HMN FINANCIAL INC
Form 10-Q
August 04, 2017
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 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 0-24100

HMN FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	41-1777397
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1016 Civic Center Drive N.W., Rochester, MN	55901
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (507) 535-1200

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

Class	Outstanding at July 27, 2017
Common stock, $0.01 par value	4,497,538

HMN FINANCIAL, INC.

CONTENTS

2

Part I – FINANCIAL INFORMATION

Item 1: Financial Statements

HMN FINANCIAL, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(Dollars in thousands)	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Cash and cash equivalents	$ 31,892	27,561
Securities available for sale:		
Mortgage-backed and related securities (amortized cost $603 and $993)	613	1,005
Other marketable securities (amortized cost $78,807 and $78,846)	78,034	77,472
	78,647	78,477
Loans held for sale	2,061	2,009
Loans receivable, net	590,259	551,171
Accrued interest receivable	2,609	2,626
Real estate, net	616	611
Federal Home Loan Bank stock, at cost	817	770
Mortgage servicing rights, net	1,655	1,604
Premises and equipment, net	8,213	8,223
Goodwill	802	802
Core deposit intangible	404	454
Prepaid expenses and other assets	1,500	1,768
Deferred tax asset, net	5,708	5,947
Total assets	$ 725,183	682,023
Liabilities and Stockholders' Equity		
Deposits	$ 634,101	592,811
Other borrowings	7,000	7,000
Accrued interest payable	214	236
Customer escrows	1,223	1,011
Accrued expenses and other liabilities	3,922	5,046
Total liabilities	646,460	606,104
Commitments and contingencies		
Stockholders' equity:		
Serial preferred stock ($.01 par value): authorized 500,000 shares; issued shares 0	0	0

Common stock ($.01 par value): authorized 16,000,000; issued shares 9,128,662	91	91
Additional paid-in capital	50,452	50,566
Retained earnings, subject to certain restrictions	89,123	86,886
Accumulated other comprehensive loss	(459)	(820)
Unearned employee stock ownership plan shares	(2,127)	(2,223)
Treasury stock, at cost 4,631,124 and 4,639,739 shares	(58,357)	(58,581)
Total stockholders' equity	78,723	75,919
Total liabilities and stockholders' equity	$ 725,183	682,023

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Interest income:				
Loans receivable	$6,701	6,774	13,061	12,868
Securities available for sale:				
Mortgage-backed and related	5	16	12	36
Other marketable	283	351	551	723
Cash equivalents	5	17	28	55
Other	5	1	6	2
Total interest income	6,999	7,159	13,658	13,684
Interest expense:				
Deposits	329	246	622	472
Federal Home Loan Bank advances and other borrowings	132	149	247	297
Total interest expense	461	395	869	769
Net interest income	6,538	6,764	12,789	12,915
Provision for loan losses	269	381	(1)	(351)
Net interest income after provision for loan losses	6,269	6,383	12,790	13,266
Non-interest income:				
Fees and service charges	845	873	1,669	1,652
Loan servicing fees	306	271	607	532
Gain on sales of loans	488	705	1,007	1,192
Other	267	253	503	481
Total non-interest income	1,906	2,102	3,786	3,857
Non-interest expense:				
Compensation and benefits	3,780	3,598	7,724	7,293
Gains on real estate owned	(1)	(75)	(7)	(424)
Occupancy and equipment	1,026	1,006	2,065	1,996
Data processing	260	281	552	554
Professional services	417	368	676	619
Other	957	855	1,776	1,686
Total non-interest expense	6,439	6,033	12,786	11,724
Income before income tax expense	1,736	2,452	3,790	5,399
Income tax expense	712	974	1,553	2,147
Net income	1,024	1,478	2,237	3,252
Other comprehensive income, net of tax	173	44	361	182

Comprehensive income attributable to common shareholders	$1,197	1,522	2,598	3,434
Basic earnings per share	$0.24	0.35	0.53	0.78
Diluted earnings per share	$0.21	0.31	0.46	0.69

