OLD POINT FINANCIAL CORP
Form 10-Q
August 12, 2014
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

or

o 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: 000-12896

OLD POINT FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

VIRGINIA	54-1265373
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1 West Mellen Street, Hampton, Virginia 23663
(Address of principal executive offices) (Zip Code)

(757) 728-1200
(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 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 o 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 o 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 o	Accelerated filer o
Non-accelerated filer o (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). o Yes No

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

4,959,009 shares of common stock ($5.00 par value) outstanding as of July 31, 2014

OLD POINT FINANCIAL CORPORATION

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PART I - FINANCIAL INFORMATION

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Balance Sheets

	June 30, 2014	December 31, 2013
	(dollars in thousands except per share data)	
	(unaudited)	
Assets		
Cash and due from banks	$20,383	$11,802
Interest-bearing due from banks	507	18,045
Federal funds sold	1,643	1,478
Cash and cash equivalents	22,533	31,325
Securities available-for-sale, at fair value	144,040	155,639
Securities held-to-maturity (fair value approximates $97,091 and $97,453)	93,990	96,847
Restricted securities	2,293	2,378
Loans, net of allowance for loan losses of $6,976 and $6,831	512,686	493,868
Premises and equipment, net	42,599	40,546
Bank-owned life insurance	23,107	22,673
Other real estate owned, net of valuation allowance of $2,700 and $2,775	6,549	6,415
Other assets	13,104	14,597
Total assets	$860,901	$864,288
Liabilities & Stockholders' Equity		
Deposits:		
Noninterest-bearing deposits	$185,277	$182,513
Savings deposits	292,481	286,085
Time deposits	238,770	256,807
Total deposits	716,528	725,405
Overnight repurchase agreements	25,677	31,175
Term repurchase agreements	412	411
Federal Home Loan Bank advances	30,000	25,000
Accrued expenses and other liabilities	2,297	1,536
Total liabilities	774,914	783,527
Commitments and contingencies	0	0
Stockholders' equity:		
Common stock, $5/share par value, 10,000,000 shares authorized;4,959,009 shares issued and outstanding	24,795	24,795
Additional paid-in capital	16,392	16,392
Retained earnings	51,859	50,376
Accumulated other comprehensive loss, net	(7,059)	(10,802)

Total stockholders' equity	85,987	80,761
Total liabilities and stockholders' equity	$ 860,901	$ 864,288

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(unaudited, dollars in thousands except per share data)			
Interest and Dividend Income:				
Interest and fees on loans	$6,122	$5,891	$12,115	$11,899
Interest on due from banks	0	19	3	33
Interest on federal funds sold	0	1	5	1
Interest on securities:				
Taxable	962	1,252	1,967	2,576
Tax-exempt	426	287	855	552
Dividends and interest on all other securities	26	26	57	44
Total interest and dividend income	7,536	7,476	15,002	15,105
Interest Expense:				
Interest on savings deposits	52	69	123	156
Interest on time deposits	595	796	1,244	1,650
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	8	7	17	19
Interest on Federal Home Loan Bank advances	307	305	609	607
Total interest expense	962	1,177	1,993	2,432
Net interest income	6,574	6,299	13,009	12,673
Provision for loan losses	100	300	350	500
Net interest income, after provision for loan losses	6,474	5,999	12,659	12,173
Noninterest Income:				
Income from fiduciary activities	793	866	1,748	1,766
Service charges on deposit accounts	1,056	1,036	2,030	2,033
Other service charges, commissions and fees	1,041	912	1,993	1,771
Income from bank-owned life insurance	217	217	433	432
Income from Old Point Mortgage	6	218	31	304
Loss on sale of available-for-sale securities, net	(7)	(21)	(7)	(21)
Other operating income	47	57	87	113
Total noninterest income	3,153	3,285	6,315	6,398
Noninterest Expense:				
Salaries and employee benefits	4,981	4,805	9,834	9,726
Occupancy and equipment	1,205	1,079	2,319	2,191
Data processing	433	413	856	835
FDIC insurance	183	174	367	357
Customer development	207	205	399	411
Legal and audit expense	153	124	277	235
Other outside service fees	152	113	271	209
Employee professional development	220	182	388	313
Marketing and advertising	127	124	251	247
Postage and courier	113	120	234	243
Loan expenses	118	87	216	177

Stationery and supplies	118	96	237	216
Capital stock tax	127	105	261	192
Loss (gain) on write-down/sale of other real estate owned	(26)	78	57	204
Other operating expense	356	345	763	719
Total noninterest expense	8,467	8,050	16,730	16,275
Income before income taxes	1,160	1,234	2,244	2,296
Income tax expense	59	219	166	380
Net income	$1,101	$1,015	$2,078	$1,916
Basic Earnings per Share:				
Average shares outstanding	4,959,009	4,959,009	4,959,009	4,959,009
Net income per share of common stock	$0.22	$0.21	$0.42	$0.39
Diluted Earnings per Share:				
Average shares outstanding	4,959,009	4,959,009	4,959,009	4,959,009
Net income per share of common stock	$0.22	$0.21	$0.42	$0.39

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(unaudited, dollars in thousands)			
Net income	$1,101	$1,015	$2,078	$1,916
Other comprehensive income (loss), net of tax				
Unrealized gains (losses) on available-for-sale securities	1,932	(6,497)	3,484	(8,223)
Amortization of unrealized losses on securities transferred to held-to-maturity	133	0	259	0
Other comprehensive income (loss)	2,065	(6,497)	3,743	(8,223)
Comprehensive income (loss)	$3,166	$(5,482)	$5,821	$(6,307)

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity

(unaudited, dollars in thousands except per share data)	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
SIX MONTHS ENDED JUNE 30, 2014						
Balance at beginning of period	4,959,009	$24,795	$16,392	$50,376	$(10,802)	$80,761
Net income	0	0	0	2,078	0	2,078
Other comprehensive income, net of tax	0	0	0	0	3,743	3,743
Cash dividends ($0.12 per share)	0	0	0	(595)	0	(595)
Balance at end of period	4,959,009	$24,795	$16,392	$51,859	$(7,059)	$85,987
SIX MONTHS ENDED JUNE 30, 2013						
Balance at beginning of period	4,959,009	$24,795	$16,392	$48,305	$(192)	$89,300
Net income	0	0	0	1,916	0	1,916
Other comprehensive loss, net of tax	0	0	0	0	(8,223)	(8,223)
Cash dividends ($0.10 per share)	0	0	0	(496)	0	(496)
Balance at end of period	4,959,009	$24,795	$16,392	$49,725	$(8,415)	$82,497

