and December 31, 2013	31,918	31,918
Additional paid-in capital	23,853,891	23,853,891
Retained earnings	2,963,515	2,763,242
Treasury stock at cost (307,750 shares) at June 30, 2014 and December 31, 2013	(2,963,918)	(2,963,918)
Accumulated other comprehensive income (loss)	273,198	(160,451)
Total stockholders’ equity	24,158,604	23,524,682
Total liabilities and stockholders’ equity	$219,790,306	$209,656,784

See accompanying notes to consolidated financial statements.

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First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries

Consolidated Statement of Operations and Comprehensive Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Interest income:				
Interest and fees on loans	$1,690,977	$1,826,649	$3,401,391	$3,643,262
Interest and dividends on investments				
Taxable	149,521	123,991	300,197	239,320
Tax-exempt	41,028	37,348	82,484	75,043
Interest on mortgage-backed securities	143,269	106,795	285,563	222,166
Total interest income	2,024,795	2,094,783	4,069,635	4,179,791
Interest expense:				
Interest on deposits	191,720	208,638	378,248	430,540
Interest on borrowings	66,890	76,022	129,656	175,463
Total interest expense	258,610	284,660	507,904	606,003
Net interest income	1,766,185	1,810,123	3,561,731	3,573,788
Provision for loan losses	—	195,753	15,765	339,827
Net interest income after provision for loan losses	1,766,185	1,614,370	3,545,966	3,233,961
Non-interest income:				
Service charges and other fees	188,126	222,279	369,218	414,719
Mortgage banking activities	128,244	161,691	224,082	332,123
Net gain (loss) on sale of premises and equipment, real estate owned and other repossessed assets	(21,251)	(5,729)	(26,064)	750
Other	49,232	86,371	113,350	157,363
Total non-interest income	344,351	464,612	680,586	904,955
Non-interest expense:				
Compensation and employee benefits	1,109,608	1,134,644	2,218,651	2,293,901
FDIC Insurance Premiums	45,330	48,978	90,874	94,677
Advertising	43,989	28,797	71,624	67,716
Occupancy	219,570	218,209	455,945	451,655
Amortization of intangible assets	10,086	29,646	39,732	59,292
Service bureau charges	83,790	77,089	146,176	154,583
Professional services	164,885	163,833	294,143	236,696
Collection activity	11,291	21,591	29,496	63,764
Real estate owned & other repossessed assets	11,732	88,153	28,681	121,419
Other	316,092	271,557	535,595	531,084
Total non-interest expense	2,016,373	2,082,497	3,910,917	4,074,787

Income (loss) before income tax benefit	94,163	(3,515)	315,635	64,129
Income tax benefit	—	—	—	—
Net income (loss)	$94,163	$(3,515)	$315,635	$64,129
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale investment securities - net of tax	160,996	(457,978)	$433,649	$(557,775)
Comprehensive income (loss)	$255,159	$(461,493)	$749,284	$(493,646)
Per share data:				
Net income (loss) per share				
Basic	$0.03	$(0.00)	$0.11	$0.02
Diluted	$0.03	$(0.00)	$0.11	$0.02
Weighted average number of shares outstanding				
Basic	2,884,049	2,884,049	2,884,049	2,884,049
Including dilutive stock options	2,884,049	2,884,049	2,884,049	2,884,049

See accompanying notes to consolidated financial statements.

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First Federal of Northern Michigan Bancorp Inc. and Subsidiaries

Consolidated Statement of Changes in Stockholders' Equity (Unaudited)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2013	31,918	(2,963,918)	23,853,891	2,763,242	(160,451)	23,524,682
Net income	—	—	—	315,635	—	315,635
Change in unrealized gain on available-for-sale securities (net of tax of $223,395)	—	—	—	—	433,649	433,649
Dividends declared	—	—	—	(115,362)	—	(115,362)
Balance at June 30, 2014	31,918	(2,963,918)	23,853,891	2,963,515	273,198	24,158,604

See accompanying notes to the consolidated financial statements.