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

For the Six-Month Period Ended June 30, 2017

(unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2016	$ 91	50,566	86,886	(820)	(2,223)	(58,581)	75,919
Net income			2,237				2,237
Other comprehensive income				361			361
Stock compensation expense		21					21
Restricted stock awards		(278)				278	0
Stock awards withheld for tax withholding						(54)	(54)
Amortization of restricted stock awards		71					71
Earned employee stock ownership plan shares		72			96		168
Balance, June 30, 2017	$ 91	50,452	89,123	(459)	(2,127)	(58,357)	78,723

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited)

	Six Months Ended June 30,	
(Dollars in thousands)	2017	2016
Cash flows from operating activities:		
Net income	$2,237	3,252
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	(1)	(351)
Depreciation	464	399
Amortization of discounts, net	0	(9)
Amortization of deferred loan fees	(125)	(802)
Amortization of core deposit intangible	50	43
Amortization of purchased loan fair value adjustments	(55)	(253)
Amortization of mortgage servicing rights	269	278
Capitalized mortgage servicing rights	(320)	(258)
Losses on sales of investments	0	9
Gain on sale of premises and equipment	(8)	0
Gain on sales of real estate	(7)	(424)
Gain on sales of loans	(1,007)	(1,192)
Proceeds from sale of loans held for sale	43,490	40,870
Disbursements on loans held for sale	(36,046)	(31,244)
Amortization of restricted stock awards	71	92
Amortization of unearned Employee Stock Ownership Plan shares	96	97
Earned Employee Stock Ownership Plan shares priced above original cost	72	30
Stock option compensation expense	21	39
Decrease (increase) in accrued interest receivable	18	(50)
Decrease in accrued interest payable	(23)	(13)
Decrease in other assets	233	239
(Decrease) increase in other liabilities	(1,103)	1,635
Other, net	46	23
Net cash provided by operating activities	8,372	12,410
Cash flows from investing activities:		
Principal collected on securities available for sale	416	628
Proceeds collected on maturities of securities available for sale	5,000	96,020
Purchases of securities available for sale	(4,999)	(59,968)
Purchase of Federal Home Loan Bank Stock	(3,255)	(1,079)
Redemption of Federal Home Loan Bank Stock	3,208	1,000
Proceeds from sales of real estate	42	1,623
Net increase in loans receivable	(45,415)	(62,447)
Acquisition payment (net of cash acquired)	0	6,080
Proceeds from sale of premises and equipment	8	0

Purchases of premises and equipment	(498)	(1,009)
Net cash used by investing activities	(45,493)	(19,152)
Cash flows from financing activities:		
Increase (decrease) in deposits	41,294	(15,288)
Stock awards withheld for tax withholding	(54)	0
Proceeds from borrowings	80,600	25,000
Repayment of borrowings	(80,600)	(25,000)
Increase in customer escrows	212	1,128
Net cash provided (used) by financing activities	41,452	(14,160)
Increase (decrease) in cash and cash equivalents	4,331	(20,902)
Cash and cash equivalents, beginning of period	27,561	39,782
Cash and cash equivalents, end of period	$31,892	18,880
Supplemental cash flow disclosures:		
Cash paid for interest	$892	777
Cash paid for income taxes	1,766	156
Supplemental noncash flow disclosures:		
Loans transferred to loans held for sale	6,641	7,891
Loans held for sale transferred to loans	164	0
Transfer of loans to real estate	40	591

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(unaudited)

(1) ***HMN Financial, Inc.***

HMN Financial, Inc. (HMN or the Company) is a stock savings bank holding company that owns 100 percent of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota, Iowa, and Wisconsin. The Bank has two wholly owned subsidiaries, Osterud Insurance Agency, Inc. (OIA), which does business as Home Federal Investment Services and offers financial planning products and services, and HFSB Property Holdings, LLC (HPH), which is currently inactive but has acted in the past as an intermediary for the Bank in holding and operating certain foreclosed properties.