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows

Six Months Ended June 30,	2014	2013
	(unaudited, in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$2,078	$ 1,916
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,030	980
Provision for loan losses	350	500
Net loss on sale of available-for-sale securities	7	21
Net amortization of securities	1,125	1,318
Net loss on disposal of premises and equipment	0	16
Net loss on write-down/sale of other real estate owned	57	204
Income from bank owned life insurance	(433)	(432)
Deferred tax (benefit) expense	130	(117)
Increase in other assets	(675)	(522)
Increase in other liabilities	761	807
Net cash provided by operating activities	4,430	4,691
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(2,275)	(11,377)
Purchases of held-to-maturity securities	0	(10,854)
Proceeds from sales of restricted securities	85	184
Proceeds from maturities and calls of available-for-sale securities	170	10,490
Proceeds from sales of available-for-sale securities	13,702	39,301
Paydowns on available-for-sale securities	4,796	18,672
Paydowns on held-to-maturity securities	2,701	0
(Increase) decrease in loans made to customers	(20,060)	230
Proceeds from sales of other real estate owned	711	1,117
Purchases of premises and equipment	(3,083)	(4,483)
Net cash provided by (used in) investing activities	(3,253)	43,280
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in noninterest-bearing deposits	2,764	1,099
Increase in savings deposits	6,396	2,568
Decrease in time deposits	(18,037)	(27,115)
Decrease in federal funds purchased, repurchase agreements and other borrowings, net	(5,497)	(11,173)
Increase in Federal Home Loan Bank advances	10,000	0
Repayment of Federal Home Loan Bank advances	(5,000)	0
Cash dividends paid on common stock	(595)	(496)
Net cash used in financing activities	(9,969)	(35,117)
Net increase (decrease) in cash and cash equivalents	(8,792)	12,854
Cash and cash equivalents at beginning of period	31,325	42,317
Cash and cash equivalents at end of period	$22,533	$ 55,171
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for:		

Interest	$2,054	$ 2,505
Income tax	$360	$ 450
SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS		
Unrealized gain (loss) on securities available-for-sale	$5,278	$ (12,459)
Loans transferred to other real estate owned	$892	$ 866
Former branch site transferred from fixed assets to foreclosed properties	$0	$ 506
Book value of equity securities transferred from other assets to available-for-sale	$100	$ 0
Amortization of unrealized loss on securities transferred to held-to-maturity	$392	$ 0

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (the Company) and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial position at June 30, 2014, the statements of income and comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013, and the statements of changes in stockholders' equity and cash flows for the six months ended June 30, 2014 and 2013. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2013 annual report on Form 10-K. Certain previously reported amounts have been reclassified to conform to current period presentation, none of which were material in nature.

Note 2. Securities

Amortized costs and fair values of securities held-to-maturity as of the dates indicated are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
June 30, 2014				
Obligations of U.S. Government agencies	$400	$ 0	$ (3)	$397
Obligations of state and political subdivisions	29,826	326	(78)	30,074
Mortgage-backed securities	63,764	2,856	0	66,620
Total	$93,990	$ 3,182	$ (81)	$97,091
December 31, 2013				
Obligations of U.S. Government agencies	$400	$ 1	$ (5)	$396
Obligations of state and political subdivisions	30,120	29	(715)	29,434
Mortgage-backed securities	66,327	1,296	0	67,623
Total	$96,847	$ 1,326	$ (720)	$97,453

Amortized costs and fair values of securities available-for-sale as of the dates indicated are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
June 30, 2014				
Obligations of U.S. Government agencies	$14,956	$ 260	$ (285)	$14,931
Obligations of state and political subdivisions	50,601	291	(1,397)	49,495
Mortgage-backed securities	78,249	3	(1,627)	76,625
Money market investments	614	0	0	614
Corporate bonds	2,298	4	(11)	2,291
Other marketable equity securities	100	0	(16)	84
Total	$146,818	$ 558	$ (3,336)	$144,040
December 31, 2013				
Obligations of U.S. Government agencies	$15,189	$ 263	$ (428)	$15,024
Obligations of state and political subdivisions	51,032	86	(4,018)	47,100
Mortgage-backed securities	94,685	0	(3,935)	90,750
Money market investments	691	0	0	691
Corporate bonds	2,098	1	(25)	2,074
Total	$163,695	$ 350	$ (8,406)	$155,639

OTHER-THAN-TEMPORARILY IMPAIRED SECURITIES

Management assesses whether the Company intends to sell or it is more-likely-than-not that the Company will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Company separates the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of expected future cash flows is due to factors that are not credit related, which are recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best-estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best-estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds, and structural support, including subordination and guarantees.

The Company has a process in place to identify debt securities that could potentially have a credit or interest-rate related impairment that is other-than-temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, and cash flow projections as indicators of credit issues. On a quarterly basis, management reviews all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. Management considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (a) the extent and length of time the fair value has been below cost; (b) the reasons for the decline in value; (c) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (d) for fixed maturity securities, the Company's intent to sell a security or whether it is more-likely-than-not the Company will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity, and for equity securities, the Company's ability and intent to hold the security for a period of time that allows for the recovery in value.

The Company has not recorded impairment charges through income on securities for the three or six months ended June 30, 2014 or the year ended December 31, 2013.

TEMPORARILY IMPAIRED SECURITIES

The following table shows the number of securities with unrealized losses, and the gross unrealized losses and fair value of the Company's investments with unrealized losses that are deemed to be temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of the dates indicated.

	June 30, 2014						
	Less Than Twelve Months		More Than Twelve Months		Total		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Number of Securities
	(dollars in thousands)						
Securities Available-for-Sale							
Debt securities:							
Obligations of U.S. Government agencies	$0	$0	$285	$4,320	$285	$4,320	1
Obligations of state and political subdivisions	29	4,983	1,368	27,004	1,397	31,987	55
Mortgage-backed securities	0	0	1,627	63,446	1,627	63,446	8
Corporate bonds	2	398	9	791	11	1,189	10
Total debt securities	31	5,381	3,289	95,561	3,320	100,942	74
Other marketable equity securities	16	84	0	0	16	84	1
Total securities available-for-sale	$47	$5,465	$3,289	$95,561	$3,336	$101,026	75
Securities Held-to-Maturity							
Obligations of U.S. Government agencies	$0	$0	$3	$97	$3	$97	1
Obligations of state and political subdivisions	14	3,625	64	3,213	78	6,838	14
Total securities held-to-maturity	$14	$3,625	$67	$3,310	$81	$6,935	15
Total securities	$61	$9,090	$3,356	$98,871	$3,417	$107,961	90