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries

Consolidated Statement of Cash Flows

	For Six Months Ended June 30, 2014 (Unaudited)	2013
Cash Flows from Operating Activities:		
Net income	$315,635	$64,129
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	184,337	200,654
Provision for loan loss	15,765	339,827
Amortization and accretion on securities	204,416	303,600
Gain on sale of loans held for sale	(89,149)	(138,002)
Originations of loans held for sale	(5,522,508)	(7,931,234)
Proceeds from sale of loans held for sale	5,406,652	7,724,458
(Gain) loss on sale of fixed assets	20,564	(8,084)
Loss on sale of real estate owned and other repossessed assets	5,500	7,334
Net change in:		
Accrued interest receivable	30,604	71,287
Other assets	(8,937)	70,530
Prepaid FDIC insurance premiums	—	582,945
Bank owned life insurance	(57,717)	(66,652)
Accrued expenses and other liabilities	(46,414)	25,283
Net cash provided by operating activities	458,748	1,246,075
Cash Flows from Investing Activities:		
Net decrease (increase) in loans (loans originated, net of principal payments)	965,394	(961,058)
Proceeds from maturity and sale of available-for-sale securities	5,570,151	10,715,273
Proceeds from sale of property and equipment	1,725	55,164
Proceeds from sale of real estate owned and other reposed assets	316,534	555,330
Purchase of securities	(16,185,678)	(9,453,079)
Purchase of premises and equipment	(86,259)	(6,585)
Net cash provided by (used for) investing activities	(9,418,133)	905,045
Cash Flows from Financing Activities:		
Dividend paid on common stock	(115,362)	—
Net increase in deposits	8,970,214	2,997,019
Net increase (decrease) in Repo Sweep accounts	—	390,318
Net increase in advances from borrowers	232,057	280,359
Advances from Federal Home Loan Bank	12,055,000	27,625,000
Repayments of Federal Home Loan Bank advances	(11,711,257)	(29,870,898)
Net cash provided by financing activities	9,430,652	1,421,798

Net increase in cash and cash equivalents	471,267	3,572,918
Cash and cash equivalents at beginning of period	2,765,833	2,751,810
Cash and cash equivalents at end of period	$3,237,100	$6,324,728
Supplemental disclosure of cash flow information:		
Cash paid during the period for		
Interest	$508,572	$622,719
Transfers of loans to foreclosed real estate and repossessed assets	$265,000	$273,000

See accompanying notes to the consolidated financial statements.

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1—BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited condensed consolidated interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q. Accordingly, certain information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements are not included herein. The interim financial statements should be read in conjunction with the financial statements of First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries and the notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2013.

All adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of financial position, results of operations and cash flows, have been made. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

Note 2— PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of First Federal of Northern Michigan Bancorp, Inc., First Federal of Northern Michigan, and the Bank's wholly owned subsidiaries, Financial Services & Mortgage Corporation ("FSMC") and FFNM Agency, Inc. FSMC invests in real estate, which includes leasing, selling, developing, and maintaining real estate properties. The main activity of FFNM Agency was to collect the stream of income associated with the sale of the Blue Cross/Blue Shield override to the Grotenhuis Group (as discussed further below). The collection of this stream of income expired in April of 2014. All significant intercompany balances and transactions have been eliminated in the consolidation.

Note 3—SECURITIES

Investment securities have been classified according to management’s intent. The carrying value and estimated fair value of securities are as follows:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$12,835	$ 41	$ (71)	$12,805
Municipal obligations	15,144	270	(130)	15,284
Corporate bonds & other obligations	1,060	17	—	1,077
Mortgage-backed securities	32,011	398	(118)	32,291
Equity securities	2	7	—	9
Total	$61,052	$ 733	$ (319)	$61,466
Securities Held to Maturity				
Municipal obligations	$2,215	$ 117	$ —	$2,332

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$7,111	$ 36	$ (105)	7,042
Municipal obligations	13,694	216	(301)	13,609
Corporate bonds & other obligations	1,085	12	—	1,097
Mortgage-backed securities	28,708	279	(384)	28,603
Equity securities	3	4	—	7
Total	$50,601	$ 547	$ (790)	$50,358
Securities Held to Maturity				
Municipal obligations	$2,255	$ 145	$ —	$2,400

The amortized cost and estimated market value of securities at June 30, 2014, by contract maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities with no specified maturity date are separately stated.