The consolidated financial statements included herein are for HMN, the Bank, OIA and HPH. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts in the consolidated financial statements for the prior year have been reclassified to conform to the current year presentation.

(2) ***Basis of Preparation***

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statement of stockholders' equity and consolidated statements of cash flows in conformity with U.S. generally accepted accounting principles (GAAP). However, all normal recurring adjustments which are, in the opinion of management, necessary for the fair presentation of the interim financial statements have been included. The results of operations for the six-month period ended June 30, 2017 are not necessarily indicative of the results which may be expected for the entire year.

(3) ***New Accounting Standards***

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in this ASU require, among other things, equity investments to be measured at fair value with changes in fair value recognized in net income and that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The amendments also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments also eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The ASU is intended to reduce diversity in practice and is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The adoption of this ASU in the first quarter of 2018 is not anticipated to have a material impact on the Company’s consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* The amendments in the ASU create *Topic 842, Leases*, and supersede the lease requirements in *Topic 840, Leases*. The objective of this ASU is to establish the principles that lessees and lessors shall apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease. The main difference between previous GAAP and this ASU is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The amendment requires a lessee to recognize in the statement of financial position a liability to make lease payments (the lease liability) and the right-of-use asset representing its right to use the underlying asset for the lease term. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply that will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified. The amendments in the ASU, for public business entities, are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The adoption of this ASU in the first quarter of 2019 is not anticipated to have a material impact on the Company’s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718).* The amendments in this ASU affect all entities that issue share-based payment awards to their employees. The amendments are intended to simplify the accounting for share-based payment transactions including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this ASU, for public business entities, are effective for fiscal years beginning after December 15, 2016, including interim periods within those annual periods. Amendments should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. The adoption of this ASU in the first quarter of 2017 did not have any impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The amendments in this ASU affect all entities that measure credit losses on financial instruments including loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial asset that has a contractual right to receive cash that is not specifically excluded. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this ASU replace the incurred loss impairment methodology required in current GAAP with a methodology that reflects expected credit losses that requires consideration of a broader range of reasonable and supportable information to estimate credit losses. The amendments in this ASU will affect entities to varying degrees depending on the credit quality of the assets held by the entity, the duration of the assets held, and how the entity applies the current incurred loss methodology. The amendments in this ASU, for public business entities that are U. S. Securities and Exchange Commission (SEC) filers, are effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods. All entities may adopt the amendments in the ASU early as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Amendments should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Management is still in the process of evaluating the impact that the adoption of this ASU in the first quarter of 2020 will have on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.* The amendments in this ASU affect all entities that are required to present a statement of cash flows under Topic 230 and address the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interest in securitization transactions; and separately identifiable cash flows and application of the predominance principle. This ASU is intended to reduce diversity in practice and is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years with early adoption permitted. Upon adoption, the amendments should be applied using a retrospective transition method to each period presented. The adoption of this ASU in the first quarter of 2018 is not anticipated to have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments – Equity Method and Joint Ventures (Topic 323).* The amendments in the ASU add and amend SEC paragraphs pursuant to the SEC staff announcement at the September 22, 2016 and November 17, 2016 Emerging Issues Task Force (EITF) meetings. The September announcement is about the disclosure of the impact that recently issued accounting standards will have on the financial statements of a registrant when such standards are adopted in a future period. The announcement applies to ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*; ASU 2016-02, *Leases (Topic 842)*; and ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* and to any subsequent amendments to these ASUs that are issued prior to their adoption. The November announcement made amendments to conform the SEC Observer comment on accounting for tax benefits resulting from investments in qualified affordable housing projects to the guidance issued in Accounting Standards Update No. 2014-01, *Investments-Equity Method and Joint Ventures (Topic 323); Accounting for Investments in Qualified Affordable Housing Projects.* This ASU is intended to improve transparency and is effective for public business entities upon issuance. The adoption of this ASU is not anticipated to have a material impact on the Company’s consolidated financial statements other than to enhance the disclosures on the effects of new accounting pronouncements as they move closer to adoption in future periods.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* The amendments in this ASU were issued to address concerns over the cost and complexity of the two-step goodwill impairment test and resulted in the removal of the second step of the test. The amendments require an entity to apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit’s carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. This ASU is intended to reduce the cost and complexity of the two-step goodwill impairment test and is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years with early adoption permitted for testing performed after January 1, 2017. Upon adoption, the amendments should be applied on a prospective basis and the entity is required to disclose the nature of and reason for the change in accounting principle upon transition. The adoption of this ASU in the fourth quarter of 2020 when the annual assessment is completed is not anticipated to have a material impact on the Company’s consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.* The amendments in this ASU shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount as discounts continue to be amortized to maturity. This ASU is intended to more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. In most cases, market participants price securities to the call date that produces the worst yield when the coupon is above current market rates and prices securities to maturity when the coupon is below market rates. As a result, the amendments more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. This ASU is intended to reduce diversity in practice and is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 with early adoption permitted. Upon adoption, the amendments should be applied using a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principles. The adoption of this ASU in the first quarter of 2019 is not anticipated to have a material impact on the Company’s consolidated financial statements.