	December 31, 2013						
	Less Than Twelve Months		More Than Twelve Months		Total		
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Number of Securities
	(dollars in thousands)						
Securities Available-for-Sale							
Debt securities:							
Obligations of U.S. Government agencies	$0	$0	$428	$4,403	$428	$4,403	1
Obligations of state and political subdivisions	3,246	36,235	772	6,450	4,018	42,685	82
Mortgage-backed securities	3,321	81,664	614	9,086	3,935	90,750	12
Corporate bonds	19	1,279	6	295	25	1,574	12
Total securities available-for-sale	$6,586	$119,178	$1,820	$20,234	$8,406	$139,412	107
Securities Held-to-Maturity							
Obligations of U.S. Government agencies	$0	$0	$5	$95	$5	$95	1
Obligations of state and political subdivisions	715	23,765	0	0	715	23,765	50
Total securities held-to-maturity	$715	$23,765	$5	$95	$720	$23,860	51
Total securities	$7,301	$142,943	$1,825	$20,329	$9,126	$163,272	158

Certain investments within the Company's portfolio had unrealized losses at June 30, 2014 and December 31, 2013, as shown in the tables above. The unrealized losses were caused by increases in market interest rates. Because the Company does not intend to sell the investments and management believes it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at June 30, 2014 or December 31, 2013.

Restricted Securities

The restricted security category is comprised of stock in the Federal Home Loan Bank of Atlanta (FHLB) and the Federal Reserve Bank (FRB). These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and the securities lack a market. Therefore, FHLB and FRB stock is carried at cost and evaluated for impairment. When evaluating these stocks for impairment, their value is determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. Restricted stock is viewed as a long-term investment and management believes that the Company has the ability and the intent to hold this stock until its value is recovered.

Note 3. Loans and the Allowance for Loan Losses

The following is a summary of the balances in each class of the Company's loan portfolio as of the dates indicated:

	June 30, 2014	December 31, 2013
	(in thousands)	
Mortgage loans on real estate:		
Residential 1-4 family	$85,206	$84,500
Commercial	294,298	287,071
Construction	14,100	14,505
Second mortgages	12,756	13,232
Equity lines of credit	38,255	32,163
Total mortgage loans on real estate	444,615	431,471
Commercial loans	34,973	30,702
Consumer loans	18,625	19,791
Other	21,449	18,735
Total loans	519,662	500,699
Less: Allowance for loan losses	(6,976)	(6,831)
Loans, net of allowance and deferred fees	$512,686	$493,868

Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts totaled $781 thousand and $641 thousand at June 30, 2014 and December 31, 2013, respectively.

CREDIT QUALITY INFORMATION

The Company uses internally-assigned risk grades to estimate the capability of borrowers to repay the contractual obligations of their loan agreements as scheduled or at all. The Company's internal risk grade system is based on experiences with similarly graded loans. Credit risk grades are updated at least quarterly as additional information becomes available, at which time management analyzes the resulting scores to track loan performance.

The Company's internally assigned risk grades are as follows:

- Pass: Loans are of acceptable risk.
- Other Assets Especially Mentioned (OAEM): Loans have potential weaknesses that deserve management's close attention.
- Substandard: Loans reflect significant deficiencies due to several adverse trends of a financial, economic or managerial nature.
- Doubtful: Loans have all the weaknesses inherent in a substandard loan with added characteristics that make collection or liquidation in full based on currently existing facts, conditions and values highly questionable or improbable.
- Loss: Loans have been charged off because they are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

The following table presents credit quality exposures by internally assigned risk ratings as of the dates indicated:

Credit Quality Information
As of June 30, 2014
(in thousands)

	Pass	OAEM	Substandard	Total
Mortgage loans on real estate:				
Residential 1-4 family	$80,378	$0	$ 4,828	$85,206
Commercial	285,386	4,266	4,646	294,298
Construction	11,196	456	2,448	14,100
Second mortgages	12,517	0	239	12,756
Equity lines of credit	37,547	0	708	38,255
Total mortgage loans on real estate	427,024	4,722	12,869	444,615
Commercial loans	34,817	85	71	34,973
Consumer loans	18,557	0	68	18,625
Other	21,449	0	0	21,449
Total	$501,847	$4,807	$ 13,008	$519,662

Credit Quality Information
As of December 31, 2013
(in thousands)

	Pass	OAEM	Substandard	Total
Mortgage loans on real estate:				
Residential 1-4 family	$78,612	$1,167	$ 4,721	$84,500
Commercial	274,749	5,693	6,629	287,071
Construction	10,319	640	3,546	14,505
Second mortgages	12,994	0	238	13,232
Equity lines of credit	31,690	0	473	32,163
Total mortgage loans on real estate	408,364	7,500	15,607	431,471
Commercial loans	30,164	319	219	30,702
Consumer loans	19,723	0	68	19,791
Other	18,735	0	0	18,735
Total	$476,986	$7,819	$ 15,894	$500,699

As of June 30, 2014 and December 31, 2013 the Company did not have any loans internally classified as Loss or Doubtful.

AGE ANALYSIS OF PAST DUE LOANS BY CLASS

All classes of loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Interest and fees continue to accrue on past due loans until the date the loan is placed in nonaccrual status, if applicable. The following table includes an aging analysis of the recorded investment in past due loans as of the dates indicated. Also included in the table below are loans that are 90 days or more past due as to interest and principal and still accruing interest, because they are well-secured and in the process of collection. Loans in nonaccrual status that are also past due are included in the aging categories in the table below.

Age Analysis of Past Due Loans as of June 30, 2014

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans (1)	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
	(in thousands)						
Mortgage loans on real estate:							
Residential 1-4 family	$534	$61	$3,460	$4,055	$81,151	$85,206	$ 0
Commercial	365	781	53	1,199	293,099	294,298	0
Construction	456	0	2,448	2,904	11,196	14,100	67
Second mortgages	3	5	33	41	12,715	12,756	33
Equity lines of credit	0	0	20	20	38,235	38,255	20
Total mortgage loans on real estate	1,358	847	6,014	8,219	436,396	444,615	120
Commercial loans	18	0	10	28	34,945	34,973	10
Consumer loans	461	582	905	1,948	16,677	18,625	861
Other	41	11	5	57	21,392	21,449	5
Total	$1,878	$1,440	$6,934	$10,252	$509,410	$519,662	$ 996

(1) For purposes of this table, Total Current Loans includes loans that are 1 - 29 days past due.

In the table above, the consumer category includes student loans with principal amounts that are 97 - 98% guaranteed by the government. The past due portion of these guaranteed loans totaled $1.9 million at June 30, 2014.