	June 30, 2014	
	Amortized Cost	Market Value
	(in thousands)	
Available For Sale:		
Due in one year or less	$3,332	$3,354
Due after one year through five years	18,095	18,130
Due in five year through ten years	6,409	6,396
Due after ten years	1,203	1,286
Subtotal	29,039	29,166
Equity securities	2	9
Mortgage-backed securities	32,011	32,291
Total	$61,052	$61,466
Held To Maturity:		
Due in one year or less	$95	$97
Due after one year through five years	500	519
Due in five year through ten years	715	765
Due after ten years	905	951

Total	$2,215	$2,332

At June 30, 2014 and December 31, 2013, securities with a carrying value and fair value of $39,000,000 and $36,000,000, respectively, were pledged to secure certain deposit accounts, FHLB advances and our line of credit at the Federal Reserve.

For the six months ended June 30, 2014 and 2013 there were no sales of securities from the investment portfolio.

The following is a summary of securities that had unrealized losses at June 30, 2014 and December 31, 2013. The information is presented for securities that have been in an unrealized loss position for less than 12 months and for more than 12 months. At June 30, 2014 there were 30 securities with unrealized losses totaling $319,000 and at December 31, 2013, the Company held 39 securities with unrealized losses totaling $790,000.

	June 30, 2014			
	Fair Value	Gross Unrealized Losses < 12 months	Fair Value	Gross Unrealized Losses > 12 months
	(in thousands)			
Available For Sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$3,233	$ (17)	$945	$ (54)
Corporate bonds & other obligations	—	—	—	—
Municipal obligations	1,711	(2)	6,321	(128)
Mortgage-backed securities	2,309	(11)	5,186	(107)
Equity securities	—	—	—	—
Total	$7,253	$ (30)	$12,452	$ (289)
Held to Maturity:				
Municipal obligations	$—	$ —	$—	$ —

	December 31, 2013			
	Fair Value	Gross Unrealized Losses < 12 months	Fair Value	Gross Unrealized Losses > 12 months
	(in thousands)			
Available For Sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$—	$ —	$894	$ (105)
Municipal obligations	7,902	(243)	1,668	(58)
Mortgage-backed securities	14,471	(334)	2,052	(50)
Equity securities	—	—	—	—
Total	$22,373	$ (577)	$4,614	$ (213)
Held to Maturity:				
Municipal obligations	$—	$ —	$—	$ —

The unrealized losses on the securities held in the portfolio are not considered other than temporary and have not been recognized into income. This decision is based on the Company’s ability and intent to hold any potentially impaired security until maturity. The performance of the security is based on the contractual terms of the agreement, the extent of the impairment and the financial condition and credit quality of the issuer. The decline in market value is considered temporary and a result of changes in interest rates and other market variables.

Note 4—LOANS

The following table sets forth the composition of our loan portfolio by loan type at the dates indicated.

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	At June 30, 2014	At December 31, 2013
	(in thousands)	
Real estate loans:		
Residential mortgage	$64,498	$63,839
Commercial loans:		
Construction - real estate	173	173
Secured by real estate	50,197	51,726
Other	12,477	12,451
Total commercial loans	62,847	64,350
Consumer loans:		
Secured by real estate	8,282	8,730
Other	1,193	1,165
Total consumer loans	9,475	9,895
Total gross loans	$136,820	$138,084
Less:		
Net deferred loan fees	(264)	(297)
Allowance for loan losses	(1,487)	(1,472)
Total loans, net	$135,069	$136,315

The following table illustrates the contractual aging of the recorded investment in past due loans by class of loans as of June 30, 2014 and December 31, 2013:

As of June 30, 2014

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
	(dollars in thousands)						
Commercial Real Estate:							
Commercial Real Estate - construction	$—	$—	$173	$173	$—	$ 173	$ —
Commercial Real Estate - other	11	—	1,441	1,452	48,745	50,197	—
Commercial - non real estate	35	—	—	35	12,442	12,477	—
Consumer:							
Consumer - Real Estate	50	11	12	73	8,209	8,282	—
Consumer - Other	—	—	—	—	1,193	1,193	—

Residential:							
Residential	1,174	346	383	1,903	62,595	64,498	22
Total	$1,270	$357	$2,009	$3,636	$133,184	$ 136,820	$ 22

As of December 31, 2013

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
	(dollars in thousands)						
Commercial Real Estate:							
Commercial Real Estate - construction	$—	$—	$173	$173	$—	$173	$ —
Commercial Real Estate - other	—	521	1,441	1,962	49,764	51,726	—
Commercial - non real estate	33	20	—	53	12,398	12,451	—
Consumer:							
Consumer - Real Estate	54	55	—	109	8,621	8,730	—
Consumer - Other	—	4	2	6	1,159	1,165	2
Residential:							
Residential	1,973	393	353	2,719	61,120	63,839	24
Total	$2,060	$993	$1,969	$5,022	$133,062	$138,084	$ 26

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The Bank uses an eight tier risk rating system to grade its commercial loans. The grade of a loan may change during the life of the loans. The risk ratings are described as follows:

Risk Grade 1 (Excellent) - Prime loans based on liquid collateral, with adequate margin or supported by strong financial statements. Probability of serious financial deterioration is unlikely. High liquidity, minimum risk, strong ratios, and low handling costs are common to these loans. This classification also includes all loans secured by certificates of deposit or cash equivalents.

Risk Grade 2 (Good) - Desirable loans of somewhat less stature than Grade 1, but with strong financial statements. Probability of serious financial deterioration is unlikely. These loans possess a sound repayment source (and/or a secondary source). These loans represent less than the normal degree of risk associated with the type of financing contemplated.

Risk Grade 3 (Satisfactory) - Satisfactory loans of average risk – may have some minor deficiency or vulnerability to changing economic conditions, but still fully collectible. There may be some minor weakness but with offsetting features or other support readily available. These loans present a normal degree of risk associated with the type of financing. Actual and projected indicators and market conditions provide satisfactory assurance that the credit shall perform in accordance with agreed terms.

Risk Grade 4 (Acceptable) - Loans considered satisfactory, but which are of slightly “below average” credit risk due to financial weaknesses or uncertainty. The loans warrant a somewhat higher than average level of monitoring to insure that weaknesses do not advance. The level of risk is considered acceptable and within normal underwriting guidelines, so long as the loan is given the proper level of management supervision.

Risk Grade 4.5 (Monitored) - Loans are considered “below average” and monitored more closely due to some credit deficiency that poses additional risk but is not considered adverse to the point of being a “classified” credit. Possible reasons for additional monitoring may include characteristics such as temporary negative debt service coverage due to weak economic conditions, borrower may have experienced recent losses from operations, declining equity and/or increasing leverage, or marginal liquidity that may affect long-term sustainability. Loans of this grade have a higher degree of risk and warrant close monitoring to insure against further deterioration. In any tables presented subsequently, Risk Grade 4.5 credits are included with Risk Grade 4 credits.

Risk Grade 5 (Other Assets Especially Mentioned) (OAEM) - Loans which possess some credit deficiency or potential weakness, which deserve close attention, but which do not yet warrant substandard classification. Such loans pose unwarranted financial risk that, if not corrected, could weaken the loan and increase risk in the future.