(4) *Fair Value Measurements*

ASC 820, *Fair Value Measurements,* establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system consisting of three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.

Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following table summarizes the assets and liabilities of the Company for which fair values are determined on a recurring basis as of June 30, 2017 and December 31, 2016.

	Carrying value at June 30, 2017			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Securities available for sale	$78,647	0	78,647	0
Mortgage loan commitments	22	0	22	0
Total	$78,669	0	78,669	0

	Carrying value at December 31, 2016			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Securities available for sale	$78,477	0	78,477	0
Mortgage loan commitments	66	0	66	0

Total	$78,543	0	78,543	0

There were no transfers between Levels 1, 2, or 3 during the three or six month periods ended June 30, 2017.

The Company may also be required, from time to time, to measure certain other financial assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held at June 30, 2017 and December 31, 2016, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related individual assets or portfolios at June 30, 2017 and December 31, 2016.

(Dollars in thousands)	Carrying value at June 30, 2017 Total	Level 1	Level 2	Level 3	Three months ended June 30, 2017 total gains (losses)	Six months ended June 30, 2017 total gains (losses)
Loans held for sale	$2,061	0	2,061	0	(26)	(8)
Mortgage servicing rights	1,655	0	1,655	0	0	0
Loans (1)	4,087	0	4,087	0	56	65
Real estate, net (2)	616	0	616	0	0	0
Total	$8,419	0	8,419	0	30	57

10

(Dollars in thousands)	Carrying value at December 31, 2016 Total	Level 1	Level 2	Level 3	Year ended December 31, 2016 total gains (losses)
Loans held for sale	$2,009	0	2,009	0	14
Mortgage servicing rights, net	1,604	0	1,604	0	0
Loans[1]	3,582	0	3,582	0	(380)
Real estate, net[2]	611	0	611	0	(197)
Total	$7,806	0	7,806	0	(563)

(1) Represents carrying value and related write-downs of loans for which adjustments are based on the appraised value of the collateral. The carrying value of loans fully charged-off is zero.

(2) Represents the fair value and related losses of foreclosed real estate and other collateral owned that were measured at fair value subsequent to their initial classification as foreclosed assets.

(5) ***Fair Value of Financial Instruments***

Generally accepted accounting principles require interim reporting period disclosure about the fair value of financial instruments, including assets, liabilities and off-balance sheet items for which it is practicable to estimate fair value. The fair value hierarchy level for each asset and liability, as defined in Note 4, have been included in the following table for June 30, 2017 and December 31, 2016. The fair value estimates are made based upon relevant market information, if available, and upon the characteristics of the financial instruments themselves. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based upon judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. The estimated fair value of the Company’s financial instruments as of June 30, 2017 and December 31, 2016 are shown below.