Age Analysis of Past Due Loans as of December 31, 2013

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans (1)	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
	(in thousands)						
Mortgage loans on real estate:							
Residential 1-4 family	$324	$82	$4,304	$4,710	$79,790	$84,500	$ 493
Commercial	120	704	53	877	286,194	287,071	0
Construction	0	0	2,545	2,545	11,960	14,505	0
Second mortgages	0	10	34	44	13,188	13,232	34
Equity lines of credit	139	0	0	139	32,024	32,163	0
Total mortgage loans on real estate	583	796	6,936	8,315	423,156	431,471	527
Commercial loans	15	80	0	95	30,607	30,702	0
Consumer loans	929	5	5	939	18,852	19,791	5

Other	51	15	14	80	18,655	18,735	14
Total	$1,578	$896	$6,955	$9,429	$491,270	$500,699	$ 546

(1) For purposes of this table, Total Current Loans includes loans that are 1 - 29 days past due.

In the table above, the consumer category includes student loans with principal amounts that are 97 - 98% guaranteed by the government. The past due portion of these guaranteed loans totaled $744 thousand at December 31, 2013.

NONACCRUAL LOANS

The Company generally places non-consumer loans in nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred or the loan reaches 90 days past due, unless the credit is well-secured and in the process of collection. Under regulatory rules, consumer loans, which are loans to individuals for household, family and other personal expenditures, and loans secured by 1-4 family residential properties are not required to be placed in nonaccrual status. Although consumer loans and loans secured by 1-4 family residential property are not required to be placed in nonaccrual status, the Company may place a consumer loan or loan secured by 1-4 family residential property in nonaccrual status, if necessary to avoid a material overstatement of interest income.

Generally, consumer loans not secured by real estate are placed in nonaccrual status only when part of the principal has been charged off. These loans are charged off or written down to the net realizable value of the collateral when deemed uncollectible, due to bankruptcy or other factors, or when they are past due based on loan product, industry practice, terms and other factors.

When management places a loan in nonaccrual status, the accrued unpaid interest receivable is reversed against interest income and the loan is accounted for by the cash or cost recovery method, until it qualifies for return to accrual status or is charged off. Generally, management returns a loan to accrual status if (a) all delinquent interest and principal payments become current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer doubtful.

The following table presents loans in nonaccrual status by class of loan as of the dates indicated:

Nonaccrual Loans by Class		
	June 30, 2014	December 31, 2013
	(in thousands)	
Mortgage loans on real estate		
Residential 1-4 family	$3,717	$ 4,024
Commercial	4,442	4,606
Construction	2,382	2,545
Total mortgage loans on real estate	10,541	11,175
Commercial loans	0	149
Consumer loans	44	0
Total	$10,585	$ 11,324

The following table presents the interest income that the Company would have earned under the original terms of its nonaccrual loans and the actual interest recorded by the Company on nonaccrual loans for the periods presented:

	Six Months Ended June 30,	
	2014	2013
	(in thousands)	
Interest income that would have been recorded under original loan terms	$369	$275

Actual interest income recorded for the period	170	51
Reduction in interest income on nonaccrual loans	$199	$224

TROUBLED DEBT RESTRUCTURINGS

The Company's loan portfolio includes certain loans that have been modified in a troubled debt restructuring (TDR), where economic concessions have been granted to borrowers who are experiencing financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reduction in the interest rate below current market rates for borrowers with similar risk profiles, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. The Company defines a TDR as nonperforming if the TDR is in nonaccrual status or is 90 days or more past due and still accruing interest at the report date.

When the Company modifies a loan, management evaluates any possible impairment as stated in the impaired loan section below.

The following table presents TDRs during the period indicated, by class of loan. The Company did not restructure any loans in the second quarter of 2014.

Troubled Debt Restructurings by Class
For the Three Months Ended June 30, 2013
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on June 30, 2013
Mortgage loans on real estate:				
Residential 1-4 family	2	$ $285	$ $285	$ $284

Troubled Debt Restructurings by Class
For the Six Months Ended June 30, 2014
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on June 30, 2014
Mortgage loans on real estate:				
Residential 1-4 family	1	$ 276	$ 276	$ 272
Construction	1	103	103	103
Second mortgages	1	89	89	88
Total	3	$ 468	$ 468	$ 463

Troubled Debt Restructurings by Class
For the Six Months Ended June 30, 2013
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on June 30, 2013
Mortgage loans on real estate:				
Residential 1-4 family	3	$ 676	$ 676	$ 673
Commercial	1	207	207	203

Total	4	$ 883	$ 883	$ 876

All loans restructured in the first six months of 2014 and 2013 were given below-market rates for debt with similar risk characteristics. At June 30, 2014 and December 31, 2013, the Company had no outstanding commitments to disburse additional funds on any TDR.

The following tables presents TDRs for the periods indicated for which there was a payment default where the default occurred within twelve months of restructuring. The Company considers a TDR in default when any of the following occurs: the loan, as restructured, becomes 90 days or more past due; the loan is moved to non-accrual status following the restructure; the loan is restructured again under terms that would qualify it as a TDR if it were not already so classified; or any portion of the loan is charged off. For the three months ended June 30, 2014, there were no TDRs for which there was a payment default where the default occurred within twelve months of restructuring.

Restructurings that Subsequently Defaulted
For the Three Months Ended June 30, 2013
(in thousands)

	Recorded Investment in Defaulting Loans as of June 30, 2013
Mortgage loans on real estate:	
Residential 1-4 family	$ 210

Restructurings that Subsequently Defaulted
For the Six Months Ended June 30, 2014
(in thousands)

	Recorded Investment in Defaulting Loans as of June 30, 2014
Mortgage loans on real estate:	
Residential 1-4 family	$ 94

Restructurings that Subsequently Defaulted
For the Six Months Ended June 30, 2013
(in thousands)

	Recorded Investment in Defaulting Loans as of June 30, 2013
Mortgage loans on real estate:	
Residential 1-4 family	$ 210
Commercial	1,843
Total	$ 2,053

The TDRs in the tables above are factored into the determination of the allowance for loan losses as of the periods indicated. These loans are included in the impaired loan analysis, as discussed below.

IMPAIRED LOANS

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans and loans modified in a TDR. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole or remaining source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs, when foreclosure is probable, instead of the discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is in nonaccrual status, all payments are applied to principal under the cost-recovery method. For financial statement purposes, the recorded investment in the loan is the actual principal balance reduced by payments that would otherwise have been applied to interest. When reporting information on these loans to the applicable customers, the unpaid principal balance is reported as if payments were applied to principal and interest under the original terms of the loan agreements. Therefore, the unpaid principal balance reported to the customer would be higher than the recorded investment in the loan for financial statement purposes. When the ultimate collectability of the total principal of the impaired loan is not in doubt and the loan is in nonaccrual status, contractual interest is credited to interest income when received under the cash-basis method.

The following table includes the recorded investment and unpaid principal balances (a portion of which may have been charged off) for impaired loans with the associated allowance amount, if applicable, as of the dates presented. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized for the periods presented. The average balances are calculated based on daily average balances.

Impaired Loans by Class
(in thousands)

	As of June 30, 2014				For the six months ended June 30, 2014	
		Recorded Investment				
	Unpaid Principal Balance	Without Valuation Allowance	With Valuation Allowance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Mortgage loans on real estate:						
Residential 1-4 family	$5,680	$4,464	$ 1,038	$ 137	$5,503	$ 60
Commercial	12,650	7,561	3,373	186	10,817	215
Construction	3,706	0	2,941	380	2,778	21
Second mortgages	455	271	153	117	460	11
Total mortgage loans on real estate	$22,491	$12,296	$ 7,505	$ 820	$19,558	$ 307
Commercial loans	0	0	0	0	74	0
Consumer loans	59	59	0	0	37	1
Total	$22,550	$12,355	$ 7,505	$ 820	$19,669	$ 308

Impaired Loans by Class
(in thousands)

	As of December 31, 2013				For the year ended December 31, 2013	
		Recorded Investment				
	Unpaid Principal Balance	Without Valuation Allowance	With Valuation Allowance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Mortgage loans on real estate:						
Residential 1-4 family	$5,713	$1,542	$ 4,009	$ 1,383	$5,152	$ 102
Commercial	12,905	6,882	4,300	307	10,631	591
Construction	3,309	2,545	0	0	2,798	0
Second mortgages	374	296	47	3	462	(19)
Equity lines of credit	0	0	0	0	97	0
Total mortgage loans on real estate	$22,301	$11,265	$ 8,356	$ 1,693	$19,140	$ 674
Commercial loans	150	149	0	0	44	6
Consumer loans	15	0	15	0	17	1
Total	$22,466	$11,414	$ 8,371	$ 1,693	$19,201	$ 681

MONITORING OF LOANS AND EFFECT OF MONITORING FOR THE ALLOWANCE FOR LOAN LOSSES
Loan officers are responsible for continual portfolio analysis and prompt identification and reporting of problem loans, which includes assigning a risk grade to each applicable loan at its origination and revising such grade as the situation dictates. Loan officers maintain frequent contact with borrowers, which should enable the loan officer to identify potential problems before other personnel. In addition, meetings with loan officers and upper management are held to discuss problem loans and review risk grades. Nonetheless, in order to avoid over-reliance upon loan officers for problem loan identification, the Company's loan review system provides for review of loans and risk grades by individuals who are independent of the loan approval process. Risk grades and historical loss rates (determined by migration analysis) by risk grades are used as a component of the calculation of the allowance for loan losses.

ALLOWANCE FOR LOAN LOSSES
Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. The Company segments the loan portfolio into categories as defined by Schedule RC-C of the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income Form 041 (Call Report). Management believes that using the Call Report categories to segment loans for this purpose results in increased efficiency and accuracy in the determination of the adequacy of the allowance for loan losses. For purposes of calculating the allowance for loan losses, loans are segmented into the following pools: commercial, real estate-construction, real estate-mortgage, consumer and other loans. The Company also sub-segments the real estate-mortgage segment into four classes: residential 1-4 family, commercial, second mortgages and equity lines of credit. The Company uses an internally developed risk evaluation model in the estimation of the credit risk process. The model and assumptions used to determine the allowance are independently validated and reviewed to ensure that the theoretical foundation, assumptions, data integrity, computational processes and reporting practices are appropriate and properly documented.

Each portfolio segment has risk characteristics as follows:

- Commercial: Commercial loans carry risks associated with the successful operation of a business or project, in addition to other risks associated with the ownership of a business. The repayment of these loans may be dependent upon the profitability and cash flows of the business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.
- Real estate-construction: Construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may at any point in time be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be the loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.
- Real estate-mortgage: Residential mortgage loans and equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral. Commercial real estate loans carry risks associated with the successful operation of a business if owner occupied. If non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts.
- Consumer loans: Consumer loans carry risks associated with the continued credit-worthiness of the borrowers and the value of the collateral. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.
- Other loans: Other loans are loans to mortgage companies, loans for purchasing or carrying securities, and loans to insurance, investment and finance companies. These loans carry risks associated with the successful operation of a business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time, depend on interest rates or fluctuate in active trading markets.

To assess the adequacy of the allowance for loan losses, the Company uses a software program that performs migration analysis on pooled segments by risk grade or by days past due. Loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on days past due, while all other loans, including loans to consumers that are secured by real estate, are segmented by risk grades. The migration analysis applied to all pools is able to track the risk grading and historical performance of individual loans throughout a number of periods set by management, which provides management with more information regarding trends (or migrations) in a particular loan segment. Loans collectively evaluated for impairment are pooled, with a historical loss rate applied to each pool. For the December 31, 2013, March 31, 2014 and June 30, 2014 calculations, the historical loss was based on migration analysis of the past nine, ten and eleven quarters, respectively.

Management also provides an allocated component of the allowance for loans that are specifically identified that may be impaired, and are individually analyzed for impairment. An allocated allowance is established when the discounted value of expected future cash flows from the impaired loan (or the collateral value or observable market price of the impaired loan) is lower than the carrying value of that loan.

Based on credit risk assessments and management's analysis of qualitative factors, additional loss factors are applied to loan balances. These additional qualitative factors include: economic conditions, trends in growth, loan concentrations, changes in certain loans, changes in underwriting, changes in management and changes in the legal and regulatory environment.

ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of $7.0 million adequate to cover loan losses inherent in the loan portfolio at June 30, 2014.

The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans for the periods presented. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

ALLOWANCE FOR LOAN LOSSES AND RECORDED INVESTMENT IN LOANS
(in thousands)

For the Six Months Ended June 30, 2014	Commercial	Real Estate - Construction	Real Estate - Mortgage	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at the beginning of period	$ 350	$ 662	$5,357	$ 294	$168	$6,831
Charge-offs	(139)	0	(249)	(93)	(77)	(558)
Recoveries	28	5	253	35	32	353
Provision for loan losses	260	483	(502)	(1)	110	350
Ending balance	$ 499	$ 1,150	$4,859	$ 235	$233	$6,976
Ending balance individually evaluated for impairment	$ 0	$ 380	$440	$ 0	$0	$820
Ending balance collectively evaluated for impairment	499	770	4,419	235	233	6,156
Ending balance	$ 499	$ 1,150	$4,859	$ 235	$233	$6,976
Loan Balances:						
Ending balance individually evaluated for impairment	$ 0	$ 2,941	$16,860	$ 59	$0	$19,860
Ending balance collectively evaluated for impairment	34,973	11,159	413,655	18,566	21,449	499,802

Ending balance	$ 34,973	$ 14,100	$430,515	$ 18,625	$21,449	$519,662

For the Year Ended December 31, 2013	Commercial	Real Estate - Construction	Real Estate - Mortgage	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at the beginning of period	$ 677	$ 187	$ 6,179	$ 204	$ 77	$ 7,324
Charge-offs	(200)	(501)	(1,548)	(141)	(316)	(2,706)
Recoveries	76	6	513	111	207	913
Provision for loan losses	(203)	970	213	120	200	1,300
Ending balance	$ 350	$ 662	$ 5,357	$ 294	$ 168	$ 6,831
Ending balance individually evaluated for impairment	$ 0	$ 0	$ 1,693	$ 0	$ 0	$ 1,693
Ending balance collectively evaluated for impairment	350	662	3,664	294	168	5,138
Ending balance	$ 350	$ 662	$ 5,357	$ 294	$ 168	$ 6,831
Loan Balances:						
Ending balance individually evaluated for impairment	$ 149	$ 2,545	$ 17,076	$ 15	$ 0	$ 19,785
Ending balance collectively evaluated for impairment	30,553	11,960	399,890	19,776	18,735	480,914
Ending balance	$ 30,702	$ 14,505	$ 416,966	$ 19,791	$ 18,735	$ 500,699

Note 4. Share-Based Compensation

Share-based compensation arrangements include stock options, restricted stock awards, performance-based awards, stock appreciation rights and employee stock purchase plans. Accounting standards require all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period.

Historically, the Company has only granted share-based compensation in the form of stock options. There were no options granted in the first six months of 2014.

On March 9, 2008, the Company's 1998 Stock Option Plan expired. Options to purchase 150,085 shares of common stock were outstanding under the Company's 1998 Stock Option Plan at June 30, 2014. The exercise price of each option equals the market price of the Company's common stock on the date of the grant and each option's maximum term is ten years.

Stock option activity for the six months ended June 30, 2014 is summarized below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding, January 1, 2014	151,335	$ 21.66		
Granted	0	0		
Exercised	0	0		
Canceled or expired	(1,250)	20.05		
Options outstanding, June 30, 2014	150,085	$ 21.68	1.93	$ 0

Options exercisable, June 30, 2014	150,085	$ 21.68	1.93	$ 0

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on June 30, 2014. This amount changes based on changes in the market value of the Company's common stock. As of June 30, 2014, the outstanding options had no intrinsic value because the exercise prices of all outstanding options were above the market value of a share of the Company's common stock.

No options were exercised during the six months ended June 30, 2014.

As of June 30, 2014, all outstanding stock options were fully vested and there was no unrecognized stock-based compensation expense.

Note 5. Pension Plan

The Company provides pension benefits for eligible participants through a non-contributory defined benefit pension plan. The plan was frozen effective September 30, 2006; therefore, no additional participants will be added to the plan. The components of net periodic pension plan cost are as follows for the periods indicated:

Three months ended June 30,	2014	2013
	(in thousands)	
Interest cost	$69	$63
Expected return on plan assets	(91)	(89)
Amortization of net loss	55	75
Net periodic pension plan cost	$33	$49

Six months ended June 30,	2014	2013
	(in thousands)	
Interest cost	$137	$126
Expected return on plan assets	(182)	(177)
Amortization of net loss	110	149
Net periodic pension plan cost	$65	$98

At June 30, 2014, management had not yet determined the amount, if any, that the Company will contribute to the plan in the year ending December 31, 2014.

Note 6. Stockholders' Equity and Earnings per Share

STOCKHOLDERS' EQUITY – ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table presents information on amounts reclassified out of accumulated other comprehensive loss, by category, during the periods indicated:

Three Months Ended	Six Months Ended	Affected Line Item on

	June 30,		June 30,		
	2014	2013	2014	2013	Consolidated Statements of Income
	(in thousands)				
Available-for-sale securities					
Realized losses on sales of securities	$(7)	$(21)	$(7)	$(21)	Loss on sale of available-for-sale securities, net
Tax benefit	(2)	(7)	(2)	(7)	Income tax benefit
	$(5)	$(14)	$(5)	$(14)	Net of tax

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The following table presents the changes in accumulated other comprehensive loss, by category, net of tax, for the periods indicated:

	Unrealized Gains (Losses) on Securities	Unrealized Losses on Securities Transferred to Held-to-Maturity	Defined Benefit Pension Plans	Accumulated Other Comprehensive Loss
	(in thousands)			
Six Months Ended June 30, 2014				
Balance at beginning of period	$(5,317)	$ (3,937)	$(1,548)	$ (10,802)
Net change for the period	3,484	259	0	3,743
Balance at end of period	$(1,833)	$ (3,678)	$(1,548)	$ (7,059)
Six Months Ended June 30, 2013				
Balance at beginning of period	$1,992	$ 0	$(2,184)	$ (192)
Net change for the period	(8,223)	0	0	(8,223)
Balance at end of period	$(6,231)	$ 0	$(2,184)	$ (8,415)

The following table presents the change in each component of accumulated other comprehensive loss on a pre-tax and after-tax basis for the periods indicated.

	Six Months Ended June 30, 2014		
	Pretax	Tax Expense (Benefit)	Net-of-Tax
	(in thousands)		
Unrealized gains on available-for-sale securities			
Unrealized holding gains arising during the period	$5,271	$ 1,792	$ 3,479
Less reclassification adjustment for losses recognized in income	(7)	(2)	(5)
Net unrealized gains on securities	5,278	1,794	3,484
Market adjustment on securities transferred to held-to-maturity			
Amortization	392	133	259
Total change in accumulated other comprehensive loss	$5,670	$ 1,927	$ 3,743

	Six Months Ended June 30, 2013		
	Pretax	Tax Expense (Benefit)	Net-of-Tax
	(in thousands)		

Unrealized losses on available-for-sale securities			
Unrealized holding losses arising during the period	$(12,480)	$(4,243)	$ (8,237)
Less reclassification adjustment for losses recognized in income	(21)	(7)	(14)
Net unrealized losses on securities	(12,459)	(4,236)	(8,223)
Total change in accumulated other comprehensive loss	$(12,459)	$(4,236)	$ (8,223)

EARNINGS PER COMMON SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares attributable to outstanding stock options. The Company did not include an average of 151 thousand and 156 thousand potential common shares attributable to outstanding stock options in the diluted earnings per share calculation for the first six months of 2014 and 2013, respectively, because they were antidilutive.

Note 7. Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-01, "Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company is currently assessing the impact that ASU 2014-01 will have on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company is currently assessing the impact that ASU 2014-04 will have on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The amendments in this ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results and include disposals of a major geographic area, a major line of business, or a major equity method investment. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. Additionally, the new guidance requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-08 to have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606". This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition", most industry-specific guidance, and some cost guidance included in Subtopic 605-35, "Revenue Recognition—Construction-Type and Production-Type Contracts". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures". This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-11 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period". The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation – Stock Compensation (Topic 718)", should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company is currently assessing the impact that ASU 2014-12 will have on its consolidated financial statements.

Note 8. Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the "Fair Value Measurements and Disclosures" topics of FASB ASU 2010-06 and FASB ASU 2011-04, the fair value of a financial instrument is the price that would be received in the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value can be a reasonable point within a range that is most representative of fair value under current market conditions.

In estimating the fair value of assets and liabilities, the Company relies mainly on two models. The first model, used by the Company's bond accounting service provider, determines the fair value of securities. Securities are priced based on an evaluation of observable market data, including benchmark yield curves, reported trades, broker/dealer quotes, and issuer spreads. Pricing is also impacted by credit information about the issuer, perceived market movements, and current news events impacting the individual sectors. For assets other than securities and for all liabilities, fair value is determined using the Company's asset/liability modeling software. The software uses current yields, anticipated yield changes, and estimated duration of assets and liabilities to calculate fair value.

In accordance with ASC 820, "Fair Value Measurements and Disclosures," the Company groups its financial assets and financial liabilities generally measured at fair value into 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.

Level 1 –	Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
Level 2 –	Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on 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 asset or liability.
Level 3 –	Valuation is based on 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 determination of fair value requires significant management judgment or estimation.

An instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

Debt and equity securities with readily determinable fair values that are classified as "available-for-sale" are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company's available-for-sale securities are considered to be Level 2 securities.

The following table presents the balances of certain assets measured at fair value on a recurring basis as of the dates indicated:

		Fair Value Measurements at June 30, 2014 Using (in thousands)		
Description	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities				
Obligations of U.S. Government agencies	$14,931	$0	$14,931	$ 0
Obligations of state and political subdivisions	49,495	0	49,495	0
Mortgage-backed securities	76,625	0	76,625	0
Money market investments	614	0	614	0
Corporate bonds	2,291	0	2,291	0
Other marketable equity securities	84	0	84	0
Total available-for-sale securities	$144,040	$0	$144,040	$ 0

		Fair Value Measurements at December 31, 2013 Using (in thousands)		
Description	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Available-for-sale securities				
Obligations of U.S. Government agencies	$15,024	$0	$15,024	$ 0
Obligations of state and political subdivisions	47,100	0	47,100	0
Mortgage-backed securities	90,750	0	90,750	0
Money market investments	691	0	691	0
Corporate bonds	2,074	0	2,074	0
Total available-for-sale securities	$155,639	$0	$155,639	$ 0

ASSETS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS
Under certain circumstances, adjustments are made to the fair value for assets and liabilities although they are not measured at fair value on an ongoing basis.

Impaired loans
Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of fair value and loss associated with impaired loans can be based on the observable market price of the loan, the fair value of the collateral securing the loan, or the present value of the loan's expected future cash flows. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable, with the vast majority of the collateral in real estate.

The value of real estate collateral is determined utilizing an income, market, or cost valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company. In the case of loans with lower balances, the Company may obtain a real estate evaluation instead of an appraisal. Evaluations utilize many of the same techniques as appraisals, and are typically performed by independent appraisers. Once received, appraisals and evaluations are reviewed by trained staff independent of the lending function to verify consistency and reasonability. Appraisals and evaluations are based on significant unobservable inputs, including but not limited to: adjustments made to comparable properties, judgments about the condition of the subject property, the availability and suitability of comparable properties, capitalization rates, projected income of the subject or comparable properties, vacancy rates, projected depreciation rates, and the state of the local and regional economy. The Company may also elect to make additional reductions in the collateral value based on management's best judgment, which represents another source of unobservable inputs. Because of the subjective nature of collateral valuation, impaired loans are considered Level 3.

Impaired loans may be secured by collateral other than real estate. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). If a loan is not collateral-dependent, its impairment may be measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate. Because the loan is discounted at its effective rate of interest, rather than at a market rate, the loan is not considered to be held at fair value and is not included in the tables below. Collateral-dependent impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as part of the provision for loan losses on the Consolidated Statements of Income.

Other Real Estate Owned (OREO)
Loans are transferred to OREO when the collateral securing them is foreclosed on. The measurement of loss associated with OREOs is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property. If there is a contract for the sale of a property, and management reasonably believes the transaction will be consummated in accordance with the terms of the contract, fair value is based on the sale price in that contract (Level 1). If management has recent information about the sale of identical properties, such as when selling multiple condominium units on the same property, the remaining units would be valued based on the observed market data (Level 2). Lacking either a contract or such recent data, management would obtain an appraisal or evaluation of the value of the collateral as discussed above under Impaired Loans (Level 3). After the asset has been booked, a new appraisal or evaluation is obtained when management has reason to believe the fair value of the property may have changed and no later than two years after the last appraisal or evaluation was received. Any fair value adjustments to OREOs below the original book value are recorded in the period incurred and expensed against current earnings.

The following table presents the assets carried on the consolidated balance sheets for which a nonrecurring change in fair value has been recorded. Assets are shown by class of loan and by level in the fair value hierarchy, as of the dates indicated. Certain impaired loans are valued by the present value of the loan's expected future cash flows, discounted at the interest rate of the loan rather than at a market rate. These loans are not carried on the consolidated balance sheets at fair value and, as such, are not included in the table below.

		Carrying Value at June 30, 2014 Using (in thousands)		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans				
Mortgage loans on real estate:				
Residential 1-4 family	$744	$0	$ 0	$ 744
Construction	2,561	0	0	2,561
Second mortgages	37	0	0	37
Total	$3,342	$0	$ 0	$ 3,342
Other real estate owned				
Residential 1-4 family	$1,261	$0	$ 0	$ 1,261
Commercial	1,735	0	0	1,735
Construction	2,670	0	0	2,670
Total	$5,666	$0	$ 0	$ 5,666

		Carrying Value at December 31, 2013 Using (in thousands)		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans				
Mortgage loans on real estate:				
Residential 1-4 family	$2,455	$0	$ 0	$ 2,455
Commercial	800	0	0	800

Second mortgages	44	0	0	44
Total	$3,299	$0	$ 0	$ 3,299
Other real estate owned				
Residential 1-4 family	$457	$0	$ 0	$ 457
Commercial	2,290	0	0	2,290
Construction	2,783	0	0	2,783
Total	$5,530	$0	$ 0	$ 5,530

The following table displays quantitative information about Level 3 Fair Value Measurements as of the dates indicated:

		Quantitative Information About Level 3 Fair Value Measurements		
Description	Fair Value at June 30, 2014 (dollars in thousands)	Valuation Techniques	Unobservable Input	Range (Average)
Impaired loans				
Residential 1-4 family real estate	$ 744	Market comparables	Selling costs	0.00% - 7.25% (1.81 %)
			Liquidation discount	0.00% - 10.00% (3.75 %)
Construction	$ 2,561	Market comparables	Selling costs	0.00% - 11.25% (3.75 %)
Second mortgages	$ 37	Market comparables	Selling costs	0.00 %
Other real estate owned				
Residential 1-4 family	$ 1,261	Market comparables	Selling costs	6.00% - 10.00% (6.00 %)
Commercial	$ 1,735	Market comparables	Selling costs	6.00% - 10.00% (6.00 %)
Construction	$ 2,670	Market comparables	Selling costs	6.00% - 10.00% (6.00 %)

		Quantitative Information About Level 3 Fair Value Measurements		
Description	Fair Value at December 31, 2013 (dollars in thousands)	Valuation Techniques	Unobservable Input	Range (Average)
Impaired loans				
Residential 1-4 family real estate	$ 2,455	Market comparables	Selling costs	3.00% - 7.25% (6.39 %)
			Liquidation discount	0.00% - 90.00% (15.56 %)
Commercial real estate	$ 800	Market comparables	Selling costs	7.25 %
Second mortgages	$ 44	Market comparables	Selling costs	7.25 %
Other real estate owned				
Residential 1-4 family	$ 457	Market comparables	Selling costs	6.00% - 10.00% (6.00 %)
Commercial	$ 2,290	Market comparables	Selling costs	6.00% - 10.00% (6.00 %)
Construction	$ 2,783	Market comparables	Selling costs	6.00% - 10.00% (6.00 %)

ASC 825, "Financial Instruments," requires disclosure about fair value of financial instruments for interim periods and excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company's assets.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

CASH AND CASH EQUIVALENTS
The carrying amounts of cash and short-term instruments, including interest-bearing due from banks, approximate fair values.

RESTRICTED SECURITIES
The restricted security category is comprised of FHLB and FRB stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and they lack a market. When the FHLB or FRB repurchases stock, they repurchase at the stock's book value. Therefore, the carrying amounts of restricted securities approximate fair value.

LOANS RECEIVABLE
The fair value of a loan is based on its interest rate in relation to its risk profile, in comparison to what an investor could earn on a different investment with a similar risk profile. Variations in risk tolerance between lenders, and thus in risk pricing, can result in the same loan being priced differently at different institutions. A bank's experience with the type of lending (such as commercial real estate) can also impact its assessment of the riskiness of a loan. A comprehensive picture of competitors' rates in relation to borrower risk profiles is not available. Since the rate and risk profile are the primary factors in determining the fair value of a loan, both of which are unobservable in the market, the Company classifies loans as Level 3 in the fair value hierarchy. Instead, the Company uses a model which estimates market value based on the loan's interest rate (regardless of its risk level) and rates for debt of similar maturities where market data is available. Fair values for non-performing loans are estimated as described above.

BANK-OWNED LIFE INSURANCE
Bank-owned life insurance represents insurance policies on certain current and former officers of the Company. The cash value of the policies is estimated using information provided by the insurance carrier. The insurance carrier uses actuarial data to estimate the value of each policy, based on the age and health of the insured relative to other individuals about whom the carrier has information. Health information can be broken down into quantitative, observable inputs, such as smoking habits, blood pressure, and weight, which, along with the insured's age, can be compared to observable data the insurance carrier has available. The carrier can then estimate the cash value of each policy. Since the cash value represents the amount of cash the Company would receive when the policies are paid, the cash value closely approximates the fair value of the policies. Accordingly, bank-owned life insurance is classified as Level 2.

DEPOSIT LIABILITIES
The fair value of demand deposits, savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. Information about the rates paid by other institutions for deposits of similar terms is readily available, and rates are mainly influenced by the term of the deposit itself. As a result, fair value calculations are based on observable inputs, and are classified as Level 2.

SHORT-TERM BORROWINGS
The carrying amounts of federal funds purchased, overnight repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Since the contractual terms of these borrowings provide all information necessary to calculate the amounts that will be due at maturity, these liabilities are classified as Level 2.

LONG-TERM BORROWINGS
The fair values of the Company's long-term borrowings are estimated based on the current cost to repay the debt in full, discounted to current values and including any prepayment penalties that may apply. As the contractual terms of the borrowing provide all the necessary inputs for this calculation, long-term borrowings are classified as Level 2.

ACCRUED INTEREST

The calculation of accrued interest is based on readily observable information, such as the rate and term of the underlying asset or liability. Since these amounts are expected to be realized quickly (generally within 30 to 90 days), the carrying value approximates fair value and is classified as Level 2.

COMMITMENTS TO EXTEND CREDIT AND IRREVOCABLE LETTERS OF CREDIT

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At June 30, 2014 and December 31, 2013, the fair value of fees charged for loan commitments and irrevocable letters of credit was immaterial.

The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments as of the dates indicated are as follows:

		Fair Value Measurements at June 30, 2014 Using (in thousands)		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	$22,533	$22,533	$ 0	$ 0
Securities available-for-sale	144,040	0	144,040	0
Securities held-to-maturity	93,990	0	97,091	0
Restricted securities	2,293	0	2,293	0
Loans, net of allowances for loan losses	512,686	0	0	512,268
Bank owned life insurance	23,107	0	23,107	0
Accrued interest receivable	2,768	0	2,768	0
Liabilities				
Deposits	$716,528	$0	$ 717,631	$ 0
Overnight repurchase agreements	25,677	0	25,677	0
Term repurchase agreements	412	0	411	0
Federal Home Loan Bank advances	30,000	0	32,092	0
Accrued interest payable	266	0	266	0

		Fair Value Measurements at December 31, 2013 Using (in thousands)		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	$31,325	$31,325	$ 0	$ 0
Securities available-for-sale	155,639	0	155,639	0
Securities held-to-maturity	96,847	0	97,453	0
Restricted securities	2,378	0	2,378	0
Loans, net of allo				