Risk Grade 6 (Substandard) - Loans are "substandard" whose full, final collectability does not appear to be a matter of serious doubt, but which nevertheless portray some form of well defined weakness that requires close supervision by Bank management. The noted weaknesses involve more than normal banking risk. One or more of the following characteristics may be exhibited in loans classified Substandard: (1) Loans possess a defined credit weakness and the likelihood that the loan shall be paid from the primary source of repayment is uncertain; (2) Loans are not adequately protected by the current net worth and/or paying capacity of the obligor; (3) primary source of repayment is gone, and the Bank is forced to rely on a secondary source of repayment such as collateral liquidation or guarantees; (4) distinct possibility that the Bank shall sustain some loss if deficiencies are not corrected; (5) unusual courses of action are needed to maintain a high probability of repayment; (6) the borrower is not generating enough cash flow to repay loan principal, however, continues to make interest payments; (7) the Bank is forced into a subordinated or unsecured position due to flaws in documentation; (8) loans have been restructured so that payment schedules, terms, and collateral represent concessions to the borrower when compared to normal loan terms; (9) the Bank is contemplating foreclosure or legal action due to the apparent deterioration in the loan; or (10) there is a significant deterioration in the market conditions and the borrower is highly vulnerable to these conditions.

Grade 7 (Doubtful) - Loans have all the weaknesses of those classified Substandard. Additionally, however, these weaknesses make collection or liquidation in full, based on existing conditions, improbable. Loans in this category are typically not performing in conformance with established terms and conditions. Full repayment is considered “Doubtful”, but extent of loss is not currently determinable.

Risk Grade 8 (Loss) - Loans are considered uncollectible and of such little value, that continuing to carry them as an asset on the Bank’s financial statements is not feasible.

The following table presents the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of June 30, 2014 and December 31, 2013:

As of June 30, 2014

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
	(dollars in thousands)		
1-2	$—	$ —	$ 25
3	—	15,389	5,750
4	—	22,511	5,867
4.5	—	4,915	660
5	—	4,508	16
6	173	2,874	159
7	—	—	—
8	—	—	—
Total	$173	$ 50,197	$ 12,477

As of December 31, 2013

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
	(dollars in thousands)		
1-2	$—	$ —	$ —
3	—	16,187	5,602
4	—	24,327	6,528
4.5	—	3,462	171
5	—	4,835	45
6	173	2,915	105

7	—	—	—
8	—	—	—
Total	$173	$ 51,726	$ 12,451

For residential real estate and other consumer credit the Company also evaluates credit quality based on the aging status of the loan and by payment activity. Loans 60 or more days past due are monitored by the collection committee.

The following tables present the risk category of loans by class based on the most recent analysis performed as of June 30, 2014 and December 31, 2013:

As of June 30, 2014	(dollars in thousands)
	Residential
Loan Grade:	
Pass	$ 63,940
Special Mention	—
Substandard	558
Total	$ 64,498

	Consumer - Real Estate (dollars in thousands)	Consumer - Other
Performing	$8,266	$ 1,193
Nonperforming	16	—
Total	$8,282	$ 1,193

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As of December 31, 2013	(dollars in thousands)
	Residential
Loan Grade:	
Pass	$ 63,164
Special Mention	—
Substandard	675
Total	$ 63,839

	Consumer - Real Estate	Consumer - Other
Performing	$ 8,723	$ 1,163
Nonperforming	7	2
Total	$ 8,730	$ 1,165

The following table presents the recorded investment in non-accrual loans by class as of June 30, 2014 and December 31, 2013:

	As of June 30, 2014	December 31, 2013
	(in thousands)	
Commercial Real Estate:		
Commercial Real Estate - construction	$173	$ 173
Commercial Real Estate - other	1,452	1,454
Commercial	—	—
Consumer:		
Consumer - real estate	16	7
Consumer - other	—	—
Residential:		
Residential	536	651
Total	$2,177	$ 2,285

The key features of the Company's loan modifications are determined on a loan-by-loan basis. Generally, our restructurings have related to interest rate reductions and loan term extensions. In the past the Company has granted reductions in interest rates, payment extensions and short-term payment forbearances as a means to maximize collectability of troubled credits. The Company has not forgiven principal to date, although this would be considered if necessary to ensure the long-term collectability of the loan. The Company's loan modifications are typically short-term in nature, although the Company would consider a long-term modification to ensure the long-term collectability of the credit. In general, a borrower must make at least six consecutive timely payments before the Company would consider a return of a restructured loan to accruing status in accordance with Federal Deposit Insurance Corporation guidelines regarding restoration of credits to accrual status.