	June 30, 2017						December 31, 2016					
			Fair value hierarchy						Fair value hierarchy			
(Dollars in thousands)	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3	Contract amount	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3	Contract amount
Financial assets:												
	$31,892	31,892	31,892				27,561	27,561	27,561			

Cash and cash equivalents												
Securities available for sale	78,647	78,647		78,647			78,477	78,477		78,477		
Loans held for sale	2,061	2,061		2,061			2,009	2,009		2,009		
Loans receivable, net	590,259	591,170		591,170			551,171	552,395		552,395		
Federal Home Loan Bank stock	817	817		817			770	770		770		
Accrued interest receivable	2,609	2,609		2,609			2,626	2,626		2,626		
Financial liabilities:												
Deposits	634,101	634,519		634,519			592,811	593,297		593,297		
Other borrowings	7,000	6,902		6,902			7,000	7,018		7,018		
Accrued interest payable	214	214		214			236	236		236		
Off-balance sheet financial instruments:												
Commitments to extend credit	22	22				215,169	66	66				184,59
Commitments to sell loans	(1)	(1)				10,773	(22)	(22)				9,595

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents approximates their fair value.

Securities Available for Sale

The fair values of securities were based upon quoted market prices for identical or similar instruments in active markets.

Loans Held for Sale

The fair values of loans held for sale were based upon quoted market prices for loans with similar interest rates and terms to maturity.

Loans Receivable, net

The fair value of the loan portfolio, with the exception of the adjustable rate portfolio, was calculated by discounting the scheduled cash flows through the estimated maturity using anticipated prepayment speeds and using discount rates that reflect the credit and interest rate risk inherent in each loan portfolio. The fair value of the adjustable loan portfolio was estimated by grouping the loans with similar characteristics and comparing the characteristics of each group to the prices quoted for similar types of loans in the secondary market.

Federal Home Loan Bank stock

The carrying amount of Federal Home Loan Bank (FHLB) stock approximates its fair value.

Accrued Interest Receivable

The carrying amount of accrued interest receivable approximates its fair value since it is short-term in nature and does not present unanticipated credit concerns.

Deposits

The fair value of demand deposits, savings accounts and certain money market account deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

The fair value estimate for deposits does not include the benefit that results from the low cost funding provided by the Company's existing deposits and long-term customer relationships compared to the cost of obtaining different sources of funding. This benefit is commonly referred to as the core deposit intangible.

Other Borrowings

The fair values of other borrowings with fixed maturities are estimated based on discounted cash flow analysis using as discount rates the interest rates charged by the FHLB for borrowings of similar remaining maturities.

Accrued Interest Payable

The carrying amount of accrued interest payable approximates its fair value since it is short-term in nature.

Commitments to Extend Credit

The fair values of commitments to extend credit are estimated using the fees normally charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counter parties.

Commitments to Sell Loans

The fair values of commitments to sell loans are estimated using the quoted market prices for loans with similar interest rates and terms to maturity.

(6) ***Other Comprehensive Income***

Other comprehensive income is defined as the change in equity during a period from transactions and other events from nonowner sources. Comprehensive income is the total of net income and other comprehensive income, which for the Company is comprised of unrealized gains and losses on securities available for sale. The components of other comprehensive income and the related tax effects were as follows:

(Dollars in thousands)	For the three months ended June 30, 2017			2016		
Securities available for sale:	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Gross unrealized gains arising during the period	$286	113	173	64	26	38
Less reclassification of net losses included in net income	0	0	0	(9)	(3)	(6)
Net unrealized gains arising during the period	286	113	173	73	29	44
Other comprehensive income	$286	113	173	73	29	44

(Dollars in thousands)	For the six months ended June 30, 2017			2016		
Securities available for sale:	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Gross unrealized gains arising during the period	$599	238	361	294	118	176
Less reclassification of net losses included in net income	0	0	0	(9)	(3)	(6)
Net unrealized gains arising during the period	599	238	361	303	121	182
Other comprehensive income	$599	238	361	303	121	182

(7) ***Securities Available For Sale***

The following table shows the gross unrealized losses and fair value for the securities available for sale portfolio, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2017 and December 31, 2016.

(Dollars in thousands)	Less Than Twelve Months # of Investments	Fair Value	Unrealized Losses	Twelve Months or More # of Investments	Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
<u>June 30, 2017</u>								
Collateralized mortgage obligations:								
	0	$0	0	1	$21	(1)	$21	(1)

Federal National Mortgage Association (FNMA)								
Other marketable securities:								
U.S. Government agency obligations	13	64,292	(686)	0	0	0	64,292	(686)
Municipal obligations	7	1,024	(2)	0	0	0	1,024	(2)
Corporate preferred stock	0	0	0	1	525	(175)	525	(175)
Total temporarily impaired securities	20	$65,316	(688)	2	$546	(176)	$65,862	(864)

	Less Than Twelve Months			Twelve Months or More			Total	
(Dollars in thousands)	# of Investments	Fair Value	Unrealized Losses	# of Investments	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016								
Collateralized mortgage obligations:								
FNMA	1	$262	(3)	1	$ 104	(2)	$366	(5)
Other marketable securities:								
U.S. Government agency obligations	13	63,896	(1,079)	0	0	0	63,896	(1,079)
Municipal obligations	14	2,327	(19)	2	214	(1)	2,541	(20)
Corporate preferred stock	0	0	0	1	350	(350)	350	(350)
Total temporarily impaired securities	28	$66,485	(1,101)	4	$ 668	(353)	$67,153	(1,454)

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the market liquidity for the investment, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer, and our intent and ability to hold the investment for a period of time sufficient to recover the temporary loss.

The unrealized losses reported for corporate preferred stock over twelve months at June 30, 2017 relates to a single trust preferred security that was issued by the holding company of a small community bank. As of June 30, 2017 interest payments were current on the trust preferred security and the issuer's subsidiary bank was considered to be "well capitalized" based on its most recent regulatory filing. Based on a review of the issuer, it was determined that the trust preferred security was not other-than-temporarily impaired at June 30, 2017. The Company does not intend to sell the trust preferred security and has the ability to hold it for a period of time sufficient to recover the temporary loss. Management believes that the Company will receive all principal and interest payments contractually due on the securities and that the decrease in the market value is primarily due to a lack of liquidity in the market for trust preferred securities. Management will continue to monitor the credit risk of the issuer and may be required to recognize other-than-temporary impairment charges on this security in future periods.

A summary of securities available for sale at June 30, 2017 and December 31, 2016 is as follows:

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2017				
Mortgage-backed securities:				
Federal Home Loan Mortgage Corporation (FHLMC)	$ 188	6	0	194
Federal National Mortgage Association (FNMA)	149	3	0	152
Collateralized mortgage obligations:				
FNMA	266	2	(1)	267
	603	11	(1)	613
Other marketable securities:				
U.S. Government agency obligations	74,978	4	(686)	74,296
Municipal obligations	2,809	11	(2)	2,818
Corporate obligations	262	3	0	265
Corporate preferred stock	700	0	(175)	525
Corporate equity	58	72	0	130
	78,807	90	(863)	78,034
	$ 79,410	101	(864)	78,647

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2016				
Mortgage-backed securities:				
FHLMC	$ 327	10	0	337
FNMA	295	7	0	302
Collateralized mortgage obligations:				
FNMA	371	0	(5)	366
	993	17	(5)	1,005
Other marketable securities:				
U.S. Government agency obligations	74,979	16	(1,079)	73,916
Municipal obligations	2,819	0	(20)	2,799
Corporate obligations	290	2	0	292
Corporate preferred stock	700	0	(350)	350
Corporate equity	58	57	0	115
	78,846	75	(1,449)	77,472
	$ 79,839	92	(1,454)	78,477

The following table indicates amortized cost and estimated fair value of securities available for sale at June 30, 2017 based upon contractual maturity adjusted for scheduled repayments of principal and projected prepayments of principal based upon current economic conditions and interest rates.

(Dollars in thousands)	Amortized Cost	Fair Value
Due less than one year	$ 15,729	15,602
Due after one year through five years	62,600	62,067
Due after five years through ten years	235	236
Due after ten years	788	612
No stated maturity	58	130
Total	$ 79,410	78,647

The allocation of mortgage-backed securities in the table above is based upon the anticipated future cash flow of the securities using estimated mortgage prepayment speeds. The allocation of other marketable securities that have call features is based on the anticipated cash flows to the call date that it is anticipated that the security will be called, or to the maturity date if it is not anticipated to be called.

(8) ***Loans Receivable, Net***

A summary of loans receivable at June 30, 2017 and December 31, 2016 is as follows:

(Dollars in thousands)	June 30, 2017	December 31, 2016
Single family	$108,312	103,255
Commercial real estate:		
Real estate rental and leasing	175,923	153,343
Other	148,677	145,737
	324,600	299,080
Consumer	74,560	73,283
Commercial business:		
Transportation industry	9,872	10,509
Other	82,478	74,667
	92,350	85,176
Total loans	599,822	560,794

Less:

Unamortized discounts	21	20
Net deferred loan costs	(503)	(300)
Allowance for loan losses	10,045	9,903
Total loans receivable, net	$590,259	551,171

15

(9) ***Allowance for Loan Losses and Credit Quality Information***

The allowance for loan losses is summarized as follows:

(Dollars in thousands)	Single Family	Commercial Real Estate	Consumer	Commercial Business	Total
For the three months ended June 30, 2017:					
Balance, March 31, 2017	$1,110	4,958	1,332	2,190	9,590
Provision for losses	(106)	452	224	(301)	269
Charge-offs	0	0	(17)	0	(17)
Recoveries	0	80	5	118	203
Balance, June 30, 2017	$1,004	5,490	1,544	2,007	10,045
For the six months ended June 30, 2017:					
Balance, December 31, 2016	$1,186	4,953	1,613	2,151	9,903
Provision for losses	(182)	363	116	(298)	(1)
Charge-offs	0	0	(218)	0	(218)
Recoveries	0	174	33	154	361
Balance, June 30, 2017	$1,004	5,490	1,544	2,007	10,045
Allocated to:					
Specific reserves	$235	248	434	71	988
General reserves	951	4,705	1,179	2,080	8,915
Balance, December 31, 2016	$1,186	4,953	1,613	2,151	9,903
Allocated to:					
Specific reserves	$194	275	199	73	741
General reserves	810	5,215	1,345	1,934	9,304
Balance, June 30, 2017	$1,004	5,490	1,544	2,007	10,045
Loans receivable at December 31, 2016:					
Individually reviewed for impairment	$1,107	1,880	940	643	4,570
Collectively reviewed for impairment	102,148	297,200	72,343	84,533	556,224
Ending balance	$103,255	299,080	73,283	85,176	560,794
Loans receivable at June 30, 2017:					
Individually reviewed for impairment	$1,393	2,163	825	447	4,828
Collectively reviewed for impairment	106,919	322,437	73,735	91,903	594,994
Ending balance	$108,312	324,600	74,560	92,350	599,822

(Dollars in thousands)	Single Family	Commercial Real Estate	Consumer	Commercial Business	Total

For the three months ended June 30, 2016:					
Balance, March 31, 2016	$ 1,050	5,437	1,395	1,481	9,363
Provision for losses	220	(37)	132	66	381
Charge-offs	0	0	(8)	(44)	(52)
Recoveries	0	427	12	194	633
Balance, June 30, 2016	$ 1,270	5,827	1,531	1,697	10,325
For the six months ended June 30, 2016:					
Balance, December 31, 2015	$ 990	6,078	1,200	1,441	9,709
Provision for losses	280	(859)	315	(87)	(351)
Charge-offs	0	0	(15)	(44)	(59)
Recoveries	0	608	31	387	1,026
Balance, June 30, 2016	$ 1,270	5,827	1,531	1,697	10,325

The following table summarizes the amount of classified and unclassified loans at June 30, 2017 and December 31, 2016:

	June 30, 2017						
	Classified					Unclassified	
(Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total	Total	Total Loans
Single family	$525	2,087	46	0	2,658	105,654	108,312
Commercial real estate:							
Real estate rental and leasing	9,098	2,216	0	0	11,314	164,609	175,923
Other	9,058	7,218	0	0	16,276	132,401	148,677
Consumer	0	645	34	146	825	73,735	74,560
Commercial business:							
Transportation industry	0	1,053	0	0	1,053	8,819	9,872
Other	8,225	3,787	0	0	12,012	70,466	82,478
	$26,906	17,006	80	146	44,138	555,684	599,822

	December 31, 2016						
	Classified					Unclassified	
(Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total	Total	Total Loans
Single family	$457	2,130	74	0	2,661	100,594	103,255
Commercial real estate:							
Real estate rental and leasing	1,577	3,156	0	0	4,733	148,610	153,343
Other	1,702	7,187	0	0	8,889	136,848	145,737
Consumer	0	531	110	299	940	72,343	73,283
Commercial business:							
Transportation industry	0	4,065	0	0	4,065	6,444	10,509
Other	3,973	2,916	0	0	6,889	67,778	74,667
	$7,709	19,985	184	299	28,177	532,617	560,794

Classified loans represent special mention, substandard (performing and non-performing), and non-performing loans categorized as doubtful and loss. Loans classified as special mention are loans that have potential weaknesses that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank’s credit position at some future date. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. A loan classified as loss is essentially uncollateralized and/or considered uncollectible and of such little value that continuance as an asset on the balance sheet may not be warranted. Loans classified as substandard or doubtful require the Bank to perform an analysis of the individual loan and charge off any loans, or portion thereof, that are deemed uncollectible.

The aging of past due loans at June 30, 2017 and December 31, 2016 is summarized as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Loans	Total Loans	Loans 90 Days or More Past Due and Still Accruing
June 30, 2017							
Single family	$1,057	252	191	1,500	106,812	108,312	0
Commercial real estate:							
Real estate rental and leasing	213	0	258	471	175,452	175,923	0
Other	0	0	0	0	148,677	148,677	0
Consumer	290	195	78	563	73,997	74,560	0
Commercial business:							
Transportation industry	0	0	0	0	9,872	9,872	0
Other	474	290	0	764	81,714	82,478	0
	$2,034	737	527	3,298	596,524	599,822	0
December 31, 2016							
Single family	$342	158	179	679	102,576	103,255	0
Commercial real estate:							
Real estate rental and leasing	0	0	0	0	153,343	153,343	0
Other	0	0	0	0	145,737	145,737	0
Consumer	412	117	140	669	72,614	73,283	0
Commercial business:							
Transportation industry	0	0	0	0	10,509	10,509	0
Other	85	0	274	359	74,308	74,667	0
	$839	275	593	1,707	559,087	560,794	0

Impaired loans include loans that are non-performing (non-accruing) and loans that have been modified in a troubled debt restructuring (TDR). The following table summarizes impaired loans and related allowances as of June 30, 2017 and December 31, 2016:

	June 30, 2017			December 31, 2016		
(Dollars in thousands)	Recorded Investment	Unpaid Principal	Related Allowance	Recorded Investment	Unpaid Principal	Related Allowance

		Balance			Balance	
Loans with no related allowance recorded:						
Single family	$524	524	0	217	217	0
Commercial real estate:						
Real estate rental and leasing	38	79	0	40	122	0
Other	26	1,682	0	26	1,771	0
Consumer	492	492	0	312	312	0
Commercial business:						
Other	0	0	0	274	356	0
Loans with an allowance recorded:						
Single family	869	869	194	890	890	235
Commercial real estate:						
Real estate rental and leasing	258	258	27	0	0	0
Other	1,841	1,841	248	1,814		