The Bank has classified approximately $2,080,000 of its impaired loans as troubled debt restructurings as of June 30, 2014. There were no commitments to extend credit to borrowers with loans classified as troubled debt restructurings as of June 30, 2014 and December 31, 2013.

For the majority of the Bank's impaired loans, the Bank will apply the observable market price methodology. However, the Bank may also utilize a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine observable market price, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months. In this process, third party evaluations are obtained and heavily relied upon. Until such time that updated evaluations are received, the Bank may discount the collateral value used.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge down in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquency, secured consumer loans are charged down to the value of collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial credits are charged down at 90 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-offs may be realized as further unsecured positions are recognized.

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2014 and December 31, 2013:

Impaired Loans As of June 30, 2014				For the Three Months Ended June 30, 2014		For the Six Months Ended June 30, 2014	
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(dollars in thousands)					(dollars in thousands)	
With no specific allowance recorded:							
Commercial	$—	$ —	$ —	$—	$ —	$—	$ —
Commercial Real Estate - Construction	—	—	—	—	—	—	—
Commercial Real Estate - Other	1,451	1,450	—	1,460	21	1,527	42
Consumer - Real Estate	17	16	—	16	—	16	—
Consumer - Other	—	—	—	—	—	—	—
Residential	659	543	—	553	3	554	4
With a specific allowance recorded:							
Commercial	—	—	—	—	—	—	—
Commercial Real Estate - Construction	1,589	173	48	173	—	173	—
Commercial Real Estate - Other	2,423	1,834	136	1,837	4	1,838	9
Consumer - Real Estate	—	—	—	—	—	—	—
Consumer - Other	—	—	—	—	—	—	—
Residential	90	90	25	90	1	90	1
Totals:							
Commercial	$—	$ —	$ —	$—	$ —	$—	$ —
	$1,589	$ 173	$ 48	$173	$ —	$173	$ —

Commercial Real Estate - Construction							
Commercial Real Estate - Other	$3,874	$ 3,284	$ 136	$3,297	$ 25	$3,365	$ 51
Consumer - Real Estate	$17	$ 16	$ —	$16	$ —	$16	$ —
Consumer - Other	$—	$ —	$ —	$—	$ —	$—	$ —
Residential	$749	$ 633	$ 25	$643	$ 4	$644	$ 5

Impaired Loans As of December 31, 2013				For the Three Months Ended June 30, 2013		For the Six Months Ended June 30, 2013	
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(dollars in thousands)					(dollars in thousands)	
With no related allowance recorded:							
Commercial	$—	$ —	$ —	$—	$ —	$—	$ —
Commercial Real Estate - Construction	—	—	—	173	—	173	—
Commercial Real Estate - Other	1,789	1,788	—	3,172	33	3,195	60
Consumer - Real Estate	8	7	—	9	—	10	—
Consumer - Other	—	—	—	—	—	—	—
Residential	954	722	—	1,793	1	1,797	2
With a specific allowance recorded:							
Commercial	—	—	—	—	—	—	—
Commercial Real Estate - Construction	1,589	173	48	—	—	—	—
Commercial Real Estate - Other	3,980	3,391	182	3,602	20	3,607	39
Consumer - Real Estate	—	—	—	—	—	—	—
Consumer - Other	—	—	—	—	—	—	—
Residential	53	30	5	—	—	—	—
Totals:							
Commercial	$—	$ —	$ —	$—	$ —	$—	$ —
Commercial Real Estate - Construction	$1,589	$ 173	$ 48	$173	$ —	$173	$ —
Commercial Real Estate - Other	$5,769	$ 5,179	$ 182	$6,774	$ 53	$6,802	$ 99
Consumer - Real Estate	$8	$ 7	$ —	$9	$ —	$10	$ —
Consumer - Other	$—	$ —	$ —	$—	$ —	$—	$ —
Residential	$1,007	$ 752	$ 5	$1,793	$ 1	$1,797	$ 2

The ALLL has a direct impact on the provision expense. An increase in the ALLL is funded through recoveries and provision expense.

Activity in the allowance for loan and lease losses was as follows for the three and six months ended June 30, 2014 and June 30, 2013, respectively: