ACNB CORP
Form 10-Q
November 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

Commission file number 1-35015

ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

Pennsylvania	**23-2233457**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
16 Lincoln Square, Gettysburg, Pennsylvania	**17325**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(717) 334-3161**

Title of each class	Name of each exchange on which registered
Common Stock, $2.50 par value per share	The NASDAQ Stock Market, LLC

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company x
Emerging growth company o	

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

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

The number of shares of the Registrant s Common Stock outstanding on November 1, 2018, was 7,042,224.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands, except per share data	September 30, 2018	September 30, 2017	December 31, 2017
ASSETS			
Cash and due from banks	**$ 18,145**	$ 17,882	$ 19,304
Interest bearing deposits with banks	**45,551**	31,609	15,137
Total Cash and Cash Equivalents	**63,696**	49,491	34,441
Equity securities with readily determinable fair values	**1,743**		
Debt securities available for sale	**162,957**	158,392	159,051
Securities held to maturity, fair value $32,767; $47,373; $44,549	**33,517**	47,369	44,829
Loans held for sale	**1,112**	1,873	1,736
Loans, net of allowance for loan losses $13,414; $14,105; $13,976	**1,259,032**	1,222,265	1,230,194
Premises and equipment	**26,097**	26,590	26,774
Restricted investment in bank stocks	**4,529**	4,821	4,773
Investment in bank-owned life insurance	**46,242**	44,666	44,935
Investments in low-income housing partnerships	**2,096**	2,587	2,446
Goodwill	**19,580**	19,580	19,580
Intangible assets	**2,628**	2,752	2,569
Foreclosed assets held for resale	**63**	275	436
Other assets	**24,507**	26,974	23,668
Total Assets	**$ 1,647,799**	$ 1,607,635	$ 1,595,432
LIABILITIES AND STOCKHOLDERS EQUITY			
LIABILITIES			
Deposits:			
Non-interest bearing	**$ 292,389**	$ 273,853	$ 279,413
Interest bearing	**1,054,854**	1,038,031	1,019,079
Total Deposits	**1,347,243**	1,311,884	1,298,492
Short-term borrowings	**38,525**	33,806	36,908
Long-term borrowings	**84,725**	96,850	94,600
Other liabilities	**12,794**	11,839	11,466
Total Liabilities	**1,483,287**	1,454,379	1,441,466
STOCKHOLDERS EQUITY			
Preferred stock, $2.50 par value; 20,000,000 shares authorized; no shares outstanding			
Common stock, $2.50 par value; 20,000,000 shares authorized; 7,104,824, 7,082,245 and 7,086,258 shares issued; 7,042,224, 7,019,645 and 7,023,658 shares outstanding	**17,762**	17,705	17,716

Treasury stock, at cost (62,600 shares)	**(728)**	(728)	(728)
Additional paid-in capital	**38,321**	37,671	37,777
Retained earnings	**118,192**	103,997	106,293
Accumulated other comprehensive loss	**(9,035)**	(5,389)	(7,092)
Total Stockholders Equity	**164,512**	153,256	153,966
Total Liabilities and Stockholders Equity	**$ 1,647,799**	$ 1,607,635	$ 1,595,432

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Dollars in thousands, except per share data	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
INTEREST AND DIVIDEND INCOME				
Loans, including fees	**$ 14,966**	$ 13,990	**$ 43,746**	$ 33,484
Securities:				
Taxable	**929**	890	**2,761**	2,474
Tax-exempt	**51**	85	**175**	352
Dividends	**77**	61	**229**	174
Other	**259**	83	**490**	120
Total Interest Income	**16,282**	15,109	**47,401**	36,604
INTEREST EXPENSE				
Deposits	**1,341**	1,080	**3,681**	2,402
Short-term borrowings	**2**	9	**29**	69
Long-term borrowings	**526**	458	**1,625**	1,274
Total Interest Expense	**1,869**	1,547	**5,335**	3,745
Net Interest Income	**14,413**	13,562	**42,066**	32,859
PROVISION FOR LOAN LOSSES	**200**		**770**	
Net Interest Income after Provision for Loan Losses	**14,213**	13,562	**41,296**	32,859
OTHER INCOME				
Service charges on deposit accounts	**839**	870	**2,465**	2,057
Income from fiduciary, investment management and brokerage activities	**632**	489	**1,762**	1,409
Earnings on investment in bank-owned life insurance	**269**	276	**807**	807
Gain on life insurance proceeds			**52**	
Net gains on sales of securities	**31**		**44**	
Net losses on equity securities	**(23)**		**(50)**	
Service charges on ATM and debit card transactions	**609**	490	**1,753**	1,229
Commissions from insurance sales	**1,450**	1,313	**4,358**	4,031
Other	**318**	492	**963**	1,007
Total Other Income	**4,125**	3,930	**12,154**	10,540
OTHER EXPENSES				
Salaries and employee benefits	**6,560**	6,715	**19,870**	18,397
Net occupancy	**700**	677	**2,199**	1,710
Equipment	**1,276**	1,039	**3,759**	2,666
Other tax	**243**	197	**684**	576
Professional services	**371**	224	**1,084**	807
Supplies and postage	**183**	187	**575**	524
Marketing and corporate relations	**98**	119	**366**	321
FDIC and regulatory	**173**	170	**521**	449
Merger related expenses		4,305		4,675
Intangible assets amortization	**175**	193	**541**	355
Foreclosed real estate (income) expenses	**(27)**	35	**105**	51

Other operating		**1,104**		1,006		**3,389**	2,970
Total Other Expenses		**10,856**		14,867		**33,093**	33,501
Income before Income Taxes		**7,482**		2,625		**20,357**	9,898
PROVISION FOR INCOME TAXES		**1,443**		713		**3,898**	2,627
Net Income	**$**	**6,039**	$	1,912	**$**	**16,459**	$ 7,271
PER SHARE DATA							
Basic earnings	**$**	**0.86**	$	0.27	**$**	**2.34**	$ 1.14
Cash dividends declared	**$**	**0.23**	$	0.20	**$**	**0.66**	$ 0.60

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

Dollars in thousands	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
NET INCOME	**$ 6,039**	$ 1,912	**$ 16,459**	$ 7,271
OTHER COMPREHENSIVE (LOSS) INCOME				
SECURITIES				
Unrealized (losses) gains arising during the period, net of income taxes of $(139), $28, $(742) and $159, respectively	**(476)**	54	**(2,195)**	306
Reclassification adjustment for net gains included in net income, net of income taxes of $7, $0, $10 and $0, respectively (A) (C)	**24**		**34**	
PENSION				
Amortization of pension net loss, transition liability, and prior service cost, net of income taxes of $29, $60, $87 and $178, respectively (B) (C)	**100**	109	**300**	329
TOTAL OTHER COMPREHENSIVE (LOSS) INCOME	**(352)**	163	**(1,861)**	635
TOTAL COMPREHENSIVE INCOME	**$ 5,687**	$ 2,075	**$ 14,598**	$ 7,906

The accompanying notes are an integral part of the consolidated financial statements.

(A) Gross amounts are included in net gains on sales or calls of securities on the Consolidated Statements of Income in total other income.

(B) Gross amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income in total other expenses.

(C) Income tax amounts are included in the provision for income taxes on the Consolidated Statements of Income.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Nine Months Ended September 30, 2018 and 2017

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
BALANCE JANUARY 1, 2017	$ 15,317	$ (728)	$ 10,941	$ 100,555	$ (6,024)	$ 120,061
Net income				7,271		7,271
Other comprehensive income, net of taxes					635	635
Common stock shares issued (949,314 shares)	2,373		26,505			28,878
Restricted stock grants (6,193 shares)	15		105			120
Restricted stock compensation expense			120			120
Cash dividends declared				(3,829)		(3,829)
BALANCE SEPTEMBER 30, 2017	$ 17,705	$ (728)	$ 37,671	$ 103,997	$ (5,389)	$ 153,256
BALANCE JANUARY 1, 2018	**$ 17,716**	**$ (728)**	**$ 37,777**	**$ 106,293**	**$ (7,092)**	**$ 153,966**
Net income				**16,459**		**16,459**
Other comprehensive loss, net of taxes					**(1,861)**	**(1,861)**
Reclassification of certain income tax effects from AOCI (1)				**82**	**(82)**	
Common stock shares issued (11,822 shares)	**29**		**362**			**391**
Restricted stock grants (6,744 shares)	**17**		**(4)**			**13**
Restricted stock compensation expense			**186**			**186**
Cash dividends declared				**(4,642)**		**(4,642)**
BALANCE SEPTEMBER 30, 2018	**$ 17,762**	**$ (728)**	**$ 38,321**	**$ 118,192**	**$ (9,035)**	**$ 164,512**

(1) In January 2018, the Corporation adopted ASU 2018-02, as a result, the Corporation made a policy election to release income tax effects, as a result of the Tax Act, from AOCI to retained earnings.

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Dollars in thousands	Nine Months Ended September 30, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 16,459**	$ 7,271
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of loans originated for sale	**(404)**	(398)
Loss (gain) on sales of foreclosed assets held for resale, including writedowns	**1**	(36)
Earnings on investment in bank-owned life insurance	**(807)**	(807)
Gain on sales or calls of securities	**(44)**	
Loss on equity securities	**50**	
Restricted stock compensation expense	**186**	120
Depreciation and amortization	**2,122**	1,622
Provision for loan losses	**770**	
Net amortization of investment securities premiums	**357**	396
Increase in accrued interest receivable	**(1,067)**	(637)
Increase in accrued interest payable	**243**	235
Mortgage loans originated for sale	**(25,244)**	(21,344)
Proceeds from sales of loans originated for sale	**26,272**	21,639
Decrease in other assets	**724**	4,394
Decrease (increase) in deferred tax expense	**398**	(3,343)
Increase in other liabilities	**1,471**	843
Net Cash Provided by Operating Activities	**21,487**	9,955
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of investment securities held to maturity	**11,307**	8,148
Proceeds from maturities of investment securities available for sale	**12,471**	18,486
Proceeds from sales of investment securities available for sale	**6,477**	
Purchase of investment securities available for sale	**(27,746)**	(12,144)
Redemption (purchase) of restricted investment in bank stocks	**244**	(136)
Net increase in loans	**(29,843)**	(63,636)
Purchase of bank-owned life insurance	**(500)**	
Bank acquisition, net of cash acquired		6,444
Insurance book- acquisition	**(600)**	
Capital expenditures	**(904)**	(1,087)
Proceeds from sales of premises and equipment		6
Proceeds from sales of foreclosed real estate	**607**	228
Net Cash Used in Investing Activities	**(28,487)**	(43,691)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	**12,976**	13,254
Net increase in time certificates of deposits and interest bearing deposits	**35,775**	37,677
Net increase (decrease) in short-term borrowings	**1,617**	(784)
Proceeds from long-term borrowings	**9,716**	24,600
Repayments on long-term borrowings	**(19,591)**	(7,000)
Dividends paid	**(4,642)**	(3,829)
Common stock issued	**404**	378
Net Cash Provided by Financing Activities	**36,255**	64,296
Net Increase in Cash and Cash Equivalents	**29,255**	30,560
CASH AND CASH EQUIVALENTS BEGINNING	**34,441**	18,931
CASH AND CASH EQUIVALENTS ENDING	**$ 63,696**	$ 49,491
Supplemental disclosures of cash flow information		
Interest paid	**$ 5,092**	$ 3,510

Income taxes paid	**$**	**3,150**	$	2,850
Loans transferred to foreclosed assets held for resale and other foreclosed transactions	**$**	**235**	$	

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Nature of Operations

ACNB Corporation (the Corporation or ACNB), headquartered in Gettysburg, Pennsylvania, provides banking, insurance, and financial services to businesses and consumers through its wholly-owned subsidiaries, ACNB Bank (Bank) and Russell Insurance Group, Inc. (RIG). The Bank engages in full-service commercial and consumer banking and wealth management services, including trust and retail brokerage, through twenty-two community banking office locations in Adams, Cumberland, Franklin and York Counties, Pennsylvania. There is also a loan production office situated in York County, Pennsylvania, as well as another loan production office in Hunt Valley, Maryland, effective July 25, 2018.

On July 1, 2017, ACNB completed its acquisition of New Windsor Bancorp, Inc. (New Windsor) of Taneytown, Maryland. At the effective time of the acquisition, New Windsor merged with and into a wholly-owned subsidiary of ACNB, immediately followed by the merger of New Windsor State Bank (NWSB) with and into ACNB Bank. ACNB Bank now operates in the Maryland market as NWSB Bank, A Division of ACNB Bank and serves this marketplace with banking and wealth management services via a network of seven community banking offices located in Carroll County, Maryland.

RIG is a full-service insurance agency based in Westminster, Maryland, with a second location in Germantown, Maryland. The agency offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients.

The Corporation s primary source of revenue is interest income on loans and investment securities and fee income on its products and services. Expenses consist of interest expense on deposits and borrowed funds, provisions for loan losses, and other operating expenses.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly ACNB Corporation s financial position and the results of operations, comprehensive income, changes in stockholders equity, and cash flows. All such adjustments are of a normal recurring nature.

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s consolidated financial statements in the 2017 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 9, 2018. It is suggested that the consolidated financial statements contained herein be read in conjunction with the consolidated financial statements and notes included in the Corporation s Annual Report on Form 10-K. The results of operations for the three and nine month periods ended September 30, 2018, are not necessarily indicative of the results to be expected for the full year.

On January 1, 2018, the Corporation adopted ASU 2014-09, *Revenue from Contracts with Customers,* and all subsequent amendments to the ASU (collectively ASC 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of

the Corporation s revenue comes from interest income, including loans and securities, that are outside the scope of ASC 606. The Corporation s services that fall within the scope of ASC 606 are presented within other income on the consolidated statement of income and are recognized as revenue as the Corporation satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on deposit accounts, service charges on ATM and debit card transactions, income from fiduciary, investment management and brokerage activities and commissions from insurance sales. ASC 606 did not result in a change to the accounting for any in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

On January 1, 2018, the Corporation adopted ASU 2016-01, *Financial Instruments Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,* which amended the guidance on the classification and measurement of financial instruments. Upon adoption of ASU 2016-01, the Corporation recognized the equity securities fair value change in net income. Previously, the fair value changes were recognized, net of tax, in other comprehensive income (loss). The adoption of this ASU did not have a material effect on the Corporation s consolidated financial condition or results of operations.

The Corporation early adopted ASU 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* The amendments in this ASU required a reclassification from accumulated other comprehensive income to retained earnings for tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21% corporate income tax rate. The amendments in this ASU would be effective for the Corporation for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The adoption of this ASU did not have a material effect on the Corporation s consolidated financial condition or results of operations.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2018, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. Acquisition of New Windsor Bancorp, Inc.

On July 1, 2017, ACNB completed its acquisition of New Windsor Bancorp Inc. (New Windsor) of Taneytown, Maryland. New Windsor was a locally owned and managed institution with seven locations in north central Maryland that complemented, enhanced and expanded ACNB s physical presence in north central Maryland. ACNB transacted the acquisition to enhance its competitive strategic position, potential prospective business opportunities, operations, management, prospective financial condition, future earnings and business prospects. Specifically, ACNB believes that the acquisition will enhance its business opportunities in Northern Maryland due to the combined company having a greater market share, market presence and the ability to offer more diverse (i.e. Trust Services) and more profitable products, as well as a broader based and geographically diversified branch system to enhance deposit collection and potentially improve funding costs. The fair value of total assets acquired as a result of the acquisition totaled $319.8 million, loans totaled $263.5 million and deposits totaled $293.3 million. Goodwill recorded in the acquisition was $13.3 million. In accordance with the terms of the Reorganization Agreement, dated November 21, 2016, as amended, New Windsor shareholders received, in aggregate, $4.5 million in cash and 938,360 shares or approximately 13% of the post transaction outstanding shares of the Corporation s common stock. The transaction was valued at $33.3 million based on the Corporation s June 30, 2017 closing price of $30.50 as quoted on NASDAQ. The results of the combined entity s operations are included in the Corporation s Consolidated Financial Statements from the date of acquisition.

The acquisition of New Windsor is being accounted for as a business combination using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at estimated fair values on the acquisition date.

The following table summarizes the consideration paid for New Windsor and the fair value of assets acquired and liabilities assumed as of the acquisition date:

Purchase Price Consideration in Common Stock

New Windsor shares outstanding		1,003,703
Shares paid cash consideration		150,555
Cash consideration (per New Windsor share)	$	30.00
Cash portion of purchase price	$	4,519,995
New Windsor shares outstanding		1,003,703
Shares paid stock consideration		853,148

Exchange ratio		1.10
Total ACNB shares issued		938,360
ACNB s share price for purposes of calculation	$	30.50
Equity portion of purchase price	$	28,619,980
Cost of shares owned by buyer	$	150,000
Total consideration paid	$	33,289,975

	In thousands		
Allocation of Purchase Price			
Total Purchase Price		$	33,290
Fair Value of Assets Acquired			
Cash and cash equivalents	10,964		
Investment securities	21,624		
Loans held for sale	1,463		
Loans	263,450		
Restricted stock	486		
Premises and equipment	8,624		
Core deposit intangible asset	2,418		
Other assets	10,792		
Total assets	319,821		
Fair Value of Liabilities Assumed			
Non-interest bearing deposits	80,006		
Interest bearing deposits	213,327		
Subordinated debt	4,688		
Other liabilities	1,782		
Total liabilities	299,803		
Net Assets Acquired			20,018
Goodwill Recorded in Acquisition		$	13,272

Pursuant to the accounting requirements, the Corporation assigned a fair value to the assets acquired and liabilities assumed of New Windsor. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Goodwill and core deposit intangibles are allocated to the banking business segment.

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

Investment securities available-for-sale

The estimated fair values of the investment securities available for sale, primarily comprised of U.S. Government agency mortgage-backed securities, U.S. government agencies and municipal bonds, were determined using Level 2 inputs in the fair value hierarchy. The fair values were determined using independent pricing services. The Corporation s independent pricing service utilized matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather relying on the security s relationship to other benchmark quoted prices. Management reviewed the data and assumptions used in pricing the securities.

Loans

Acquired loans (impaired and non-impaired) are initially recorded at their acquisition-date fair values using Level 3 inputs. Fair values are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, expected life time losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Specifically, the Corporation has prepared three separate loan fair value adjustments that it believed a market participant might employ in estimating the entire fair value adjustment necessary under ASC 820-10 for the acquired loan portfolio. The three-separate fair valuation methodology employed are: 1) an interest rate loan fair value adjustment, 2) a general credit fair value adjustment, and 3) a specific credit fair value adjustment for purchased credit impaired loans subject to ASC 310-30 procedures. The acquired loans were recorded at fair value at the acquisition date without carryover of New Windsor s previously established allowance for loan losses. The fair value of the financial assets acquired included loans receivable with a gross amortized cost basis of $272,646,000. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired.

The credit adjustment on purchased credit impaired loans is derived in accordance with ASC 310-30 and represents the portion of the loan balances that has been deemed uncollectible based on the Corporation s expectations of future cash flows for each respective loan.

In thousands		
Gross amortized cost basis at July 1, 2017	$	272,646
Interest rate fair value adjustment on pools of homogeneous loans		(731)
Credit fair value adjustment on pools of homogeneous loans		(4,501)
Credit fair value adjustment on purchased credit impaired loans		(3,964)
Fair value of acquired loans at July 1, 2017	$	263,450

For loans acquired without evidence of credit quality deterioration, ACNB prepared the interest rate loan fair value and credit fair value adjustments. Loans were grouped into homogeneous pools by characteristics such as loan type, term, collateral and rate. Market rates for similar loans were obtained from various internal and external data sources and reviewed by management for reasonableness. The average of these rates was used as the fair value interest rate a market participant would utilize. A present value approach was utilized to calculate the interest rate fair value discount of $731,000.

Additionally for loans acquired without credit deterioration, a credit fair value adjustment was calculated using a two-part credit fair value analysis: 1) expected lifetime credit migration losses; and 2) estimated fair value adjustment for certain qualitative factors. The expected lifetime losses were calculated using historical losses observed at the Bank, NWSB and peer banks. ACNB also estimated an environmental factor to apply to each loan type. The environmental factor represents a potential discount which may arise due to general credit and economic factors. A credit fair value discount of $4.5 million was determined. Both the interest rate and credit fair value adjustments relate to loans acquired without evidence of credit quality deterioration will be substantially recognized as interest income on a level yield amortization method over the expected life of the loans.

The following table presents the acquired purchased credit impaired loans receivable at the Acquisition Date:

In thousands		
Contractual principal and interest at acquisition	$	13,439
Nonaccretable difference		(5,651)
Expected cash flows at acquisition		7,788
Accretable yield		(1,458)
Fair value of purchased impaired loans	$	6,330

Premises and Equipment

The Corporation acquired seven branches from New Windsor. The fair value of New Windsor s premises, including land, buildings, and improvements, was determined based upon independent third-party appraisals and other data in the market in which the premises are located. The Corporation prepared an internal analysis to compare the lease contract obligations to comparable market rental rates. The Corporation believed that the leased contract rates were in a reasonable range of market rental rates and concluded that no fair market value adjustment related to leasehold interest was necessary.

Core Deposit Intangible

The fair value of the core deposit intangible was determined based on a discounted cash flow analysis using a discount rate commensurate with market participants. To calculate cash flows, deposit account servicing costs (net of deposit fee income) and interest expense on deposits were compared to the cost of alternative funding sources available through national brokered CD offering rates. The projected cash flows were developed using projected deposit attrition rates. The core deposit intangible will be amortized over ten years using the sum-of-years digits method.

Time Deposits

The fair value adjustment for time deposits represents a discount from the value of the contractual repayments of fixed-maturity deposits using prevailing market interest rates for similar-term time deposits. The time deposit discount of approximately $847,500 is being amortized into income on a level yield amortization method over the contractual life of the deposits.

Long-term Borrowings

The Corporation assumed a trust preferred subordinated debt in connection with the acquisition. The fair value of the trust preferred subordinated debt was determined based upon an estimated fair value from an independent brokerage firm. The trust preferred capital note was valued at a discount of $312,500, which is being amortized into income on a level yield amortization method based upon the assumed market rate, and the term of the trust preferred subordinated debt instrument.

3. Earnings Per Share and Restricted Stock Plan

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 7,033,437 and 6,383,149 weighted average shares of common stock outstanding for the nine months ended September 30, 2018 and 2017, respectively, and 7,038,768 and 7,004,346 for the three months ended September 30, 2018 and 2017, respectively. All outstanding unvested restricted stock awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation.

The Corporation has a restricted stock plan available to selected employees and directors of the Corporation and the Bank to advance the best interests of the Corporation and its stockholders. The plan provides those persons who have responsibility for its growth with additional incentives by allowing them to acquire ownership in the Corporation and, thereby, encouraging them to contribute to the success of the Corporation and the Bank. Plan expense is recognized over the vesting period of the stock issued under the plan. As of September 30, 2018, 26,045 shares were issued to employees under this plan, of which 19,485 were fully vested, no shares vested during the quarter, and the remaining 6,560 will vest over the next two years. $42,000 and $0 of compensation expenses related to the grants were recognized during the three months ended September 30, 2018 and 2017, respectively. $159,000 and $120,000 of compensation expenses related to the grants were recognized during the nine months ended September 30, 2018 and 2017, respectively.

4. Retirement Benefits

The components of net periodic benefit expense related to the non-contributory, defined benefit pension plan for the three and nine month periods ended September 30 were as follows:

	Three Months Ended September 30,		**Nine Months Ended September 30**	
In thousands	**2018**	**2017**	**2018**	**2017**
Service cost	**$ 215**	$ 210	**$ 645**	$ 630
Interest cost	**274**	284	**822**	852
Expected return on plan assets	**(693)**	(630)	**(2,077)**	(1,890)
Amortization of net loss	**129**	169	**386**	507
Net Periodic Benefit Expense	**$ (75)**	$ 33	**$ (224)**	$ 99

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2017, that it had not yet determined the amount the Bank planned on contributing to the defined benefit plan in 2018. As of September 30, 2018, this contribution amount had still not been determined. Effective April 1, 2012, no inactive or former participant in the plan is eligible to again participate in the plan, and no employee hired after March 31, 2012, is eligible to participate in the plan. As of the last annual census, ACNB Bank had a

combined 353 active, vested, terminated and retired persons in the plan.

5. Guarantees

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers.

The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $4,479,000 in standby letters of credit as of September 30, 2018. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of September 30, 2018, for guarantees under standby letters of credit issued is not material.

6. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of taxes, are as follows:

In thousands		Unrealized (Losses) Gains on Securities	Pension Liability	Accumulated Other Comprehensive Loss
BALANCE	**SEPTEMBER 30, 2018**	**$ (3,199)**	**$ (5,836)**	**$ (9,035)**
BALANCE	DECEMBER 31, 2017	$ (957)	$ (6,135)	$ (7,092)
BALANCE	SEPTEMBER 30, 2017	$ 40	$ (5,429)	$ (5,389)

7. Segment Reporting

The Corporation has two reporting segments, the Bank and RIG. RIG is managed separately from the banking segment, which includes the Bank and related financial services that the Corporation offers through its banking subsidiary. RIG offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients.

Segment information for the nine month periods ended September 30, 2018 and 2017, is as follows:

In thousands	Banking	Insurance	Total
2018			
Net interest income and other income from external customers	**$ 50,015**	**$ 4,205**	**$ 54,220**
Income before income taxes	**19,146**	**1,211**	**20,357**
Total assets	**1,635,033**	**12,766**	**1,647,799**
Capital expenditures	**847**	**57**	**904**
2017			
Net interest income and other income from external customers	$ 39,536	$ 3,863	$ 43,399
Income before income taxes	9,099	799	9,898
Total assets	1,598,331	9,304	1,607,635
Capital expenditures	1,087		1,087

Segment information for the three month periods ended September 30, 2018 and 2017, is as follows:

In thousands	Banking	Insurance	Total
2018			
Net interest income and other income from external customers	**$ 17,235**	**$ 1,303**	**$ 18,538**
Income before income taxes	**7,115**	**367**	**7,482**
Total assets	**1,635,033**	**12,766**	**1,647,799**
Capital expenditures	**233**	**16**	**249**
2017			
Net interest income and other income from external customers	$ 16,321	$ 1,171	$ 17,492
Income before income taxes	2,424	201	2,625
Total assets	1,598,331	9,304	1,607,635
Capital expenditures	284		284

Customer renewal lists are amortized over their estimated useful lives which range from eight to thirteen years. Core deposit intangible assets are primarily amortized over 10 years using accelerated methods. Goodwill is not amortized, but rather is analyzed annually for impairment. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. Tax amortization of goodwill and the intangible assets is deductible for tax purposes. Tax amortization of the goodwill associated with the New Windsor acquisition is not deductible for federal income tax purposes.

8. Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Debt securities not classified as held to maturity or trading are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in other comprehensive income (loss). As of January 1, 2018, equity securities with readily determined fair values are recorded at fair value with changes in fair value recognized in net income. Prior to 2018, fair value changes were reported, net of tax, in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Amortized cost and fair value of securities at September 30, 2018, and December 31, 2017, were as follows:

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
SEPTEMBER 30, 2018				
U.S. Government and agencies	**$ 125,594**	**$**	**$ 3,518**	**$ 122,076**
Mortgage-backed securities, residential	**31,676**	**107**	**692**	**31,091**
State and municipal	**9,819**	**54**	**83**	**9,790**
	$ 167,089	**$ 161**	**$ 4,293**	**$ 162,957**
DECEMBER 31, 2017				
U.S. Government and agencies	$ 105,899	$ 2	$ 1,818	$ 104,083
Mortgage-backed securities, residential	34,473	461	101	34,833
State and municipal	13,227	109	42	13,294
Corporate bonds	5,000	57		5,057
CRA mutual fund	1,044		9	1,035
Stock in other banks	647	102		749
	$ 160,290	$ 731	$ 1,970	$ 159,051
SECURITIES HELD TO MATURITY				
SEPTEMBER 30, 2018				
U.S. Government and agencies	**$ 12,000**	**$**	**$ 117**	**$ 11,883**
Mortgage-backed securities, residential	**21,517**		**633**	**20,884**
	$ 33,517	**$**	**$ 750**	**$ 32,767**
DECEMBER 31, 2017				
U.S. Government and agencies	$ 19,000	$ 2	$ 99	$ 18,903
Mortgage-backed securities, residential	25,829	55	238	25,646
	$ 44,829	$ 57	$ 337	$ 44,549

The Corporation adopted ASU 2016-01, *Financial Instruments Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* effective January 1, 2018. The required fair value disclosures are as follows:

In thousands	Fair Value at January 1, 2018	Unrealized Gains	Unrealized Losses	Fair Value at September 30, 2018
SEPTEMBER 30, 2018				
Equity securities with a readily determinable fair value	**$ 1,793**	**$ 31**	**$ 81**	**$ 1,743**

The following table shows the Corporation s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2018, and December 31, 2017:

In thousands	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
SECURITIES AVAILABLE FOR SALE						
SEPTEMBER 30, 2018						
U.S. Government and agencies	**$ 44,842**	**$ 771**	**$ 76,734**	**$ 2,747**	**$ 121,576**	**$ 3,518**
Mortgage-backed securities, residential	**20,998**	**493**	**4,517**	**199**	**25,515**	**692**
State and municipal	**1,397**	**19**	**1,911**	**64**	**3,308**	**83**
	$ 67,237	**$ 1,283**	**$ 83,162**	**$ 3,010**	**$ 150,399**	**$ 4,293**
DECEMBER 31, 2017						
U.S. Government and agencies	$ 42,775	$ 445	$ 58,279	$ 1,373	$ 101,054	$ 1,818
Mortgage-backed securities, residential	7,228	56	2,845	45	10,073	101
State and municipal	1,042	8	1,950	34	2,992	42
CRA Mutual Fund			1,035	9	1,035	9
	$ 51,045	$ 509	$ 64,109	$ 1,461	$ 115,154	$ 1,970
SECURITIES HELD TO MATURITY						
SEPTEMBER 30, 2018						
U.S. Government and agencies	**$ 2,955**	**$ 45**	**$ 8,928**	**$ 72**	**$ 11,883**	**$ 117**
Mortgage-backed securities, residential	**11,386**	**243**	**9,498**	**390**	**20,884**	**633**
	$ 14,341	**$ 288**	**$ 18,426**	**$ 462**	**$ 32,767**	**$ 750**
DECEMBER 31, 2017						
U.S. Government and agencies	$ 4,985	$ 15	$ 10,916	$ 84	$ 15,901	$ 99
Mortgage-backed securities, residential	4,946	29	11,070	209	16,016	238
	$ 9,931	$ 44	$ 21,986	$ 293	$ 31,917	$ 337

All mortgage-backed security investments are government sponsored enterprise (GSE) pass-through instruments issued by the Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA) or Federal Home Loan Mortgage Corporation (FHLMC), which guarantee the timely payment of principal on these investments.

At September 30, 2018, seventy-four available for sale U.S. Government and agency securities had unrealized losses that individually did not exceed 7% of amortized cost. Fifty of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At September 30, 2018, thirty-eight available for sale residential mortgage-backed securities had unrealized losses that individually did not exceed 5% of amortized cost. Seven of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At September 30, 2018, twelve available for sale state and municipal securities had unrealized losses that individually did not exceed 6% of amortized cost. Eight of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At September 30, 2018, seven held to maturity U.S. Government and agency securities had unrealized losses that individually did not exceed 2% of amortized cost. Five of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At September 30, 2018, thirty-four held to maturity residential mortgage-backed securities had unrealized losses that individually did not exceed 5% of amortized cost. Thirteen of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

In analyzing the issuer s financial condition, management considers industry analysts reports, financial performance, and projected target prices of investment analysts within a one-year time frame. Based on the above information, management has determined that none of these investments are other-than-temporarily impaired.

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses independent service providers to provide matrix pricing.

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At September 30, 2018, management had not identified any securities with an unrealized loss that it intends to sell or will be required to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses.

Amortized cost and fair value at September 30, 2018, by contractual maturity, where applicable, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	**$ 10,050**	**$ 10,013**	**$ 6,000**	**$ 5,980**
Over 1 year through 5 years	**121,477**	**118,020**	**6,000**	**5,903**
Over 5 years through 10 years	**3,886**	**3,833**		
Over 10 years				
Mortgage-backed securities, residential	**31,676**	**31,091**	**21,517**	**20,884**
	$ 167,089	**$ 162,957**	**$ 33,517**	**$ 32,767**

The Corporation realized $31,000 and $44,000 gross gains on sales of securities available for sale during the three and nine month periods ended September 30, 2018, respectively. The corporation did not realize any gross gains or losses on sales of securities during the three and nine month period ended September 30, 2017.

At September 30, 2018, and December 31, 2017, securities with a carrying value of $181,820,000 and $157,601,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

9. Loans

The Corporation grants commercial, residential, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout southcentral Pennsylvania and northern Maryland. The ability of the Corporation s debtors to honor their contracts is dependent upon the real estate values and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The loans receivable portfolio is segmented into commercial, residential mortgage, home equity lines of credit, and consumer loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, and commercial real estate construction.

The accrual of interest on residential mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued, but not collected, for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses (the allowance) is established as losses are estimated to occur through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The reserve for unfunded lending commitments represents management s estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statement of condition. The amount of the reserve for unfunded lending commitments is not material to the consolidated financial statements.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity, and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for the previous twelve quarters for each of these categories of loans, adjusted for qualitative risk factors. These qualitative risk factors include:

- lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;

- national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans;

- the nature and volume of the portfolio and terms of loans;
- the experience, ability and depth of lending management and staff;
- the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management s best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. It covers risks that are inherently difficult to quantify including, but not limited to, collateral risk, information risk, and historical charge-off risk.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal and/or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and/or interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and commercial construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

A specific allocation within the allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of the Corporation s impaired loans are measured based on the estimated fair value of the loan s collateral or the discounted cash flows method.

It is the policy of the Corporation to order an updated valuation on all real estate secured loans when the loan becomes 90 days past due and there has not been an updated valuation completed within the previous 12 months. In addition, the Corporation orders third-party valuations on all impaired real estate collateralized loans within 30 days of the loan being classified as impaired. Until the valuations are completed, the Corporation utilizes the most recent independent third-party real estate valuation to estimate the need for a specific allocation to be assigned to the loan. These existing valuations are discounted downward to account for such things as the age of the existing collateral valuation, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral. Once the updated valuation is completed, the collateral value is updated accordingly.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower s financial statements, inventory reports, accounts receivable aging reports, equipment appraisals, or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The Corporation actively monitors the values of collateral as well as the age of the valuation of impaired loans. Management believes that the Corporation s market area is not as volatile as other areas throughout the United States, therefore valuations are ordered at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined.

For impaired loans secured by collateral other than real estate, the Corporation considers the net book value of the collateral, as recorded in the most recent financial statements of the borrower, and determines fair value based on estimates made by management.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a troubled debt restructure.

Loans whose terms are modified are classified as troubled debt restructured loans if the Corporation grants such borrowers concessions that it would not otherwise consider and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate, a below market interest rate given the risk associated with the loan, or an extension of a loan s stated maturity date. Nonaccrual troubled debt restructurings may be restored to accrual status if principal and interest payments, under the modified terms, are current for a sustained period of time and, based on a well-documented credit evaluation of the borrower s financial condition, there is reasonable assurance of repayment. Loans classified as troubled debt restructurings are generally designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into credit quality rating categories. The borrower s overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are generally evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments.

Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful, and loss. Loans classified special mention have potential weaknesses that deserve management s close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, federal and state regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management s comprehensive analysis of the loan portfolio and economic conditions, management believes the current level of the allowance for loan losses is adequate.

Commercial and Industrial Lending The Corporation originates commercial and industrial loans primarily to businesses located in its primary market area and surrounding areas. These loans are used for various business purposes which include short-term loans and lines of credit to finance machinery and equipment purchases, inventory, and accounts receivable. Generally, the maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Most business lines of credit are written on demand and may be renewed annually.

Commercial and industrial loans are generally secured with short-term assets; however, in many cases, additional collateral such as real estate is provided as additional security for the loan. Loan-to-value maximum values have been established by the Corporation and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, collateral appraisals, etc.

In underwriting commercial and industrial loans, an analysis is performed to evaluate the borrower s character and capacity to repay the loan, the adequacy of the borrower s capital and collateral, as well as the conditions affecting the borrower. Evaluation of the borrower s past, present and future cash flows is also an important aspect of the Corporation s analysis.

Commercial loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions.

Commercial Real Estate Lending The Corporation engages in commercial real estate lending in its primary market area and surrounding areas. The Corporation s commercial loan portfolio is secured primarily by commercial retail space, office buildings, and hotels. Generally, commercial real estate loans have terms that do not exceed 20 years, have loan-to-value ratios of up to 80% of the appraised value of the property, and are typically secured by personal guarantees of the borrowers.

In underwriting these loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower s credit history, and the reliability and predictability of the cash flow generated by the property securing the loan. Appraisals on properties securing commercial real estate loans originated by the Corporation are performed by independent appraisers.

Commercial real estate loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the complexities involved in valuing the underlying collateral.

Commercial Real Estate Construction Lending The Corporation engages in commercial real estate construction lending in its primary market area and surrounding areas. The Corporation s commercial real estate construction lending consists of commercial and residential site development loans, as well as commercial building construction and residential housing construction loans.

The Corporation s commercial real estate construction loans are generally secured with the subject property. Terms of construction loans depend on the specifics of the project, such as estimated absorption rates, estimated time to complete, etc.

In underwriting commercial real estate construction loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower s credit history, and the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate construction loans originated by the Corporation are performed by independent appraisers.

Commercial real estate construction loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the uncertainties surrounding total construction costs.

Residential Mortgage Lending One-to-four family residential mortgage loan originations, including home equity closed-end loans, are generated by the Corporation s marketing efforts, its present customers, walk-in customers, and referrals. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

The Corporation offers fixed-rate and adjustable-rate mortgage loans with terms up to a maximum of 30 years for both permanent structures and those under construction. The Corporation s one-to-four family residential mortgage originations are secured primarily by properties located in its primary market area and surrounding areas. The majority of the Corporation s residential mortgage loans originate with a loan-to-value of 80% or less. Loans in excess of 80% are required to have private mortgage insurance.

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower s financial ability to repay the loan as agreed and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney s title opinion or title insurance, as well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged in subprime residential mortgage originations.

Residential mortgage loans present a moderate level of risk due primarily to general economic conditions, as well as a continued weak housing market.

Home Equity Lines of Credit Lending The Corporation originates home equity lines of credit primarily within the Corporation s market area or with customers primarily from the market area. Home equity lines of credit are generated by the Corporation s marketing efforts, its present customers, walk-in customers, and referrals.

Home equity lines of credit are secured by the borrower s primary residence with a maximum loan-to-value of 90% and a maximum term of 20 years. In underwriting home equity lines of credit, the Corporation evaluates both the value of the property securing the loan and the borrower s financial ability to repay the loan as agreed. The ability to repay is determined by the borrower s employment history, current financial condition, and credit background.

Home equity lines of credit generally present a moderate level of risk due primarily to general economic conditions, as well as a continued weak housing market.

Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values deteriorate.

Consumer Lending The Corporation offers a variety of secured and unsecured consumer loans, including those for vehicles and mobile homes and loans secured by savings deposits. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

Consumer loan terms vary according to the type and value of collateral and the creditworthiness of the borrower. In underwriting consumer loans, a thorough analysis of the borrower s financial ability to repay the loan as agreed is performed. The ability to repay is determined by the borrower s employment history, current financial condition, and credit background.

Consumer loans may entail greater credit risk than residential mortgage loans or home equity lines of credit, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Acquired Loans

Acquired loans (impaired and non-impaired) are initially recorded at their acquisition-date fair values using Level 3 inputs. Fair values are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, expected lifetime losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Specifically, the Corporation has prepared three separate loan fair value adjustments that it believed a market participant might employ in estimating the entire fair value adjustment necessary under ASC 820-10 for the acquired loan portfolio. The three-separate fair valuation methodology employed are: 1) an interest rate loan fair value adjustment, 2) a general credit fair value adjustment, and 3) a specific credit fair value adjustment for purchased credit impaired loans subject to ASC 310-30 procedures.

The carryover of allowance for loan losses related to acquired loans is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. The allowance for loan losses on acquired loans reflects only those losses incurred after acquisition and represents the present value of cash flows expected at acquisition that is no longer expected to be collected. Acquired loans are marked to fair value on the date of acquisition. In conjunction with the quarterly evaluation of the adequacy of the allowance for loan losses, the Corporation performs an analysis on acquired loans to determine whether or not there has been subsequent deterioration in relation to those loans. If deterioration has occurred, the Corporation will include these loans in the calculation of the allowance for loan losses after the initial valuation, and provide accordingly.

Upon acquisition, in accordance with US GAAP, the Corporation has individually determined whether each acquired loan is within the scope of ASC 310-30. The Corporation s senior lending management reviewed the accounting seller s loan portfolio on a loan by loan basis to determine if any loans met the two-part definition of an impaired loan as defined by ASC 310-30: 1) Credit deterioration on the loan from its inception until the acquisition date, and 2) It is probable that not all of the contractual cash flows will be collected on the loan.

Acquired ASC 310-20 loans, which are loans that did not meet the criteria above, were pooled into groups of similar loans based on various factors including borrower type, loan purpose, and collateral type. For these pools, the Corporation used certain loan information, including outstanding principal balance, estimated expected losses, weighted average maturity, weighted average margin, and weighted average interest rate along with estimated prepayment rates, expected lifetime losses, environment factors to estimate the expected cash flow for each loan pool.

With regards to ASC 310-30 loans, for external disclosure purposes, the aggregate contractual cash flows less the aggregate expected cash flows resulted in a credit related non-accretable yield amount. The aggregate expected cash flows less the acquisition date fair value resulted in an accretable yield amount. The accretable yield reflects the contractual cash flows management expects to collect above the loan s acquisition date fair value and will be recognized over the life of the loan on a level-yield basis as a component of interest income.

Over the life of the acquired ASC 310-30 loan, the Corporation continues to estimate cash flows expected to be collected. Decreases in expected cash flows, other than from prepayments or rate adjustments, are recognized as impairments through a charge to the provision for credit losses resulting in an increase in the allowance for credit losses. Subsequent improvements in cash flows result in first, reversal of existing valuation allowances recognized subsequent to acquisition, if any, and next, an increase in the amount of accretable yield to be subsequently recognized on a prospective basis over the loan s remaining life.

Acquired ASC 310-30 loans that met the criteria for non-accrual of interest prior to acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if we can reasonably estimate the timing and amount of expected cash flows on such loans. Accordingly, we do not consider acquired contractually delinquent loans to be non-accruing and continue to recognize interest income on these loans using the accretion model.

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within the Corporation s internal risk rating system as of September 30, 2018, and December 31, 2017:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
SEPTEMBER 30, 2018					
Originated Loans					
Commercial and industrial	$ 167,353	$ 3,094	$ 171	$	$ 170,618
Commercial real estate	363,982	18,218	8,421		390,621
Commercial real estate construction	13,520	1,005	249		14,774
Residential mortgage	378,301	6,909	649		385,859
Home equity lines of credit	87,180	235	148		87,563
Consumer	14,337				14,337
Total Originated Loans	1,024,673	29,461	9,638		1,063,772
Acquired Loans					
Commercial and industrial	5,336	123	(4)		5,455
Commercial real estate	120,035	8,616	3,562		132,213
Commercial real estate construction	3,223	723			3,946
Residential mortgage	42,522	2,293	2,861		47,676
Home equity lines of credit	18,635	88	393		19,116
Consumer	268				268
Total Acquired Loans	190,019	11,843	6,812		208,674
Total Loans					
Commercial and industrial	172,689	3,217	167		176,073
Commercial real estate	484,017	26,834	11,983		522,834
Commercial real estate construction	16,743	1,728	249		18,720
Residential mortgage	420,823	9,202	3,510		433,535
Home equity lines of credit	105,815	323	541		106,679
Consumer	14,605				14,605
Total Loans	$ 1,214,692	$ 41,304	$ 16,450	$	$ 1,272,446

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
DECEMBER 31, 2017					
Originated Loans					
Commercial and industrial	$ 154,177	$ 3,466	$ 1,812	$	$ 159,455
Commercial real estate	325,002	17,666	9,277		351,945
Commercial real estate construction	27,413	767	250		28,430
Residential mortgage	363,195	3,251	478		366,924
Home equity lines of credit	81,976	360			82,336
Consumer	14,454				14,454
Total Originated Loans	966,217	25,510	11,817		1,003,544
Acquired Loans					
Commercial and industrial	6,120	244	10		6,374
Commercial real estate	124,852	12,734	3,228		140,814
Commercial real estate construction	6,742	388			7,130
Residential mortgage	52,959	2,762	3,248		58,969
Home equity lines of credit	24,990	88	378		25,456
Consumer	1,525	358			1,883
Total Acquired Loans	217,188	16,574	6,864		240,626
Total Loans					
Commercial and industrial	160,297	3,710	1,822		165,829
Commercial real estate	449,854	30,400	12,505		492,759
Commercial real estate construction	34,155	1,155	250		35,560
Residential mortgage	416,154	6,013	3,726		425,893
Home equity lines of credit	106,966	448	378		107,792
Consumer	15,979	358			16,337
Total Loans	$ 1,183,405	$ 42,084	$ 18,681	$	$ 1,244,170

The following table provides changes in accretable yield for all acquired loans accounted for under ASC 310-30. Loans accounted for under ASC 310-20 are not included in this table.

In thousands	Nine Months Ended September 30, 2018
Balance at beginning of period	**$ 1,234**
Acquisitions of impaired loans	
Reclassification from non-accretable differences	**288**
Accretion to loan interest income	**(490)**
Balance at end of period	**$ 1,032**

Cash flows expected to be collected on acquired loans are estimated quarterly by incorporating several key assumptions similar to the initial estimate of fair value. These key assumptions include probability of default and the amount of actual prepayments after the acquisition date. Prepayments affect the estimated life of the loans and could change the amount of interest income, and possibly principal expected to be collected. In reforecasting future estimated cash flows, credit loss expectations are adjusted as necessary. Improved cash flow expectations for loans or pools are recorded first as a reversal of previously recorded impairment, if any, and then as an increase in prospective yield when all previously recorded impairment has been recaptured. Decreases in expected cash flows are recognized as impairment through a charge to the provision for loan losses and credit to the allowance for loan losses.

The following table summarizes information relative to impaired loans by loan portfolio class as of September 30, 2018, and December 31, 2017:

In thousands	Impaired Loans with Allowance: Recorded Investment	Impaired Loans with Allowance: Unpaid Principal Balance	Related Allowance	Impaired Loans with No Allowance: Recorded Investment	Impaired Loans with No Allowance: Unpaid Principal Balance
SEPTEMBER 30, 2018					
Commercial and industrial	**$**	**$**	**$**	**$**	**$**
Commercial real estate				**7,188**	**7,188**
Commercial real estate construction					
Residential mortgage				**533**	**533**
Home equity lines of credit	**148**	**148**	**148**		
	$ 148	**$ 148**	**$ 148**	**$ 7,721**	**$ 7,721**
DECEMBER 31, 2017					
Commercial and industrial	$ 1,311	$ 1,311	$ 792	$ 188	$ 188
Commercial real estate	832	832	60	7,528	7,528
Commercial real estate construction					
Residential mortgage	377	377	377	101	101
	$ 2,520	$ 2,520	$ 1,229	$ 7,817	$ 7,817

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the three months ended September 30, 2018 and 2017:

In thousands	Impaired Loans with Allowance: Average Recorded Investment	Impaired Loans with Allowance: Interest Income	Impaired Loans with No Allowance: Average Recorded Investment	Impaired Loans with No Allowance: Interest Income
SEPTEMBER 30, 2018				
Commercial and industrial	**$**	**$**	**$**	**$**
Commercial real estate			**7,215**	**36**
Commercial real estate construction				
Residential mortgage			**317**	
Home equity lines of credit	**74**			
	$ 74	**$**	**$ 7,532**	**$ 36**
SEPTEMBER 30, 2017				
Commercial and industrial	$ 1,360	$	$ 734	$
Commercial real estate	832		7,626	80
Commercial real estate construction				
Residential mortgage	378		101	
	$ 2,570	$	$ 8,461	$ 80

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the nine months ended September 30, 2018 and 2017:

In thousands	Impaired Loans with Allowance: Average Recorded Investment	Impaired Loans with Allowance: Interest Income	Impaired Loans with No Allowance: Average Recorded Investment	Impaired Loans with No Allowance: Interest Income
SEPTEMBER 30, 2018				
Commercial and industrial	**$ 545**	**$**	**$ 92**	**$ 44**
Commercial real estate			**7,525**	**118**
Commercial real estate construction				
Residential mortgage	**94**		**209**	
Home equity lines of credit	**37**			
	$ 676	**$**	**$ 7,826**	**$ 162**
SEPTEMBER 30, 2017				
Commercial and industrial	$ 1,152	$	$ 934	$
Commercial real estate	416		8,155	293
Commercial real estate construction			75	25
Residential mortgage	377		238	15
	$ 1,945	$	$ 9,402	$ 333

No additional funds are committed to be advanced in connection with impaired loans.

The following table presents nonaccrual loans by loan portfolio class as of September 30, 2018, and December 31, 2017, the table below excludes $6.9 million in purchase credit impaired loans, net of unamortized fair value adjustments:

In thousands	September 30, 2018	December 31, 2017
Commercial and industrial	**$**	$ 1,499
Commercial real estate	**3,281**	4,378
Commercial real estate construction		
Residential mortgage	**533**	478
Home equity lines of credit	**148**	
	$ 3,962	$ 6,355

The Corporation classifies certain loans as troubled debt restructurings when credit terms to a borrower in financial difficulty are modified. The modifications may include a reduction in rate, an extension in term and/or the restructuring of scheduled principal payments. All of the Corporation s troubled debt restructured loans are also impaired loans, of which some have resulted in a specific allocation and, subsequently, a charge-off as appropriate. Included in the non-accrual loan total at September 30, 2018 and December 31, 2017, were $2,500,000 and $3,400,000, respectively, of troubled debt restructurings. In addition to the troubled debt restructurings included in non-accrual loans, the Corporation also has loans classified as accruing troubled debt restructurings at September 30, 2018 and December 31, 2017, which total $3,900,000 and $4,000,000, respectively. As of September 30, 2018 and 2017, there were no defaulted troubled debt restructured loans. There were no charge-offs or specific allocation on any of the troubled debt restructured loans for the three and nine months ended September 30, 2018 and 2017. One troubled debt restructured loan paid off during 2018 in the amount of $832,000 and one paid off during 2017 in the amount of $283,000. All other troubled debt restructured loans were current as of September 30, 2018, with respect to their associated forbearance agreement, except for one loan which has had periodic late payments. As of September 30, 2018, no loans classified as a troubled debt restructured loan have active forbearance agreements. The forbearance agreements have expired or the loans have paid off.

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There were no loans whose terms have been modified resulting in troubled debt restructurings during the three and nine months ended September 30, 2018 and 2017.

Consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process at September 30, 2018 and December 31, 2017, totaled $800,000 and $848,000, respectively.

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due.

The following table presents the classes of the loan portfolio summarized by the past due status as of September 30, 2018, and December 31, 2017:

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
SEPTEMBER 30, 2018							
Originated Loans							
Commercial and industrial	$ 69	$	$ 4	$ 73	$ 170,545	$ 170,618	$ 4
Commercial real estate	186	569	2,575	3,330	387,291	390,621	
Commercial real estate construction					14,774	14,774	
Residential mortgage	298	1,254	1,535	3,087	382,772	385,859	1,001
Home equity lines of credit	364		323	687	86,876	87,563	175
Consumer	51	24	33	108	14,229	14,337	33
Total originated loans	968	1,847	4,470	7,285	1,056,487	1,063,772	1,213
Acquired Loans							
Commercial and industrial					5,455	5,455	
Commercial real estate	218		857	1,075	131,138	132,213	857
Commercial real estate construction			77	77	3,869	3,946	77
Residential mortgage	16	3	125	144	47,532	47,676	125
Home equity lines of credit	641	63	70	774	18,342	19,116	70
Consumer					268	268	
Total acquired loans	875	66	1,129	2,070	206,604	208,674	1,129
Total Loans							
Commercial and industrial	69		4	73	176,000	176,073	4
Commercial real estate	404	569	3,432	4,405	518,429	522,834	857
Commercial real estate construction			77	77	18,643	18,720	77
Residential mortgage	314	1,257	1,660	3,231	430,304	433,535	1,126
Home equity lines of credit	1,005	63	393	1,461	105,218	106,679	245
Consumer	51	24	33	108	14,497	14,605	33
Total Loans	$ 1,843	$ 1,913	$ 5,599	$ 9,355	$ 1,263,091	$ 1,272,446	$ 2,342

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
DECEMBER 31, 2017							
Originated Loans							
Commercial and industrial	$ 55	$ 76	$ 1,503	$ 1,634	$ 157,821	$ 159,455	$ 4
Commercial real estate	436	317	1,400	2,153	349,792	351,945	88
Commercial real estate construction	252			252	28,178	28,430	
Residential mortgage	3,006	646	1,500	5,152	361,772	366,924	1,022
Home equity lines of credit	254	29	183	466	81,870	82,336	183
Consumer	72	26	3	101	14,353	14,454	3
Total originated loans	4,075	1,094	4,589	9,758	993,786	1,003,544	1,300
Acquired Loans							
Commercial and industrial	83			83	6,291	6,374	
Commercial real estate	916			916	139,898	140,814	
Commercial real estate construction					7,130	7,130	
Residential mortgage	930	304	137	1,371	57,598	58,969	137
Home equity lines of credit	83		70	153	25,303	25,456	70
Consumer					1,883	1,883	
Total acquired loans	2,012	304	207	2,523	238,103	240,626	207
Total Loans							
Commercial and industrial	138	76	1,503	1,717	164,112	165,829	4
Commercial real estate	1,352	317	1,400	3,069	489,690	492,759	88
Commercial real estate construction	252			252	35,308	35,560	
Residential mortgage	3,936	950	1,637	6,523	419,370	425,893	1,159
Home equity lines of credit	337	29	253	619	107,173	107,792	253
Consumer	72	26	3	101	16,236	16,337	3
Total Loans	$ 6,087	$ 1,398	$ 4,796	$ 12,281	$ 1,231,889	$ 1,244,170	$ 1,507

The following tables summarize the allowance for loan losses and recorded investment in loans receivable:

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF AND FOR THE PERIOD ENDED SEPTEMBER 30, 2018								
Allowance for Loan Losses								
Beginning balance - July 1, 2018	**$ 2,433**	**$ 5,721**	**$ 146**	**$ 2,840**	**$ 564**	**$ 673**	**$ 766**	**$ 13,143**
Charge-offs	**(33)**					**(29)**		**(62)**
Recoveries	**22**		**103**	**8**				**133**
Provisions	**185**	**123**	**(50)**	**(95)**	**131**	**(9)**	**(85)**	**200**
Ending balance - September 30, 2018	**$ 2,607**	**$ 5,844**	**$ 199**	**$ 2,753**	**$ 695**	**$ 635**	**$ 681**	**$ 13,414**
Beginning balance - January 1, 2018	**$ 3,219**	**$ 5,228**	**$ 126**	**$ 3,226**	**$ 612**	**$ 749**	**$ 816**	**$ 13,976**
Charge-offs	**(911)**	**(33)**		**(489)**		**(66)**		**(1,499)**
Recoveries	**33**		**103**	**30**		**1**		**167**
Provisions	**266**	**649**	**(30)**	**(14)**	**83**	**(49)**	**(135)**	**770**
Ending balance - September 30, 2018	**$ 2,607**	**$ 5,844**	**$ 199**	**$ 2,753**	**$ 695**	**$ 635**	**$ 681**	**$ 13,414**
Ending balance: individually evaluated for impairment	**$**	**$**	**$**	**$**	**$ 148**	**$**	**$**	**$ 148**
Ending balance: collectively evaluated for impairment	**$ 2,607**	**$ 5,844**	**$ 199**	**$ 2,753**	**$ 547**	**$ 635**	**$ 681**	**$ 13,266**
Loans Receivable								
Ending balance	**$ 176,073**	**$ 522,834**	**$ 18,720**	**$ 433,535**	**$ 106,679**	**$ 14,605**	**$**	**$ 1,272,446**
Ending balance: individually evaluated for impairment	**$**	**$ 7,188**	**$**	**$ 533**	**$ 148**	**$**	**$**	**$ 7,869**
Ending balance: collectively evaluated for impairment	**$ 176,073**	**$ 515,646**	**$ 18,720**	**$ 433,002**	**$ 106,531**	**$ 14,605**	**$**	**$ 1,264,577**
AS OF AND FOR THE PERIOD ENDED SEPTEMBER 30, 2017								
Allowance for Loan Losses								
Beginning Balance - July 1, 2017	$ 3,246	$ 5,210	$ 135	$ 3,368	$ 607	$ 815	$ 767	$ 14,148
Charge-offs	(60)			(15)	(9)	(18)		(102)
Recoveries	8		40	10		1		59
Provisions	73	195	(31)	(101)	29	12	(177)	
Ending balance - September 30, 2017	$ 3,267	$ 5,405	$ 144	$ 3,262	$ 627	$ 810	$ 590	$ 14,105

Beginning Balance - January 1, 2017	$ 3,055	$ 4,968	$ 147	$ 3,478	$ 648	$ 923	$ 975	$ 14,194
Charge-offs	(129)			(32)	(9)	(102)		(272)
Recoveries	17	61	40	52		13		183
Provisions	324	376	(43)	(236)	(12)	(24)	(385)	
Ending balance - September 30, 2017	$ 3,267	$ 5,405	$ 144	$ 3,262	$ 627	$ 810	$ 590	$ 14,105
Ending balance: individually evaluated for impairment	$ 698	$ 117	$	$ 377	$	$	$	$ 1,192
Ending balance: collectively evaluated for impairment	$ 2,569	$ 5,288	$ 144	$ 2,885	$ 627	$ 810	$ 590	$ 12,913
Loans Receivable								
Ending balance	$ 169,037	$ 483,673	$ 39,779	$ 421,732	$ 105,113	$ 17,036	$	$ 1,236,370
Ending balance: individually evaluated for impairment	$ 1,743	$ 8,413	$	$ 478	$	$	$	$ 10,634
Ending balance: collectively evaluated for impairment	$ 167,294	$ 475,260	$ 39,779	$ 421,254	$ 105,113	$ 17,036	$	$ 1,225,736

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF DECEMBER 31, 2017								
Allowance for Loan Losses								
Ending balance	$ 3,219	$ 5,228	$ 126	$ 3,226	$ 612	$ 749	$ 816	$ 13,976
Ending balance: individually evaluated for impairment	$ 792	$ 60	$	$ 377	$	$	$	$ 1,229
Ending balance: collectively evaluated for impairment	$ 2,427	$ 5,168	$ 126	$ 2,849	$ 612	$ 749	$ 816	$ 12,747
Loans Receivable								
Ending balance	$ 165,829	$ 492,759	$ 35,560	$ 425,893	$ 107,792	$ 16,337	$	$ 1,244,170
Ending balance: individually evaluated for impairment	$ 1,499	$ 8,360	$	$ 478	$	$	$	$ 10,337
Ending balance: collectively evaluated for impairment	$ 164,330	$ 484,399	$ 35,560	$ 425,415	$ 107,792	$ 16,337	$	$ 1,233,833

10. Fair Value Measurements

Management uses its best judgment in estimating the fair value of the Corporation s financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective reporting dates and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance further clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not

associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value measurement and disclosure guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis of measurement used, at September 30, 2018, and December 31, 2017, are as follows:

		September 30, 2018			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		**$ 122,076**	**$**	**$ 122,076**	**$**
Mortgage-backed securities, residential		**31,091**		**31,091**	
State and municipal		**9,790**		**9,790**	
Total securities available for sale	**Recurring**	**$ 162,957**	**$**	**$ 162,957**	**$**
Equity securities with readily determinable fair values	**Recurring**	**$ 1,743**	**$ 1,743**	**$**	**$**
Collateral dependent impaired loans	**Nonrecurring**	**$ 3,907**	**$**	**$**	**$ 3,907**

		December 31, 2017			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		$ 104,083	$	$ 104,083	$
Mortgage-backed securities, residential		34,833		34,833	
State and municipal		13,294		13,294	
Corporate bonds		5,057		5,057	
CRA mutual fund		1,035	1,035		
Stock in other banks		749	749		
Total securities available for sale	Recurring	$ 159,051	$ 1,784	$ 157,267	$
Collateral dependent impaired loans	Nonrecurring	$ 5,426	$	$	$ 5,426

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Corporation has utilized Level 3 inputs to determine fair value:

	Quantitative Information about Level 3 Fair Value Measurements				
Dollars in thousands	**Fair Value Estimate**	**Valuation Technique**	**Unobservable Input**	**Range**	**Weighted Average**
September 30, 2018					
Impaired loans	**$ 3,907**	**Appraisal of collateral (a)**	**Appraisal adjustments (b)**	**(10) - (50)%**	**(28)%**
December 31, 2017					
Impaired loans	$ 5,426	Appraisal of collateral (a)	Appraisal adjustments (b)	(10) - (50)%	(36)%

(a) Fair value is generally determined through management s estimate or independent third-party appraisals of the underlying collateral, which generally includes various Level 3 inputs which are not observable.

(b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percentage of the appraisal. Higher downward adjustments are caused by negative changes to the collateral or conditions in the real estate market, actual offers or sales contracts received,

and/or age of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of certain Corporation financial instruments at September 30, 2018, and December 31, 2017:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the consolidated statement of condition for cash and short-term instruments approximate those assets fair value. U.S. currency is Level 1 and cash equivalents are Level 2.

Securities

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing, and uses the valuation of another provider to compare for reasonableness.

Loans Held for Sale (Carried at Lower of Cost or Fair Value)

The fair values of mortgage loans held for sale are determined based on amounts to be received at settlement by establishing the respective buyer requirement or market interest rates.

Loans (Carried at Cost)

The fair values of non-impaired loans are estimated using discounted cash flow analyses with the exit pricing concept, as well as using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments, and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Loans for which the Corporation has measured impairment are generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less the valuation allowance and/or charge-offs.

Foreclosed Assets Held for Resale

The fair value of real estate acquired through foreclosure is based on independent third-party appraisals of the properties. These assets are included as Level 3 fair values, based upon appraisals that consider the sales prices of similar properties in the proximate vicinity.

It is the policy of the Corporation to have the initial market value of a foreclosed asset held for resale determined by an independent third-party valuation. If the Corporation already has a valid appraisal on file for the property and that appraisal has been completed within the previous 12 months, another appraisal shall not be required when the Corporation acquires ownership of that real estate. Further, the Corporation shall update the market value of each foreclosed asset with an independent third-party valuation at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined. These valuations may be adjusted downward to account for specialized use of the property, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral.

Restricted Investment in Bank Stock (Carried at Cost)

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amounts of accrued interest receivable and accrued interest payable approximate their fair value.

Deposits (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (e.g., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings (Carried at Cost)

The carrying amounts of short-term borrowings approximate their fair values.

Long-Term Borrowings (Carried at Cost)

The fair values of long-term borrowings are estimated using discounted cash flow analysis with the exit pricing concept, based on quoted prices for new borrowings with similar credit risk characteristics, terms, and remaining maturity. The prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party. The fair value of the trust preferred subordinated debt, included in long-term borrowings, was determined based upon an estimated fair value from an independent brokerage firm.

Off-Balance Sheet Credit-Related Instruments

The fair values for the Corporation s off-balance sheet financial instruments (specifically, lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing.

The following presents the carrying amount, exit pricing concept fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of September 30, 2018:

	September 30, 2018				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	**$ 18,145**	**$ 18,145**	**$ 7,981**	**$ 10,164**	**$**
Interest-bearing deposits in banks	**45,551**	**45,551**	**45,551**		
Equity securities with readily determinable fair value	**1,743**	**1,743**	**1,743**		
Investment securities available for sale	**162,957**	**162,957**		**162,957**	
Investment securities held to maturity	**33,517**	**32,767**		**32,767**	
Loans held for sale	**1,112**	**1,112**		**1,112**	
Loans, less allowance for loan losses	**1,259,032**	**1,218,667**			**1,218,667**
Accrued interest receivable	**4,737**	**4,737**		**4,737**	
Restricted investment in bank stocks	**4,529**	**4,529**		**4,529**	
Financial liabilities:					
Demand deposits and savings	**984,704**	**984,704**		**984,704**	
Time deposits	**362,539**	**357,603**		**357,603**	
Short-term borrowings	**38,525**	**38,525**		**38,525**	
Long-term borrowings	**79,725**	**79,383**		**79,383**	
Trust preferred subordinated debt	**5,000**	**4,699**		**4,699**	
Accrued interest payable	**1,406**	**1,406**		**1,406**	
Off-balance sheet financial instruments					

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of December 31, 2017:

	December 31, 2017				
In thousands	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 19,304	$ 19,304	$ 8,313	$ 10,991	$
Interest-bearing deposits in banks	15,137	15,137	15,137		
Investment securities available for sale	159,051	159,051	1,784	157,267	
Investment securities held to maturity	44,829	44,549		44,549	
Loans held for sale	1,736	1,736		1,736	
Loans, less allowance for loan losses	1,230,194	1,213,932			1,213,932
Accrued interest receivable	3,670	3,670		3,670	
Restricted investment in bank stocks	4,773	4,773		4,773	
Financial liabilities:					
Demand deposits and savings	944,399	944,399		944,399	
Time deposits	354,093	351,057		351,057	
Short-term borrowings	36,908	36,908		36,908	
Long-term borrowings	89,600	89,571		89,571	
Trust preferred subordinated debt	5,000	4,692		4,692	
Accrued interest payable	1,163	1,163		1,163	
Off-balance sheet financial instruments					

11. Securities Sold Under Agreements to Repurchase (Repurchase Agreements)

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Corporation s consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Corporation be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Corporation could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third-party financial institution in the counterparty s custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Corporation in a segregated custodial account under a tri-party agreement.

The following table presents the short-term borrowings subject to an enforceable master netting arrangement or repurchase agreement as of September 30, 2018, and December 31, 2017:

In thousands		Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		
					Financial Instruments	Cash Collateral Pledged	Net Amount
September 30, 2018							
Repurchase agreements							
Commercial customers and government entities	(a)	**$ 38,525**	**$**	**$ 38,525**	**$ (38,525)**	**$**	**$**
December 31, 2017							
Repurchase agreements							
Commercial customers and government entities	(a)	$ 36,908	$	$ 36,908	$ (36,908)	$	$

(a) As of September 30, 2018, and December 31, 2017, the fair value of securities pledged in connection with repurchase agreements was $43,541,000 and $42,397,000, respectively.

The following table presents the remaining contractual maturity of the master netting arrangement or repurchase agreements as of September 30, 2018:

	Remaining Contractual Maturity of the Agreements				
In thousands	Overnight and Continuous	Up to 30 Days	30 - 90 Days	Greater than 90 Days	Total
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	**$ 38,525**	**$**	**$**	**$**	**$ 38,525**
Total	**$ 38,525**	**$**	**$**	**$**	**$ 38,525**

12. Borrowings

The Corporation had long-term debt outstanding as follows:

In thousands	September 30, 2018	December 31, 2017
FHLB advances	**$ 74,216**	$ 85,000
Loan payable to local bank	**4,509**	4,600
Loan payable to local bank	**1,000**	
Trust preferred subordinated debt	**5,000**	5,000
	$ 84,725	$ 94,600

The FHLB advances are collateralized by the assets defined in the security agreement and FHLB capital stock. FHLB advances have maturity dates from 2018 to 2022 with a weighted average rate of 2.35%.

The loan payable to a local bank has a fixed rate of 4.5% for the first five years and a variable rate of interest with Prime Rate thereafter to final maturity in June 2028. The principal balance of this note may be prepaid at any time without penalty.

The loan payable to a local bank is a commercial revolving line of credit which has a variable rate equal to the Wall Street Journal Prime Rate, 5.25% at September 30, 2018. Principal shall be payable when and in amounts demanded by the Bank. The line has an initial expiration date of May 1, 2019.

The trust preferred subordinated debt is comprised of debt securities issued by New Windsor in June 2005 and assumed by ACNB Corporation through the acquisition. New Windsor issued $5,000,000 of 6.39% fixed rate capital securities to institutional investors in a private pooled transaction. The proceeds were transferred to New Windsor as trust preferred subordinated debt under the same terms and conditions. The Corporation then contributed the full amount to the Bank in the form of Tier 1 capital. The Corporation has, through various contractual arrangements, fully and unconditionally guaranteed all of the trust obligations with respect to the capital securities.

13. Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. Intangible assets that have finite lives, such as core deposit intangibles, customer relationship intangibles and renewal lists, are amortized over their estimated useful lives and subject to periodic impairment testing. Core deposit intangibles are primarily amortized over ten years using accelerated methods. Customer renewal lists are amortized over their estimated useful lives which range from eight to thirteen years.

This acquisition of New Windsor resulted in goodwill of approximately $13,272,000 and generated $2,418,000 in core deposit intangibles.

Combining goodwill resulting from this transaction with existing goodwill from the 2005 RIG purchase of $6,308,000, total goodwill included in the Corporation s consolidated statement of condition is $19,580,000. Goodwill is not deductible for federal income tax purposes. Goodwill, which has an indefinite useful life, is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired.

The carrying value and accumulated amortization of the intangible assets (RIG customer lists and New Windsor core deposit intangibles) are as follows:

In thousands	Gross carrying amount	Accumulated amortization
RIG amortized intangible assets	$ 7,263	$ 6,514
New Windsor core deposit intangibles	2,418	539

The RIG intangible assets are being amortized over 10 years on a straight line basis. The New Windsor core deposit intangible is being amortized using a sum of the year s method over a 10-year period.

Goodwill is subject to impairment testing at the reporting unit level, which must be conducted at least annually. The Corporation performs impairment testing during the fourth quarter of each year, or more frequently if impairment indicators exist. We also continue to monitor other intangibles for impairment and to evaluate carrying amounts, as necessary.

14. New Accounting Pronouncements

ASU 2016-02, ASU 2018-10 and ASU 2018-11

In February 2016, the FASB issued ASU 2016-02, *Leases*.

From the lessee s perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record an ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessee. From the lessor s perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing lease. If the lessor doesn t convey risks and rewards or control, an operating lease results.

The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases.* In this ASU, FASB corrects inconsistencies in the guidance and clarifies how to apply certain provisions of the leases standard. The amendment targets 16 issues:

- residual value guarantees;
- rate implicit in the lease;
- lessee reassessment of lease classification;
- lessor reassessment of lease term and purchase option;
- variable lease payments that depend on an index or a rate;
- investment tax credits;
- lease term and purchase option;
- transition guidance for amounts previously recognized in business combinations;
- recognition of certain transition adjustments in earnings rather than equity;
- transition guidance for leases previously classified as capital leases under Topic 840;

- transition guidance for modifications to leases previously classified as direct financing or sales-type leases under Topic 840;

- transition guidance for sale and leaseback transactions;

- impairment of net investment in the lease;

- unguaranteed residual asset;

- effect of initial direct costs on rate implicit in the lease; and,

- failed sale and leaseback transaction.

The effective date and transition requirements are consistent with ASU 2016-02. For entities that have early adopted Topic 842 issued in ASU 2016-02, the amendments are effective upon issuance.

In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements.* The ASU provides an optional transition method for adopting the new leases guidance in Topic 842 that will eliminate comparative period reporting under the new guidance in the year of adoption. This option addresses preparer feedback about the related costs of presenting comparative periods under Topic 842. Under the optional transition method, only the most recent period presented will reflect the adoption of Topic 842 with a cumulative-effect adjustment to the opening balance of retained earnings, and the comparative prior periods will be reported under the previous guidance in Topic 840.

Also, the ASU offers lessors a practical expedient that mirrors the practical expedient already provided to lessees in ASU 2016-02, *Leases (Topic 842)*. The new practical expedient will allow lessors to elect, by class of underlying asset, to not separate nonlease components from the associated lease component when specified conditions are met. Examples of nonlease components include equipment maintenance services, common area maintenance services in real estate, or other goods or services provided to the lessee apart from the right to use the underlying asset.

The practical expedient must be applied consistently for all lease contracts.

The effective date and transition requirements for lessors electing the practical expedient for separating components of a contract are the same as the requirements for Topic 842 issued in ASU 2016-02. For entities that have early adopted Topic 842, the ASU provides specific transition guidance for lessors electing the practical expedient.

While the Corporation is currently evaluating the timing and impact of adopting ASU 2016-02, ASU 2018-10 and ASU 2018-11, the ultimate impact of adopting ASU 2016-02, ASU 2018-10 and ASU 2018-11 will depend on the Corporation s lease portfolio as of the adoption date and interest rates at that time. The Corporation expects to recognize right-of-use assets and lease liabilities for substantially all of its operating lease commitments based on the present value of committed lease payments as of the date of adoption. The effect on operations and capital adequacy is not expected to be material.

ASU 2016-13

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*

ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (PCD assets), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price (gross up approach) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis.

Certain incremental disclosures are required. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within the fiscal year. For public business entities that are SEC filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted.

The Corporation is currently evaluating the impact this ASU will have on its consolidated financial condition or results of operations. Management has developed a committee to address CECL and the committee is currently evaluating options to comply with the ASU in a timely

manner.

ASU 2017-08

In March 2017, the FASB issued ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities*.

ASU 2017-08 shortens the amortization period for premiums on purchased callable debt securities to the earliest call date (i.e., yield-to-earliest call amortization), rather than amortizing over the full contractual term. The ASU does not change the accounting for securities held at a discount.

The amendments apply to callable debt securities with explicit, noncontingent call features that are callable at fixed prices and on preset dates. If a security may be prepaid based upon prepayments of the underlying loans, not because the issuer exercised a date specific call option, it is excluded from the scope of the new standard. However, for instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the amendments. Further, the amendments apply to all premiums on callable debt securities, regardless of how they were generated.

The amendments require companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. If the security has additional future call dates, any excess of the amortized cost basis over the amount repayable by the issuer at the next call date should be amortized to the next call date.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

The Corporation has evaluated the provision of ASU 2017-08 to determine the potential impact of the new standard and has determined that it is not expected to have a significant impact on its consolidated financial condition or results of operations, as the Corporation holds one security that this ASU would impact.

ASU 2017-04

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment.*

ASU 2017-04 eliminates Step 2 of the goodwill impairment test. As such, an entity will perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the reporting unit s carrying amount exceeds its fair value. If fair value exceeds the carrying amount, no impairment should be recorded. Any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Impairment losses on goodwill cannot be reversed once recognized.

An entity may still perform the optional qualitative assessment for a reporting unit to determine if it is more likely than not that goodwill is impaired. However, the ASU eliminates the requirement to perform a qualitative assessment for any reporting unit with a zero or negative carrying amount. Therefore, the same one-step impairment assessment will apply to all reporting units. However, for a reporting unit with a zero or negative carrying amount, the ASU adds a requirement to disclose the amount of goodwill allocated to it and the reportable segment in which it is included.

For public business entities that are SEC filers, the amendments are effective with their annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

The Corporation has evaluated the provision of ASU 2017-04 to determine the potential impact of the new standard and has determined that it is not expected to have an impact on its consolidated financial condition or results of operations based on the current circumstances.

ASU 2018-09

In July 2018, the FASB issued ASU 2018-09, *Codification Improvements.*

The ASU contains various improvements to various topics in the codification, including clarification that an entity must disclose the required and actual amounts of regulatory capital for each measure of regulatory capital for which the entity must comply.

For year-end public business entities, the improvements are effective upon issuance, which was July 2018. The Corporation has evaluated the improvements of ASU 2018-09 and determined that the ASU will not impact its consolidated financial condition or results of operations since the Corporation already discloses capital requirements with the Management s Discussion and Analysis section of the Form 10-Q.

ASU 2018-13

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement.*

This ASU removes, modifies, and adds to existing fair value measurement disclosure requirements. The following are removed:

- transfers between Level 1 and Level 2 of the fair value hierarchy;

- the policy for determining when transfers between any of the three levels have occurred; and,

- the valuation processes used for Level 3 measurements.

The following are modified:

- a clarification that the Level 3 measurement uncertainty disclosure should communicate information about the uncertainty at the balance sheet date.

The following are new:

- for public entities, the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 instruments held at the balance sheet date; and,

- for public entities, the range and weighted average of significant unobservable inputs used for Level 3 measurements. For certain unobservable inputs, an option to disclose other quantitative information in place of the weighted average is available to the extent that it would be a more reasonable and rational method to reflect the distribution of unobservable inputs.

The ASU is effective for all entities in fiscal years beginning after December 15, 2019, including interim periods, which is first effective for calendar year entities in the March 31, 2020, interim financial statements. Early adoption is permitted. In addition, an entity may early adopt any of the removed or modified disclosures immediately and delay adoption of the new disclosures until the effective date.

The Corporation is currently evaluating the impact this ASU will have on its consolidated financial condition or results of operations.

ASU 2018-14

In August 2018, the FASB issued ASU 2018-14, *Compensation Retirement Benefits Defined Benefit Plans General (Topic 715-20): Disclosure Framework Changes to the Disclosure Requirements for Defined Benefit Plans.*

The ASU removes the following disclosures:

- the amounts in accumulated other comprehensive income that the entity expects to recognize in net periodic benefit cost during the next fiscal year;

- the amount and timing of plan assets expected to be returned to the employer; and,

- certain related party disclosures.

The ASU clarifies the following disclosure requirements:

- the projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets must be disclosed; and,

- the accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets must be disclosed.

The ASU adds the following disclosure requirements:

- the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates; and,

- an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

The ASU is effective for public business entities in fiscal years ending after December 15, 2020. Early adoption is permitted.

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The Corporation is currently evaluating the impact this ASU will have on its consolidated financial condition or results of operations.

ACNB CORPORATION

ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION AND FORWARD-LOOKING STATEMENTS

Introduction

The following is management s discussion and analysis of the significant changes in the financial condition, results of operations, comprehensive income, capital resources, and liquidity presented in its accompanying consolidated financial statements for ACNB Corporation (the Corporation or ACNB), a financial holding company. Please read this discussion in conjunction with the consolidated financial statements and disclosures included herein. Current performance does not guarantee, assure or indicate similar performance in the future.

Forward-Looking Statements

In addition to historical information, this Form 10-Q contains forward-looking statements. Examples of forward-looking statements include, but are not limited to, (a) projections or statements regarding future earnings, expenses, net interest income, other income, earnings or loss per share, asset mix and quality, growth prospects, capital structure, and other financial terms, (b) statements of plans and objectives of management or the Board of Directors, and (c) statements of assumptions, such as economic conditions in the Corporation s market areas. Such forward-looking statements can be identified by the use of forward-looking terminology such as believes , expects , may , intends , will , should , anticipates negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy. Forward-looking statements are subject to certain risks and uncertainties such as local economic conditions, competitive factors, and regulatory limitations. Actual results may differ materially from those projected in the forward-looking statements. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: the effects of governmental and fiscal policies, as well as legislative and regulatory changes; the effects of new laws and regulations, specifically the impact of the Tax Cuts and Jobs Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act; impacts of the new capital and liquidity requirements of the Basel III standards; the effects of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters; ineffectiveness of the business strategy due to changes in current or future market conditions; future actions or inactions of the United States government, including the effects of short- and long-term federal budget and tax negotiations and a failure to increase the government debt limit or a prolonged shutdown of the federal government; the effects of economic conditions on current customers, specifically the effect of the economy on loan customers ability to repay loans; the effects of competition, and of changes in laws and regulations on competition, including industry consolidation and development of competing financial products and services; the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities, and interest rate protection agreements, as well as interest rate risks; difficulties in acquisitions and integrating and operating acquired business operations, including information technology difficulties; challenges in establishing and maintaining operations in new markets; the effects of technology changes; volatilities in the securities markets; the effect of general economic conditions and more specifically in the Corporation s market area; the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities; acts of war or terrorism; disruption of credit and equity markets; the ability to manage current levels of impaired assets; the loss of certain key officers; the ability to maintain the value and image of the Corporation s brand and protect the Corporation s intellectual property rights; continued relationships with major customers; and, potential impacts to the Corporation from continually evolving cybersecurity and other technological risks and attacks, including additional costs, reputational damage, regulatory penalties, and financial losses. We caution readers not to place undue reliance on these forward-looking statements. They only reflect management s analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances. Please carefully review the risk factors described in other documents the Corporation files from time to time with the Securities and Exchange Commission, including the Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K.

CRITICAL ACCOUNTING POLICIES

The accounting policies that the Corporation s management deems to be most important to the portrayal of its financial condition and results of operations, and that require management s most difficult, subjective or complex judgment, often result in the need to make estimates about the effect of such matters which are inherently uncertain. The following policies are deemed to be critical accounting policies by management:

The allowance for loan losses represents management s estimate of probable losses inherent in the loan portfolio. Management makes numerous assumptions, estimates and adjustments in determining an adequate allowance. The Corporation assesses the level of potential loss associated with its loan portfolio and provides for that exposure through an allowance for loan losses. The allowance is established through a provision for loan losses charged to earnings. The allowance is an estimate of the losses inherent in the loan portfolio as of the end of each reporting period. The Corporation assesses the adequacy of its allowance on a quarterly basis. The specific methodologies applied on a consistent basis are discussed in greater detail under the caption, *Allowance for Loan Losses*, in a subsequent section of this Management s Discussion and Analysis of Financial Condition and Results of Operations.

The evaluation of securities for other-than-temporary impairment requires a significant amount of judgment. In estimating other-than-temporary impairment losses, management considers various factors including the length of time the fair value has been below cost, the financial condition of the issuer, and the Corporation s intent to sell, or requirement to sell, the security before recovery of its value. Declines in fair value that are determined to be other than temporary are charged against earnings.

Accounting Standard Codification (ASC) Topic 350, *Intangibles Goodwill and Other*, requires that goodwill is not amortized to expense, but rather that it be assessed or tested for impairment at least annually. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on RIG s outstanding goodwill from its most recent testing, which was performed as of October 1, 2017. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. The Corporation has not identified any such events and, accordingly, has not tested goodwill resulting from the acquisition of New Windsor Bancorp, Inc. (New Windsor) for impairment during the nine months ended September 30, 2018. ACNB plans on testing New Windsor goodwill during 2018. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

RESULTS OF OPERATIONS

Quarter ended September 30, 2018, compared to Quarter ended September 30, 2017

Executive Summary

Net income for the three months ended September 30, 2018, was $6,039,000, compared to $1,912,000 for the same quarter in 2017, an increase of $4,127,000 or 215.8%. Basic earnings per share was $0.86 in 2018 and $0.27 in 2017. The higher net income in the third quarter of 2018 was primarily a result of merger expenses incurred in the third quarter of 2017, the additional revenue and cost efficiencies of the acquisition of New Windsor on July 1, 2017, as well as organic net revenue growth. In addition, net income was aided by a lower effective tax rate due to the Tax Cuts and Jobs Act effective on January 1, 2018. Net interest income for the quarter ended September 30, 2018 increased $851,000, or 6.3%, as increases in total interest income were greater than increases in total interest expense including net interest income earned on the acquired earning asset and paying liabilities acquired from New Windsor. Provision for loan losses was $200,000 for the quarter ended September 30, 2018, compared to $0 for the same quarter in 2017, based on the adequacy analysis of the allowance for loan losses calculation at the end of each period, resulting in an allowance to total loans of 1.05% at September 30, 2018. Other income increased $195,000, or 5.0%, due in part to increases from the New Windsor sources (brokerage, investment, and trust) and insurance agency revenue. Other expenses decreased $4,011,000, or 27.0%, due to $4,305,000 in merger-related expenses incurred in the third quarter 2017; otherwise increased expenses included technology costs and expenses related to the operation of the new southern market, NWSB Bank, A Division of ACNB Bank.

Net Interest Income

Net interest income totaled $14,413,000 for the three months ended September 30, 2018, compared to $13,562,000 for the same period in 2017, an increase of $851,000, or 6.3%. Net interest income increased due to an increase in interest income to a greater extent than an increase in interest expense. Interest income increased $1,173,000, or 7.8%, due to a 1.6% increase in average earning asset volume from organic growth and increased rates due to market increases and due to purchase accounting adjustments. The increase in interest expense resulted from deposit rate increases in addition to organic deposit growth. Increased lending, average volume was up 0.6%, was a result of a concerted effort by management to offset the recent year trend of interest income decreases due to the market area s heightened competition and declines in the U.S. Treasury yields and other market driver interest rates. Only in recent quarters has this trend reversed to higher yields although the difference between longer term rates and shorter term rates is compressed. These driver rates affect new loan originations and are indexed to a portion of the loan portfolio in that a change in the driver rates changes the yield on new loans and on existing loans at subsequent interest rate reset dates.

In this manner, interest income yield was negatively affected as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates in recent years. Interest income increased on investment securities due to higher market rates. An appropriate amount of earning assets remained in short-term, low-rate money market type accounts during the third quarter of 2018; and there exists ample ability to borrow for liquidity needs. The ability to increase lending is contingent on the effects of intense competition that has reduced new loans and may result in the payoff of existing loans, as well as economic conditions in the Corporation s marketplace. As to funding costs, interest rates on alternative funding sources, such as the FHLB, and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the third quarter of 2018, several of the core deposit rates continued at rate levels in response to continued low rates on earning assets. Interest expense increased $322,000, or 20.8%, due to higher rates on transaction deposits, certificate of deposit rate increases and use of higher cost borrowings. This trend of higher rates is expected to continue due to higher rates at competing banks due to liquidity needs in conjunction with the Federal Reserve FOMC raising short-term rates starting in mid-December 2015 and continuing through 2018. For more information about interest rate risk, please refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and filed with the SEC on March 9, 2018. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the third quarter of 2018 was 3.64% compared to 3.50% during the same period in 2017. Also comparing the third quarter of 2018 to 2017, the yield on interest earning assets increased by 0.24% and the cost of interest bearing liabilities increased by 0.10%. The net interest margin was 3.78% for the third quarter of 2018 and 3.62% for the third quarter of 2017. The net interest margin increase was partly a result of purchase accounting adjustments which added 16 basis points, and acquiring and originating loans at the current market rate in order to increase loan volume and attempt to maintain total net interest income net of purchasing lower yielding investments to properly collateralize local government accounts and repurchase agreements.

Average earning assets were $1,512,000,000 during the third quarter of 2018, an increase of $24,000,000 from the average for the third quarter of 2017. Average interest bearing liabilities were $1,172,000,000 in the third quarter of 2018, an increase of $19,000,000 from the same period in 2017. Non-interest demand deposits increased $13,000,000 on average.

Provision for Loan Losses

The provision for loan losses was $200,000 in the third quarter of 2018 and $0 in the third quarter of 2017. The determination of a need for a provision was a result of the analysis of the adequacy of the allowance for loan losses calculation. The allowance for loan and lease losses does not include the loans acquired from the New Windsor acquisition which were recorded at fair value as of the acquisition date. Without the New Windsor loans, total impaired loans at September 30, 2018 were 24.0% lower compared to December 31, 2017. Nonaccrual loans decreased by 37.7%, or $2,393,000, since December 31, 2017; all substandard loans decreased by 11.9% in that period. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. Management concluded that the loan portfolio exhibited continued general improvement in quantitative and qualitative measurements as shown in the tables and narrative in this Management s Discussion and Analysis and the Notes to the Consolidated Financial Statements. This assessment concluded that credit quality was stable, charge offs were low, and past due loans manageable. This same analysis concluded that the unallocated allowance should be in the same range in 2018 compared with the previous quarter. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the third quarter of 2018, the Corporation had a net recovery of $71,000, as compared to net charge-offs of $43,000 for the third quarter of 2017.

Other Income

Total other income was $4,125,000 for the three months ended September 30, 2018, up $195,000, or 5.0%, from the third quarter of 2017. Fees from deposit accounts decreased by $31,000, or 3.6%, due to variations in volume. Fee volume varies with balance levels, account transaction activity, and customer-driven events such as overdrawing account balances. Various specific government regulations effectively limit fee assessments related to deposit accounts, making future revenue levels uncertain. Revenue from ATM and debit card transactions increased by $119,000 or 24.3%, to $609,000 due to variations in volume and mix. The longer term trend had been increases resulting from consumer desire to use more electronic delivery channels; however, regulations or legal challenges for large financial institutions may impact industry pricing for such transactions and fees in connection therewith in future periods, the effect of which cannot be currently quantified.

A more immediate challenge to this revenue source is the retail system-wide security breaches in the merchant base that are negatively affecting consumer confidence in the debit card channel. Income from fiduciary, investment management and brokerage activities, which includes fees from both institutional and personal trust, investment management services, estate settlement and brokerage services, totaled $632,000 for the three months ended September 30, 2018, as compared to $489,000 for the third quarter of 2017, a 29.2% net increase as a net result of higher fee volume from increased assets under management, higher sporadic estate fee income and higher fees on brokerage relationships brought over in the New Windsor acquisition. Earnings on bank-owned life insurance decreased by $7,000, or 2.5%, as a result of varying crediting rates. At the Corporation s wholly-owned insurance subsidiary, Russell Insurance Group, Inc. (RIG), revenue was up by $137,000, or 10.4%, to $1,450,000 during the period due to higher direct bill volume. A continuing risk to RIG revenue is nonrenewal of large commercial accounts and actions by insurance carriers to reduce commissions paid to agencies such as RIG. Contingent or extra commission payments from insurance carriers are received in the second quarter of each year. Heightened pressure on commissions is expected to continue in this business line from insurance company actions. There was a $31,000 net gain on sales of securities during the third quarter of 2018 and no gains or losses on sales of securities during the third quarter of 2017. A $23,000 net loss was recognized on local bank and CRA-related equity securities during the third quarter of 2018 due to the adoption of ASU 2016-01 on January 1, 2018. Other income in the three months ended September 30, 2018, was down by $174,000, or 35.4%, to $318,000 due to lower sales of residential mortgages and the timing of an annual printed check incentive receipt, partially offset by various other fee income increases, mostly volume related.

Other Expenses

Other expenses for the quarter ended September 30, 2018 were $10,856,000, a decrease of $4,011,000 or 27.0%. Acquisition and integration costs related to the New Windsor acquisition totaled $0 for the third quarter of 2018 compared to $4,305,000 for the third quarter of 2017. Merger expenses in all of 2017 included legal and consulting expenses to effect the legal merger, investment banking and preparing purchase accounting adjustments. Integration expenses included certain severance payments to New Windsor staff separated by the merger, consultant costs to integrate New Windsor bank systems into ACNB s, and the cost to terminate all New Windsor core banking and electronic technology systems contracts. These costs were all necessary to provide requisite internal controls and cost effective core banking technology systems going forward. The costs of integrating all systems into one system was important to the merger viability, ongoing system integrity and realization of cost reductions.

The largest component of other expenses is salaries and employee benefits, which decreased by $155,000, or 2.3%, when comparing the third quarter of 2018 to the same period a year ago. Overall, the decrease in salaries and employee benefits was the result of increases and decreases as follows:

- turnover and delays in replacing customer-facing staff due to a competitive labor market;
- increased staff in support functions and higher skilled mix of employees necessitated by regulations and growth;
- normal merit increases to employees and associated payroll taxes;
- varying performance-based commissions and incentives;

- efficiencies garnered in actively managing employee benefit plan costs, including health insurance;

- varying cost of 401(k) plan and non-qualified retirement plan benefits; and,

- defined benefit pension expense, which was down by $108,000, or (327.3)%, when comparing the three months ended September 30, 2018, to the three months ended September 30, 2017, resulting from the change in discount rates which increases or decreases the future pension obligations (creating volatility in the expense), return on assets at the latest annual evaluation date due to market conditions and changes in actuarial assumptions reflecting increased longevity.

The Corporation s overall pension plan investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation s risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date, which in recent years has experienced fair value volatility and low discount rates. The expense could also be higher in future years due to volatility in the discount rates at the latest measurement date, lower plan returns, and change in mortality tables utilized. The ACNB plan has maintained a well-funded status under ERISA rules.

Net occupancy expense increased by $23,000, or 3.4%, mostly due higher net lease expense and depreciation. Equipment expense increased by $237,000, or 22.8%, due to cost of instituting technologies for upcoming accounting-related changes as well as ongoing support and maintenance of financial systems applications and security technology. Equipment expense is subject to ever-increasing technology demands and the need for system upgrades for security and reliability purposes. In addition, debit card processing increased due to more volume.

Professional services expense totaled $371,000 during the third quarter of 2018, as compared to $224,000 for the same period in 2017, a change of $147,000, or 65.6%. This category includes expenses related to legal corporate governance, risk, compliance management and audit engagements, and legal counsel matters in connection with loans. It varies with specific engagements that are not on a regular recurring basis.

Marketing and corporate relations expenses were $98,000 for the third quarter of 2018, or 17.6% lower, as compared to the same period of 2017. Marketing expense varies with the timing and amount of planned advertising production and media expenditures, typically related to the promotion of certain in-market banking and trust products.

Foreclosed assets held for resale consist of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expense was $27,000 and $35,000 for the three months ended September 30, 2018 and 2017, respectively. The expense varies based upon the number and mix of commercial and residential real estate properties, unpaid property taxes, and deferred maintenance required upon acquisition. In addition, some properties suffer decreases in value after acquisition, requiring write-downs to fair value during the prolonged marketing cycles for these distressed properties. The lower expense in 2018 was related to a better final disposition recovery on one property. Foreclosed assets held for resale expenses or recoveries will vary in the remainder of 2018 depending on the successful closing of sales agreements on some existing properties and the unknown expenses related to new properties acquired.

Other tax expense increased by $46,000, or 23.4%, comparing the three months ended September 30, 2018 and 2017, due to higher Pennsylvania Bank Shares Tax. The Pennsylvania Bank Shares Tax is a shareholders equity-based tax and is subject to increases based on state government budget proposals and the level of the stockholders equity base that increased with the New Windsor merger. Supplies and postage expense decreased by 2.1% due to variation in timing of sporadic refills. FDIC and regulatory expense increased 1.8% based on higher net asset base offset by FDIC rate decreases and state regulatory rate increases. Intangible amortization decreased 9.3% due to fully amortized insurance books of business. Other operating expenses increased by $98,000, or 9.7%, in the third quarter of 2018, as compared to the third quarter of 2017. Increases included increases for increased insurance, retail product improvement and corporate governance expense. Losses, which include the expense of reimbursing debit card customers for unauthorized transactions to their accounts resulting from various merchant database breaches and other third-party fraudulent use, added approximately $19,000 to other expenses in the third quarter of 2018 compared to $11,000 in the third quarter of 2017. Third-party breaches also cause additional card inventory and processing costs to the Corporation, none of which is expected to be recovered from the third-party merchants or other parties where the breaches occur. The debit card electronic delivery channel is valued by customers and provides significant revenue to the Corporation. The expense related to reimbursements is unpredictable and varying, but ACNB has policies and procedures to limit exposure.

Provision for Income Taxes

The Corporation recognized income taxes of $1,443,000, or 19.3% of pretax income, during the third quarter of 2018, as compared to $713,000, or 27.2% of pretax income, during the same period in 2017. The variances from the federal statutory rate of 21% and 35% in the respective periods are generally due to tax-exempt income from investments in and loans to state and local units of government at below-market rates (an indirect form of taxation), investment in bank-owned life insurance, and investments in low-income housing partnerships (which qualify for federal tax credits). In addition, 2018 includes Maryland corporation income taxes. Low-income housing tax credits were $72,000 for the three months ended September 30, 2018 and 2017, respectively.

Nine Months ended September 30, 2018, compared to Nine Months ended September 30, 2017

Executive Summary

Net income for the nine months ended September 30, 2018, was $16,459,000, compared to $7,271,000 for the same nine months in 2017, an increase of $9,188,000 or 126.4%. Basic earnings per share was $2.34 in 2018 and $1.14 in 2017. The higher net income was a result of the additional revenues and cost efficiencies of the acquisition of New Windsor on July 1, 2017, as well as organic net revenue growth. In addition, net income was aided by a lower effective tax rate due to the Tax Cuts and Jobs Act effective on January 1, 2018.

Net interest income for the nine months ended September 30, 2018 increased $9,207,000, or 28.0%, as increases in total interest income were greater than increases in total interest expense including net interest income earned on the acquired earning asset and paying liabilities acquired from New Windsor. Provision for loan losses was $770,000 for the nine months ended September 30, 2018, compared to $0 for the same nine months in 2017, based on the adequacy analysis of the allowance for loan losses calculation at the end of each period, resulting in an allowance to total loans of 1.05% at September 30, 2018. Other income increased $1,614,000, or 15.3%, due in part to increases from the New Windsor sources, primarily deposit fees along with insurance commissions and trust fee increases. Other expenses decreased $408,000, or 1.2%, due to $4,675,000 merger-related expenses incurred in 2017 mostly offset by higher expenses related to the operation of the new southern market, NWSB Bank, A Division of ACNB Bank along with increasing technology and corporate governance costs.

Net Interest Income

Net interest income totaled $42,066,000 for the nine months ended September 30, 2018, compared to $32,859,000 for the same period in 2017, an increase of $9,207,000, or 28.0%. Net interest income increased due to an increase in interest income to a greater extent than an increase in interest expense. Interest income increased $10,797,000, or 29.5%, due to a 20.1% increase in average earning asset volume from organic growth and the July 1, 2017, addition of New Windsor assets and increased rates based on purchase accounting adjustments. The increase in interest expense resulted from deposit rate increases in addition to organic deposit growth and the addition of New Windsor deposits. Increased lending was a result of the New Windsor acquisition and a concerted effort by management to offset the recent years trend of interest income decreases due to the market area s heightened competition and declines in the U.S. Treasury yields and other market driver interest rates. Only in recent quarters has this trend reversed to somewhat higher yields although the difference between longer term rates and shorter term rates is compressed. These driver rates affect new loan originations and are indexed to a portion of the loan portfolio in that a change in the driver rates changes the yield on new loans and on existing loans at subsequent interest rate reset dates. In this manner, interest income yield was negatively affected as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates in recent years. Interest income increased on investment securities with the investments acquired from New Windsor and due to higher market rates. An appropriate amount of earning assets remained in short-term, low-rate money market type accounts during the first nine months of 2018; and there exists ample ability to borrow for liquidity needs. The ability to increase lending is contingent on the effects of intense competition that can reduce new loans and may result in the payoff of existing loans, as well as economic conditions in the Corporation s marketplace. As to funding costs, interest rates on alternative funding sources, such as the FHLB, and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the first nine months of 2018, several of the core deposit rates continued at appropriate rates in response to continued low rates on earning assets. Interest expense increased $1,590,000, or 42.5%, due to increased volume for the New Windsor acquired deposits and due to higher rates on transaction deposits, certificate of deposit rate increases and use of higher cost borrowings. This trend of higher rates is expected to continue due to higher rates at competing banks due to liquidity needs in conjunction with the Federal Reserve FOMC raising short-term rates starting in mid-December 2015 and continuing into 2018. For more information about interest rate risk, please refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and filed with the SEC on March 9, 2018. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the first nine months of 2018 was 3.65% compared to 3.45% during the same period in 2017. Also comparing the first nine months of 2018 to 2017, the yield on interest earning assets increased by 0.31% and the cost of interest bearing liabilities increased by 0.11%. The net interest margin was 3.78% for the first nine months of 2018 and 3.55% for the first nine months of 2017. The net interest margin increase was mainly a result of purchase accounting adjustments which added 19 basis points and acquiring and originating loans at the current market rate in order to increase loan volume and attempt to maintain total net interest income net of purchasing lower yielding investments to properly collateralize local government accounts and repurchase agreements.

Average earning assets were $1,488,000,000 during the first nine months of 2018, an increase of $249,000,000 from the average for the first nine months of 2017. Average interest bearing liabilities were $1,161,000,000 in the first nine months of 2018, an increase of $166,000,000 from the same period in 2017. Non-interest demand deposits increased $75,000,000 on average.

Provision for Loan Losses

The provision for loan losses was $770,000 in the first nine months of 2018 and $0 in the first nine months of 2017. The determination of a need for a provision was a result of the analysis of the adequacy of the allowance for loan losses calculation.

The allowance for loan and lease losses does not include the loans acquired from the New Windsor acquisition which were recorded at fair value as of the acquisition date. Without the New Windsor loans, total impaired loans at September 30, 2018 were 24.0% lower compared to December 31, 2017. Nonaccrual loans decreased by 37.7%, or $2,393,000, since December 31, 2017; all substandard loans decreased by 11.9% in that period. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. Management concluded that the loan portfolio exhibited continued general improvement in quantitative and qualitative measurements as shown in the tables and narrative in this Management s Discussion and Analysis and the Notes to the Consolidated Financial Statements. This assessment concluded that credit quality was stable, charge offs were low, and past due loans manageable. This same analysis concluded that the unallocated allowance should be in the same range in 2018 compared with the previous quarter. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the first nine months of 2018, the Corporation had net charge-offs of $1,332,000, as compared to net charge-offs of $89,000 for the first nine months of 2017.

Other Income

Total other income was $12,154,000 for the nine months ended September 30, 2018, up $1,614,000, or 15.3%, from the first nine months of 2017. Fees from deposit accounts increased by $408,000, or 19.8%, due to variations in volume from organic growth and the New Windsor acquisition. Fee volume varies with balance levels, account transaction activity, and customer-driven events such as overdrawing account balances. Various specific government regulations effectively limit fee assessments related to deposit accounts, making future revenue levels uncertain. Revenue from ATM and debit card transactions increased by $524,000 or 42.6%, to $1,753,000 due to variations in volume and mix including volume from New Windsor customers. The longer term trend had been increases resulting from consumer desire to use more electronic delivery channels; however, regulations or legal challenges for large financial institutions may impact industry pricing for such transactions and fees in connection therewith in future periods, the effect of which cannot be currently quantified. A more immediate challenge to this revenue source is the retail system-wide security breaches in the merchant base that are negatively affecting consumer confidence in the debit card channel. Income from fiduciary, investment management and brokerage activities, which includes fees from both institutional and personal trust, investment management services, estate settlement and brokerage services, totaled $1,762,000 for the nine months ended September 30, 2018, as compared to $1,409,000 for the first nine months of 2017, a 25.1% net increase as a net result of higher fee volume from increased assets under management, higher sporadic estate fee income and fees on brokerage relationships brought over in the New Windsor acquisition. Earnings on bank-owned life insurance decreased by $0, or 0.0%, as a result of offsetting crediting rates and volume, an additional $52,000 was received on a death claim. At the Corporation s wholly-owned insurance subsidiary, Russell Insurance Group, Inc. (RIG), revenue was up by $327,000, or 8.1%, to $4,358,000 during the period due to higher contingent commission and direct bill commissions. A continuing risk to RIG revenue is nonrenewal of large commercial accounts and actions by insurance carriers to reduce commissions paid to agencies such as RIG. Contingent or extra commission payments from insurance carriers are received in the second quarter of each year. Heightened pressure on commissions is expected to continue in this business line from insurance company actions to lower commissions. There was $44,000 in gains on odd lot sale of MBS security tails and a corporate bond during the first nine months of 2018 and no gains or losses on sales of securities during the first nine months of 2017, however a $50,000 net loss was recognized on local bank and CRA-related equity securities since the adoption of ASU 2016-01 on January 1, 2018. Other income in the nine months ended September 30, 2018, was down by $44,000, or 4.4%, to $963,000 due to higher sales of residential mortgages offset by the timing of an annual printed check incentive receipt.

Impairment Testing

RIG has certain long-lived assets, including purchased intangible assets subject to amortization, such as insurance books of business, and associated goodwill assets, which are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statement of condition and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill, which has an indefinite useful life, is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. Accounting rules permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The goodwill impairment analysis currently used by the Corporation is a two-step test. The first step, used to identify potential impairment, involves comparing the reporting unit s estimated fair value to its carrying value, including goodwill.

If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. Further, a new FASB update eliminates the second step test, thus basing impairment on the estimated fair value to the carrying value including goodwill.

The testing for potential impairment involves methods that include both current and projected income amounts, and RIG s fair value remained above the carrying value as of the most recent annual impairment test date. Thus, the results of the annual evaluations determined that there was no impairment of RIG s goodwill, including the testing at October 1, 2017. However, declines in RIG s net income or changes in external market factors, including likely buyers that are assumed in impairment testing, may require an impairment charge to goodwill. The Corporation has not identified any such events, and, accordingly, has not tested goodwill resulting from the acquisition of New Windsor for impairment during the nine months ended June 30, 2018. ACNB plans on testing New Windsor goodwill during 2018. Should it be determined in a future period that the goodwill has been impaired, then a charge to earnings will be recorded in the period that such a determination is made.

Other Expenses

Other expenses for the nine months ended September 30, 2018 were $33,093,000, a decrease of $408,000 or 1.2%. Acquisition and integration costs related to the New Windsor acquisition totaled $0 for the first nine months of 2018 compared to $4,675,000 for the first nine months of 2017. Merger expenses in all of 2017 included legal and consulting expenses to effect the legal merger, investment banking and preparing purchase accounting adjustments. Integration expenses included certain severance payments to New Windsor staff separated by the merger, consultant costs to integrate New Windsor bank systems into ACNB s, and the cost to terminate all New Windsor core banking and electronic technology systems contracts. These costs were all necessary to provide requisite internal controls and cost effective core banking technology systems going forward. The costs of integrating all systems into one system was important to the merger viability, ongoing system integrity, and realization of cost reductions.

The largest component of other expenses is salaries and employee benefits, which increased by $1,473,000, or 8.0%, when comparing the first nine months of 2018 to the same period a year ago. Overall, the increase in salaries and employee benefits was the result of:

- retaining customer-facing staff in a competitive labor market;

- increased staff in support functions and higher skilled mix of employees necessitated by regulations and growth;

- normal merit increases to employees and associated payroll taxes;

- varying performance-based commissions and incentives;

- higher employee benefit plan costs, including health insurance;

- increases related to 401(k) plan and non-qualified retirement plan benefits; and,

- defined benefit pension expense, which was down by $323,000, or (326.3)%, when comparing the nine months ended September 30, 2018, to the nine months ended September 30, 2017, resulting from the change in discount rates which increases or decreases the future pension obligations (creating volatility in the expense), return on assets at the latest annual evaluation date due to market conditions and changes in actuarial assumptions reflecting increased longevity.

The Corporation s overall pension plan investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation s risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements.

However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date, which in recent years has experienced fair value volatility and low discount rates. The expense could also be higher in future years due to volatility in the discount rates at the latest measurement date, lower plan returns, and change in mortality tables utilized. The ACNB plan has maintained a well-funded status under ERISA rules.

Net occupancy expense increased by $489,000, or 28.6%, mostly due to seven more offices from the New Windsor acquisition. Equipment expense increased by $1,093,000, or 41.0% due to instituting technologies for upcoming accounting-related changes as well as ongoing support and maintenance of financial systems applications and security technology. Equipment expense is subject to ever-increasing technology demands and the need for system upgrades for security and reliability purposes. In addition, debit card processing increased due to more volume.

Professional services, not including merger expense, totaled $1,084,000 during the first nine months of 2018, as compared to $807,000 for the same period in 2017, an increase of $277,000, or 34.3%. This category includes expenses related to legal corporate governance, risk, compliance management and audit engagements, and legal counsel matters in connection with loans. It varies with specific engagements that are not on a regular recurring basis.

Marketing and corporate relations expenses were $366,000 for the first nine months of 2018, or 14.0% higher, as compared to the same period of 2017. Marketing expense varies with the timing and amount of planned advertising production and media expenditures, typically related to the promotion of certain in-market banking and trust products.

Foreclosed assets held for resale consist of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expense was $105,000 and $51,000 for the nine months ended September 30, 2018 and 2017, respectively. The expense varies based upon the number and mix of commercial and residential real estate properties, unpaid property taxes, and deferred maintenance required upon acquisition. In addition, some properties suffer decreases in value after acquisition, requiring write-downs to fair value during the prolonged marketing cycles for these distressed properties. The higher expense in 2018 is related to properties with high remediation and carrying costs. Foreclosed assets held for resale expenses or recoveries will vary in the remainder of 2018 depending on the successful closing of sales agreements on some existing properties and the unknown expenses related to new properties acquired.

Other tax expense increased by $108,000, or 18.8%, comparing the nine months ended September 30, 2018 and 2017, due to 2017 recoveries on a sales tax challenge received partially offsetting higher Pennsylvania Bank Shares Tax. The Pennsylvania Bank Shares Tax is a shareholders equity-based tax and is subject to increases based on state government budget proposals. Supplies and postage expense increased by 9.7% due to variation in timing of sporadic refills and increased New Windsor volume. FDIC and regulatory expense increased 16.0% based on higher net asset base offset by FDIC rate decreases and state regulatory rate increases. Intangible amortization increased 52.4% due to amortization of core deposit intangible from the New Windsor acquisition. Other operating expenses increased by $419,000, or 14.1%, in the first nine months of 2018, as compared to the first nine months of 2017. Increases included increases for electronic delivery and telecommunications for the expanded New Windsor customer base and offices and increased corporate governance expense. Losses, which include the expense of reimbursing debit card customers for unauthorized transactions to their accounts resulting from various merchant database breaches and other third-party fraudulent use, added approximately $90,000 to other expenses in the first nine months of 2018 compared to $70,000 in the first nine months of 2017. Third-party breaches also cause additional card inventory and processing costs to the Corporation, none of which is expected to be recovered from the third-party merchants or other parties where the breaches occur. The debit card electronic delivery channel is valued by customers and provides significant revenue to the Corporation. The expense related to reimbursements is unpredictable and varying, but ACNB has policies and procedures to limit exposure.

Provision for Income Taxes

The Corporation recognized income taxes of $3,898,000, or 19.1% of pretax income, during the first nine months of 2018, as compared to $2,627,000, or 26.5% of pretax income, during the same period in 2017. A change of tax law statutory rates under the Tax Cuts and Jobs Act lowered the effective tax rate. The variances from the federal statutory rate of 21% and 35% in the respective periods are generally due to tax-exempt income from investments in and loans to state and local units of government at below-market rates (an indirect form of taxation), investment in bank-owned life insurance, and investments in low-income housing partnerships (which qualify for federal tax credits). In addition, 2018 includes Maryland corporation income taxes. Low-income housing tax credits were $215,000 for the nine months ended September 30, 2018 and 2017, respectively.

FINANCIAL CONDITION

Assets totaled $1,647,799,000 at September 30, 2018, compared to $1,595,432,000 at December 31, 2017, and $1,607,635,000 at September 30, 2017. Average earning assets during the nine months ended September 30, 2018, increased to $1,487,560,000 from $1,262,000,000 during the same period in 2017. Average interest bearing liabilities increased in 2018 to $1,160,675,000 from $1,002,000,000 in 2017, while average non-interest bearing deposits increased by $74,730,000.

Investment Securities

ACNB uses investment securities to generate interest and dividend income, manage interest rate risk, provide collateral for certain funding products, and provide liquidity. The changes in the securities portfolio were from the New Windsor acquisition (available for sale fair value at acquisition of $21,624,000) net of purchases and matured securities to provide proper collateral for public deposits. Investing into investment security portfolio assets over the last several years was made more challenging due to the Federal Reserve Bank s program commonly called Quantitative Easing in which, by the Federal Reserve s open market purchases, the yields are maintained at a lower level than would otherwise be the case. The investment portfolio is comprised of U.S. Government agency, municipal, and corporate securities. These securities provide the appropriate characteristics with respect to credit quality, yield and maturity relative to the management of the overall balance sheet.

At September 30, 2018, the securities balance included a net unrealized loss on available for sale securities of $3,199,000, net of taxes, on amortized cost of $167,089,000 versus a net unrealized loss of $957,000, net of taxes, on amortized cost of $160,290,000 at December 31, 2017, and a net unrealized gain of $40,000, net of taxes, on amortized cost of $158,330,000 at September 30, 2017. The change in fair value of available for sale securities during 2018 was a result of the securities acquired from New Windsor and the higher amount of investments in the available for sale portfolio, offset by a decrease in fair value from an increase in the U.S. Treasury yield curve rates and the spread from this yield curve required by investors on the types of investment securities that ACNB owns. The Federal Reserve ceased their rate-decreasing Quantitative Easing program in 2014 and increased the fed funds rate in mid-December 2015 through 2018 that has caused the U.S. Treasury yield curve to increase in the time relevant to the investment securities in the Corporation s portfolio as of September 30, 2018. Previously, after a prolonged period of inaction by the Federal Reserve after lowering rates on the yield curve most conducive to stimulating the housing market and to boost employment and consumption was augmented by a combination of weak domestic and international economic conditions, leading to generally lower rates on the yield curve. However, fair values were volatile on any given day in all periods presented and such volatility will continue.

At September 30, 2018, the securities balance included held to maturity securities with an amortized cost of $33,517,000 and a fair value of $32,767,000, as compared to an amortized cost of $44,829,000 and a fair value of $44,549,000 at December 31, 2017, and an amortized cost of $47,369,000 and a fair value of $47,373,000 at September 30, 2017. The held to maturity securities are U.S. government agency debentures and pass-through mortgage-backed securities in which the full payment of principal and interest is guaranteed; however, they were not classified as available for sale because these securities are generally used as required collateral for certain eligible government accounts or repurchase agreements. They are also held for possible pledging to access additional liquidity for banking subsidiary needs in the form of FHLB borrowings. No held to maturity securities were acquired from New Windsor.

The Corporation does not own investments consisting of pools of Alt-A or subprime mortgages, private label mortgage-backed securities, or trust preferred investments.

The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1) or by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt

securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses independent service providers to provide matrix pricing. Please refer to Note 8 Securities in the Notes to Consolidated Financial Statements for more information on the security portfolio and Note 10 Fair Value Measurements in the Notes to Consolidated Financial Statements for more information about fair value.

Loans

Loans outstanding increased by $36,076,000, or 2.9%, from September 30, 2017, to September 30, 2018, and increased by $28,276,000, or 2.3%, from December 31, 2017, to September 30, 2018. The low growth year to date is attributable to intense competition and early payoffs. The year over year increase in loan volume was primarily from the fair value acquired from New Windsor of $263,450,000 at July 1, 2017 and the balance was a net increase of new loans net of payoff and paydowns.

These results came from the determined efforts by management to lend to creditworthy borrowers subject to the Corporation s disciplined underwriting standards, despite intense competition. In all periods, residential real estate lending and refinance activity was slow and commercial loans were subject to refinancing to competition for different rates or terms. As a normal course of business, more payoffs are anticipated in the remainder of 2018 from either customers cash reserves or refinancing at competing banks. Nonetheless, during the first nine months of 2018, total commercial purpose loans slightly increased while local market portfolio residential mortgages increased but to a lesser extent. Total commercial purpose segments increased $23,479,000, or 3.4%, as compared to December 31, 2017. These loans are spread among diverse categories that include municipal governments/school districts, commercial real estate, commercial real estate construction, and commercial and industrial. Included in the commercial, financial and agricultural category are loans to Pennsylvania school districts, municipalities (including townships) and essential purpose authorities. In most cases, these loans are backed by the general obligation of the local government body. In many cases, these loans are obtained through a bid process with other local and regional banks. The loans are bank qualified for mostly tax free interest income treatment for federal income taxes. These loans totaled $89,119,000 at September 30, 2018, an increase of 1% from $88,484,000 held at the end of 2017 as these loans are especially subject to refinancing. Residential real estate mortgage lending, which includes smaller commercial purpose loans secured by the owner s home, increased by $6,529,000, or 1.2%, as compared to December 31, 2017. These loans are to local borrowers who preferred loan types that would not be sold into the secondary mortgage market. Of the $540,214,000 total in residential mortgage loans at September 30, 2018, $142,320,000 were secured by junior liens or home equity loans, which are also in many cases junior liens. Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a senior security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market weakens, property values deteriorate, or rates increase sharply. Non-real estate secured consumer loans comprise 1.1% of the portfolio, with automobile-secured loans representing 0.0% of the portfolio.

Most of the Corporation s lending activities are with customers located within southcentral Pennsylvania and in the northern Maryland area. This region currently and historically has lower unemployment rates than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential properties that total $278,767,000, or 21.9% of total loans, at September 30, 2018. These borrowers are geographically dispersed throughout ACNB s marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and other commercial purpose facilities. Because of the varied nature of the tenants, in aggregate, management believes that these loans present an acceptable risk when compared to commercial loans in general. ACNB does not originate or hold Alt-A or subprime mortgages in its loan portfolio.

Allowance for Loan Losses

ACNB maintains the allowance for loan losses at a level believed to be adequate by management to absorb probable losses in the loan portfolio, and it is funded through a provision for loan losses charged to earnings. On a quarterly basis, ACNB utilizes a defined methodology in determining the adequacy of the allowance for loan losses, which considers specific credit reviews, past loan losses, historical experience, and qualitative factors. This methodology results in an allowance that is considered appropriate in light of the high degree of judgment required and that is prudent and conservative, but not excessive.

Management assigns internal risk ratings for each commercial lending relationship. Utilizing historical loss experience, adjusted for changes in trends, conditions, and other relevant factors, management derives estimated losses for non-rated and non-classified loans. When management identifies impaired loans with uncertain collectibility of principal and interest, it evaluates a specific reserve on a quarterly basis in order to estimate potential losses. Management s analysis considers:

- adverse situations that may affect the borrower s ability to repay;
- the current estimated fair value of underlying collateral; and,

- prevailing market conditions.

If management determines a loan is not impaired, a specific reserve allocation is not required. Management then places the loan in a pool of loans with similar risk factors and assigns the general loss factor to determine the reserve. For homogeneous loan types, such as consumer and residential mortgage loans, management bases specific allocations on the average loss ratio for the previous twelve quarters for each specific loan pool. Additionally, management adjusts projected loss ratios for other factors, including the following:

- lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;

- national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans;

- nature and volume of the portfolio and terms of loans;

- experience, ability and depth of lending management and staff;

- volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,

- existence and effect of any concentrations of credit and changes in the level of such concentrations.

Management determines the unallocated portion of the allowance for loan losses, which represents the difference between the reported allowance for loan losses and the calculated allowance for loan losses, based on the following criteria:

- the risk of imprecision in the specific and general reserve allocations;

- the perceived level of consumer and small business loans with demonstrated weaknesses for which it is not practicable to develop specific allocations;

- other potential exposure in the loan portfolio;

- variances in management s assessment of national, regional and local economic conditions; and,

- other internal or external factors that management believes appropriate at that time.

The unallocated portion of the allowance is deemed to be appropriate as it reflects an uncertainty that remains in the loan portfolio; specifically reserves where the Corporation believes that tertiary losses are probable above the loss amount derived using appraisal-based loss estimation, where such additional loss estimates are in accordance with regulatory and GAAP guidance. Appraisal-based loss derivation does not fully develop the loss present in certain unique, ultimately bank-owned collateral. The Corporation has determined that the amount of provision in 2018 and the resulting allowance at September 30, 2018, are appropriate given the continuing level of risk in the loan portfolio. Further,

management believes the unallocated allowance is appropriate, because even though the impaired loans decreased since 2017 the growth in the loan portfolio is centered around commercial real estate which continues to have little increase in value and low liquidity. In addition, there are certain loans that, although they did not meet the criteria for impairment, management believes there was a strong possibility that these loans represented potential losses at September 30, 2018. The amount of unallocated portion of the allowance was decreased at September 30, 2018 as management concluded that the loan portfolio exhibited continued general improvement in quantitative and qualitative measurements. This assessment concluded that credit quality was stable, charge offs were low, and past due loans manageable.

Management believes the above methodology accurately reflects losses inherent in the portfolio. Management charges actual loan losses to the allowance for loan losses. Management periodically updates the methodology and the assumptions discussed above.

Management bases the provision for loan losses, or lack of provision, on the overall analysis taking into account the methodology discussed above, which is consistent with recent improvement in the credit quality in the loan portfolio. The provision for year-to-date September 30, 2018 and 2017, was $770,000 and $0, respectively. More specifically, even though total loans increased and the provision expense increased, the allowance for loan losses was derived with data that most impaired credits were, in the opinion of management, adequately collateralized.

Federal and state regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management s comprehensive analysis of the loan portfolio and economic conditions, management believes the current level of the allowance for loan losses is adequate.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model).

Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. Upon adoption, the change in this accounting guidance could result in an increase in the Corporation s allowance for loan losses and require the Corporation to record loan losses more rapidly.

The allowance for loan losses at September 30, 2018, was $13,414,000, or 1.05% of loans, as compared to $14,105,000, or 1.14% of loans, at September 30, 2017, and $13,976,000, or 1.12% of loans, at December 31, 2017. The decrease from prior periods resulted from charge-offs exceeding recoveries and provisions, as shown in the table below. In the following discussion, acquired loans from New Windsor were recorded at fair value at the acquisition date and are not included in the tables and information below, see more information in Note 9 Loans in the Notes to Consolidated Financial Statements.

Changes in the allowance for loan losses were as follows:

In thousands	Nine Months Ended September 30, 2018	Year Ended December 31, 2017	Nine Months Ended September 30, 2017
Beginning balance - January 1	**$ 13,976**	$ 14,194	$ 14,194
Provisions charged to operations	**770**		
Recoveries on charged-off loans	**167**	243	183
Loans charged-off	**(1,499)**	(461)	(272)
Ending balance	**$ 13,414**	$ 13,976	$ 14,105

Loans past due 90 days and still accruing were $2,342,000 and nonaccrual loans were $3,962,000 as of September 30, 2018. $2,527,000 of the nonaccrual balance at September 30, 2018, were in troubled debt restructured loans. $3,907,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $1,626,000 at September 30, 2017, while nonaccruals were $6,695,000. $3,434,000 of the nonaccrual balance at September 30, 2017, was in troubled debt restructured loans. $3,939,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $1,507,000 at December 31, 2017, while nonaccruals were $6,355,000. $3,405,000 of the nonaccrual balance at December 31, 2017, were in troubled debt restructured loans. $3,982,000 of the impaired loans were accruing troubled debt restructured loans. Total additional loans classified as substandard (potential problem loans) at September 30, 2018, September 30, 2017, and December 31, 2017, were approximately $1,406,000, $8,029,000 and $1,064,000, respectively.

The acquisition of New Windsor loans at fair value did not require a provision expense. More specifically, even with the manageable level of nonaccrual loans and with substandard loans in the third quarter of 2018, a $200,000 provision addition to the allowance was necessary due to the level of charge-offs making the total provision for the year to date of $770,000. As to nonaccrual and substandard loans, management believes that adequate collateralization generally exists for these loans in accordance with GAAP. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors.

Information on nonaccrual loans, by collateral type rather than loan class, at September 30, 2018, as compared to December 31, 2017, is as follows:

Dollars in thousands	Number of Credit Relationships	Balance	Specific Loss Allocations	Current Year Charge-Offs	Location	Originated
September 30, 2018						
Owner occupied commercial real estate	**7**	**$ 3,281**	**$**	**$ 33**	**In market**	**1995 - 2012**
Investment/rental residential real estate	**1**	**533**		**376**	**In market**	**2003 - 2011**
Commercial and industrial				**809**	**In market**	**2006 - 2015**
Total	**8**	**$ 3,814**	**$**	**$ 1,218**		
December 31, 2017						
Owner occupied commercial real estate	9	4,378	60		In market	1995 - 2012
Investment/rental residential real estate	2	478	377		In market	2003 - 2011
Commercial and industrial	3	1,499	792		In market	2006 - 2015
Total	14	$ 6,355	$ 1,229	$		

Management deemed it appropriate to provide this type of more detailed information by collateral type in order to provide additional detail on the loans.

All nonaccrual impaired loans are to borrowers located within the market area served by the Corporation in southcentral Pennsylvania and nearby areas of northern Maryland. All nonaccrual impaired loans were originated by ACNB s banking subsidiary, except for one participation loan discussed below, between 1995 and 2015 for purposes listed in the classifications in the table above.

Owner occupied commercial real estate and construction at September 30, 2018, includes seven unrelated loan relationships, all of which, except for a $2,256,000 loan relationship for a retreat property, have balances of less than $431,000 each, for which the real estate is collateral and is used in connection with a business enterprise that is suffering economic stress or is out of business. The retreat property loan originated in 2008 was added to nonaccrual in the second quarter of 2017 and is supported by adequate collateral. One of two improved parcels is being actively marketed for sale. Another property added in the second quarter of 2017 is an $832,000 loan with modified terms and conditions originated in 2011 secured by a tourism related lodging real estate that was assigned $60,000 in specific allocation based on a sales contract. The property was sold in 2018 at a smaller loss. A third property added in the second quarter 2017 was a $597,000 loan relationship ($444,000 in commercial and industrial and $153,000 in owner occupied commercial real estate) with normal terms and conditions secured by a construction business assets that was charged off in 2018 with a $367,000 loss. The other loans in this category were originated between 1995 and 2012 and are business loans impacted by specific borrower credit situations. Most loans in this category are making principal payments. Collection efforts will continue unless it is deemed in the best interest of the Corporation to initiate foreclosure procedures.

Investment/rental residential real estate at September 30, 2018, includes one loan relationships totaling $533,000 for which the real estate is collateral and the purpose of which is for speculation, rental, or other non-owner occupied uses. One loan with multiple separate rental houses was added in the second quarter of 2016 and the $376,000 specific loss allocation was charged off in 2018. One unrelated loan for approximately $101,000 in this category at April 2015, was stayed from further foreclosure action by a bankruptcy filing.

All impaired commercial and industrial loans at September 30, 2018 were settled, one participation loan with standard terms and conditions including repayment from conversion of trade assets for a business in southcentral Pennsylvania in Chapter 11 bankruptcy that has a balance of $0 after $1,717,000 in principal payments since it was moved to nonaccrual in the third quarter of 2014 after becoming delinquent. An unrelated $868,000 commercial loan relationship to finance a subcontract and change orders was moved to nonaccrual in the fourth quarter of 2016 with a $517,000 specific allocation when part of the amount due to the subcontractor to perform on the loan was in dispute with the contractor and continues to be litigated.

The loan was settled in the second quarter of 2018 with a $442,000 charge off.

The Corporation utilizes a systematic review of its loan portfolio on a quarterly basis in order to determine the adequacy of the allowance for loan losses. In addition, ACNB engages the services of an outside independent loan review function and sets the timing and coverage of loan reviews during the year. The results of this independent loan review are included in the systematic review of the loan portfolio. The allowance for loan losses consists of a component for individual loan impairment, primarily based on the loan s collateral fair value and expected cash flow. A watch list of loans is identified for evaluation based on internal and external loan grading and reviews. Loans other than those determined to be impaired are grouped into pools of loans with similar credit risk characteristics. These loans are evaluated as groups with allocations made to the allowance based on historical loss experience adjusted for current trends in delinquencies, trends in underwriting and oversight, concentrations of credit, and general economic conditions within the Corporation s trading area. The provision expense was based on the loans discussed above, as well as current trends in the watch list and the local economy as a whole. The charge-offs discussed elsewhere in this Management s Discussion and Analysis create the recent loss history experience and result in the qualitative adjustment which, in turn, affects the calculation of losses inherent in the portfolio. The provision for loan losses (or lack thereof) for 2018 and 2017 was a result of the measurement of the adequacy of the allowance for loan losses at each period.

Premises and Equipment

During the quarter ended June 30, 2016, a building was sold and the Corporation is leasing back a portion of that building. In connection with these transactions, a gain of $1,147,000 was realized, of which $447,000 was recognized in the quarter ended June 30, 2016 and the remaining $700,000 deferred for future recognition over the lease back term. A reduction of lease expense of $53,000 was recognized in the first nine months of 2018. A reduction of lease expense of $53,000 was recognized in the first nine months of 2017. ACNB valued six buildings acquired from New Windsor at $8,624,000 at July 1, 2017.

Foreclosed Assets Held for Resale

Foreclosed assets held for resale consists of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. These fair values, less estimated costs to sell, become the Corporation s new cost basis. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. The carrying value of real estate acquired through foreclosure totaled $63,000 for one property and borrower at September 30, 2018, compared to $436,000 for three unrelated properties and borrowers at December 31, 2017. The decrease in the carrying value was due to the properties sold in 2018. All properties are being actively marketed. The Corporation expects to obtain and market additional foreclosed assets through the remainder of 2018; however, the total amount and timing is currently not certain.

Deposits

ACNB relies on deposits as a primary source of funds for lending activities with total deposits of $1,347,243,000 as of September 30, 2018. Deposits increased by $35,359,000, or 2.7%, from September 30, 2017, to September 30, 2018, and increased by $48,751,000, or 3.8%, from December 31, 2017, to September 30, 2018. Deposits acquired from New Windsor totaled $293,333,000 on July 1, 2017. Deposits vary between quarters mostly reflecting different levels held by local government and school districts during different times of the year. ACNB s deposit pricing function employs a disciplined pricing approach based upon alternative funding rates, but also strives to price deposits to be competitive with relevant local competition, including a local government investment trust, credit unions and larger regional banks. During the recession and subsequent slow recovery, deposit growth mix experienced a shift to transaction accounts as customers put more value in liquidity and FDIC insurance. Products, such as money market accounts and interest-bearing transaction accounts that had suffered declines in past years,

continued with recovered balances; however, more recent trends suggest a return to more normal, lower balances. ACNB s ability to maintain and add to its deposit base may be impacted by the reluctance of consumers to accept low rates and by competition willing to pay above market rates to attract market share. Alternatively, if rates rise rapidly and the equity markets recover, funds could leave the Corporation or be priced higher to maintain deposits.

Borrowings

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase and short-term borrowings from the FHLB. As of September 30, 2018, short-term borrowings were $38,525,000, as compared to $36,908,000 at December 31, 2017, and $33,806,000 at September 30, 2017. Agreements to repurchase accounts are within the commercial and local government customer base and have attributes similar to core deposits. Investment securities are pledged in sufficient amounts to collateralize these agreements. In comparison to year-end 2017, repurchase agreement balances were up $1,617,000, or 4.4%, due to changes in the cash flow position of ACNB s commercial and local government customer base and competition from non-bank sources. There were no short-term FHLB borrowings at September 30, 2018, December 31, 2017, and September 30, 2017.

Short-term FHLB borrowings are used to even out funding from seasonal and daily fluctuations in the deposit base. Long-term borrowings consist of longer-term advances from the FHLB that provides term funding of loan assets, and Corporate borrowings that were acquired or originated in regards to the acquisition of New Windsor. Long-term borrowings totaled $84,725,000 at September 30, 2018, versus $94,600,000 at December 31, 2017, and $96,850,000 at September 30, 2017. The Corporation decreased long-term borrowings 12.5% from September 30, 2017. A $4.6 million borrowing from a local bank was made to fund cash payment to shareholders of the New Windsor acquisition and Russell Insurance Group, Inc. borrowed $1,000,000 from a local bank at the end of the third quarter 2018 to fund an impending book of business purchase. $11.0 million was the net decrease to FHLB borrowings to balance loan demand and deposit growth. Laddered FHLB fixed-rate term advances were taken in 2018 to mature from 2021 to 2022 to reduce net liability sensitivity. In addition, $5 million was subordinated debt acquired from New Windsor. Please refer to the *Liquidity* discussion below for more information on the Corporation s ability to borrow.

Capital

ACNB s capital management strategies have been developed to provide an appropriate rate of return, in the opinion of management, to stockholders, while maintaining its well-capitalized regulatory position in relationship to its risk exposure. Total stockholders equity was $164,512,000 at September 30, 2018, compared to $153,966,000 at December 31, 2017, and $153,256,000 at September 30, 2017. Stockholders equity increased in the first nine months of 2018 by $10,546,000 due to $11,899,000 in earnings retained in capital.

The acquisition of New Windsor resulted in 938,360 new ACNB shares issued to the New Windsor shareholders valued at $28,620,000 in 2017.

A $1,943,000 increase in accumulated other comprehensive loss was a result of a net increase in the fair value of the investment portfolio and changes in the net funded position of the defined benefit pension plan. Other comprehensive income or loss is mainly caused by fixed-rate investment securities gaining or losing value in different interest rate environments and changes in the net funded position of the defined benefit pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During the first nine months of 2018, ACNB earned $16,459,000 and paid dividends of $4,642,000 for a dividend payout ratio of 28.2%. During the first nine months of 2017, ACNB earned $7,271,000 and paid dividends of $3,829,000 for a dividend payout ratio of 52.7%.

ACNB Corporation has a Dividend Reinvestment and Stock Purchase Plan that provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. Year-to-date September 30, 2018, 11,822 shares were issued under this plan with proceeds in the amount of $391,000. Year-to-date September 30, 2017, 10,954 shares were issued under this plan with proceeds in the amount of $258,000. Proceeds are used for general corporate purposes.

ACNB Corporation has a Restricted Stock plan available to selected officers and employees of the Bank, to advance the best interest of ACNB Corporation and its shareholders. The plan provides those persons who have responsibility for its growth with additional incentive by allowing them to acquire an ownership in ACNB Corporation and thereby encouraging them to contribute to the success of the Corporation. To date, 26,045 shares were issued under this plan. Proceeds are used for general corporate purposes.

ACNB is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on ACNB. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, ACNB must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and reclassifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require ACNB to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. Management believes, as of September 30, 2018, and December 31, 2017, that ACNB s banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as well capitalized for regulatory purposes.

There are no subsequent conditions or events that management believes have changed the banking subsidiary s category.

Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2015, while larger institutions (generally those with assets of $250 billion or more) began compliance effective January 1, 2014. The final rules call for the following capital requirements:

- a minimum ratio of common Tier 1 capital to risk-weighted assets of 4.5%;
- a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%;
- a minimum ratio of total capital to risk-weighted assets of 8.0%; and,
- a minimum leverage ratio of 4.0%.

In addition, the final rules establish a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations began on January 1, 2016.

Under the initially proposed rules, accumulated other comprehensive income (AOCI) would have been included in a banking organization s common equity Tier 1 capital. The final rules allow community banks to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The opt-out election must be made in the first call report or FR Y-9 series report that is filed after the financial institution becomes subject to the final rule. The Corporation elected to opt-out.

The rules permanently grandfather non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010, for inclusion in the Tier 1 capital of banking organizations with total consolidated assets of less than $15 billion as of December 31, 2009, and banking organizations that were mutual holding companies as of May 19, 2010.

The proposed rules would have modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposures into two categories in order to determine the applicable risk weight. In response to commenter concerns about the burden of calculating the risk weights and the potential negative effect on credit availability, the final rules do not adopt the proposed risk weights, but retain the current risk weights for mortgage exposures under the general risk-based capital rules.

Consistent with the Dodd-Frank Act, the new rules replace the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures. Alternatively, banking organizations may use the existing gross-up approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250 percent risk weight.

Under the new rules, mortgage servicing assets and certain deferred tax assets are subject to stricter limitations than those applicable under the current general risk-based capital rule. The new rules also increase the risk weights for past due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

The Corporation calculated regulatory ratios as of September 30, 2018, and confirmed no material impact on the capital, operations, liquidity, and earnings of the Corporation and the banking subsidiary from the changes in the regulations.

Risk-Based Capital

ACNB Corporation considers the capital ratios of the banking subsidiary to be the relevant measurement of capital adequacy.

The banking subsidiary s capital ratios are as follows:

	September 30, 2018	December 31, 2017	To Be Well Capitalized Under Prompt Corrective Action Regulations
Tier 1 leverage ratio (to average assets)	**9.29%**	8.70%	5.00%
Common Tier 1 capital ratio (to risk-weighted assets)	**12.75%**	12.34%	6.50%
Tier 1 risk-based capital ratio (to risk-weighted assets)	**12.75%**	12.34%	8.00%
Total risk-based capital ratio	**13.90%**	13.58%	10.00%

Liquidity

Effective liquidity management ensures the cash flow requirements of depositors and borrowers, as well as the operating cash needs of ACNB, are met.

ACNB s funds are available from a variety of sources, including assets that are readily convertible such as interest bearing deposits with banks, maturities and repayments from the securities portfolio, scheduled repayments of loans receivable, the core deposit base, and the ability to borrow from the FHLB. At September 30, 2018, ACNB s banking subsidiary had a borrowing capacity of approximately $678,883,000 from the FHLB, of which $582,427,000 was available. Because of various restrictions and requirements on utilizing the available balance, ACNB considers $413,000,000 to be the practicable additional borrowing capacity, which is considered to be sufficient for operational needs. The FHLB system is self-capitalizing, member-owned, and its member banks stock is not publicly traded. ACNB creates its borrowing capacity with the FHLB by granting a security interest in certain loan assets with requisite credit quality. ACNB has reviewed information on the FHLB system and the FHLB of Pittsburgh, and has concluded that they have the capacity and intent to continue to provide both operational and contingency liquidity. The FHLB of Pittsburgh instituted a requirement that a member s investment securities must be moved into a safekeeping account under FHLB control to be considered in the calculation of maximum borrowing capacity. The Corporation currently has securities in safekeeping at the FHLB of Pittsburgh; however, the safekeeping account is under the Corporation s control. As better contingent liquidity is maintained by keeping the securities under the Corporation s control, the Corporation has not moved the securities which, in effect, lowered the Corporation s maximum borrowing capacity. However, there is no practical reduction in borrowing capacity as the securities can be moved into the FHLB-controlled account promptly if they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreements to customers of ACNB s banking subsidiary totaling approximately $38,525,000 and $36,908,000 at September 30, 2018, and December 31, 2017, respectively. These agreements vary in balance according to the cash flow needs of customers and competing accounts at other financial organizations.

The liquidity of the parent company also represents an important aspect of liquidity management. The parent company s cash outflows consist principally of dividends to stockholders and corporate expenses. The main source of funding for the parent company is the dividends it receives from its subsidiaries. Federal and state banking regulations place certain legal restrictions and other practicable safety and soundness restrictions

on dividends paid to the parent company from the subsidiary bank.

ACNB manages liquidity by monitoring projected cash inflows and outflows on a daily basis, and believes it has sufficient funding sources to maintain sufficient liquidity under varying degrees of business conditions.

Off-Balance Sheet Arrangements

The Corporation is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and, to a lesser extent, standby letters of credit. At September 30, 2018, the Corporation had unfunded outstanding commitments to extend credit of approximately $289,190,000 and outstanding standby letters of credit of approximately $4,479,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements.

Market Risks

Financial institutions can be exposed to several market risks that may impact the value or future earnings capacity of the organization. These risks involve interest rate risk, foreign currency exchange risk, commodity price risk, and equity market price risk. ACNB s primary market risk is interest rate risk. Interest rate risk is inherent because, as a financial institution, ACNB derives a significant amount of its operating revenue from purchasing funds (customer deposits and wholesale borrowings) at various terms and rates. These funds are then invested into earning assets (primarily loans and investments) at various terms and rates.

RECENT DEVELOPMENTS

BANK SECRECY ACT (BSA) - The Bank Secrecy Act, as amended by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act), imposes obligations on U.S. financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. Financial institutions also are required to respond to requests for information from federal banking agencies and law enforcement agencies. Information sharing among financial institutions for the above purposes is encouraged by an exemption granted to complying financial institutions from the privacy provisions of the Gramm-Leach-Bliley Act and other privacy laws. Financial institutions that hold correspondent accounts for foreign banks or provide banking services to foreign individuals are required to take measures to avoid dealing with certain foreign individuals or entities, including foreign banks with profiles that raise money laundering concerns and are prohibited from dealing with foreign shell banks and persons from jurisdictions of particular concern. The primary federal banking agencies and the Secretary of the Treasury have adopted regulations to implement several of these provisions. Effective May 11, 2018, the Bank must comply with the new Customer Due Diligence Rule, which clarified and strengthened the existing obligations for identifying new and existing customers and includes risk-based procedures for conducting ongoing customer due diligence. All financial institutions are also required to establish internal anti-money laundering programs. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act. The Corporation s banking subsidiary has a BSA and USA PATRIOT Act compliance program commensurate with its risk profile and appetite.

TAX CUTS AND JOBS ACT - On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. Among other changes, the Tax Cuts and Jobs Act reduces the federal corporate tax rate from 35% to 21% effective January 1, 2018. ACNB anticipates that this tax rate change should reduce its federal income tax liability in future years beginning with 2018. However, the Corporation did recognize certain effects of the tax law changes in 2017. U.S. generally accepted accounting principles require companies to revalue their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the reporting period of enactment. Since the enactment took place in December 2017, the Corporation revalued its net deferred tax assets in the fourth quarter of 2017, resulting in an approximately $1.7 million reduction to earnings in 2017.

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (DODD-FRANK) - In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Dodd-Frank was intended to effect a fundamental restructuring of federal banking regulation. Among other things, Dodd-Frank created the Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. Dodd-Frank additionally created a new independent federal regulator to administer federal consumer protection laws. Dodd-Frank has had and will continue to have a significant impact on ACNB s business operations as its provisions take effect. It is expected that, as various implementing rules and regulations are released, they will increase ACNB s operating and compliance costs and could increase the banking subsidiary s interest expense. Among the provisions that are likely to affect ACNB are the following:

Holding Company Capital Requirements

Dodd-Frank requires the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010, by a bank holding company with less than $15 billion in assets as of December 31, 2009. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion, consistent with safety and soundness.

Deposit Insurance

Dodd-Frank permanently increased the maximum deposit insurance amount for banks, savings institutions, and credit unions to $250,000 per depositor. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. Dodd-Frank requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Dodd-Frank also eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance

Dodd-Frank requires publicly-traded companies to give stockholders a non-binding vote on executive compensation at least every three years, a non-binding vote regarding the frequency of the vote on executive compensation at least every six years, and a non-binding vote on golden parachute payments in connection with approvals of mergers and acquisitions unless previously voted on by the stockholders. Additionally, Dodd-Frank directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded. Dodd-Frank also gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Prohibition Against Charter Conversions of Troubled Institutions

Dodd-Frank prohibits a depository institution from converting from a state to a federal charter, or vice versa, while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator, which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating thereto.

Interstate Branching

Dodd-Frank authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks are able to enter new markets more freely.

Limits on Interstate Acquisitions and Mergers

Dodd-Frank precludes a bank holding company from engaging in an interstate acquisition the acquisition of a bank outside its home state unless the bank holding company is both well capitalized and well managed. Furthermore, a bank may not engage in an interstate merger with

another bank headquartered in another state unless the surviving institution will be well capitalized and well managed. The previous standard in both cases was adequately capitalized and adequately managed.

Limits on Interchange Fees

Dodd-Frank amended the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

Consumer Financial Protection Bureau

Dodd-Frank created the independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes.

The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower s ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE - Pursuant to Dodd-Frank as highlighted above, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine the consumer s ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and, (8) credit history. Alternatively, the mortgage lender can originate qualified mortgages , which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage, the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Loans which meet these criteria will be considered qualified mortgages and, as a result, generally protect lenders from fines or litigation in the event of foreclosure. Qualified mortgages that are higher-priced (e.g., subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not higher-priced (e.g., prime loans) are given a safe harbor of compliance. The impact of the final rule, and the subsequent amendments thereto, on the Corporation s lending activities and the Corporation s statements of income or condition has had little or no impact; however, management will continue to monitor the implementation of the rule for any potential effects on the Corporation s business.

DEPARTMENT OF DEFENSE MILITARY LENDING RULE - In 2015, the U.S. Department of Defense issued a final rule which restricts pricing and terms of certain credit extended to active duty military personnel and their families. This rule, which was implemented effective October 3, 2016, caps the interest rate on certain credit extensions to an annual percentage rate of 36% and restricts other fees. The rule requires financial institutions to verify whether customers are military personnel subject to the rule. The impact of this final rule, and any subsequent amendments thereto, on the Corporation s lending activities and the Corporation s statements of income or condition has had little or no impact; however, management will continue to monitor the implementation of the rule for any potential effects on the Corporation s business.

SUPERVISION AND REGULATION

Dividends

ACNB is a legal entity separate and distinct from its subsidiary bank. ACNB s revenues, on a parent company only basis, result primarily from dividends paid to the Corporation by its subsidiaries. Federal and state laws regulate the payment of dividends by ACNB s subsidiary bank. For further information, please refer to *Regulation of Bank* below.

Regulation of Bank

The operations of the subsidiary bank are subject to statutes applicable to banks chartered under the banking laws of Pennsylvania, to state nonmember banks of the Federal Reserve, and to banks whose deposits are insured by the FDIC. The subsidiary bank s operations are also subject to regulations of the Pennsylvania Department of Banking and Securities, Federal Reserve, and FDIC.

The Pennsylvania Department of Banking and Securities, which has primary supervisory authority over banks chartered in Pennsylvania, regularly examines banks in such areas as reserves, loans, investments, management practices, and other aspects of operations. The subsidiary bank is also subject to examination by the FDIC for safety and soundness, as well as consumer compliance. These examinations are designed for the protection of the subsidiary bank s depositors rather than ACNB s shareholders. The subsidiary bank must file quarterly and annual reports to the Federal Financial Institutions Examination Council, or FFIEC.

Monetary and Fiscal Policy

ACNB and its subsidiary bank are affected by the monetary and fiscal policies of government agencies, including the Federal Reserve and FDIC. Through open market securities transactions and changes in its discount rate and reserve requirements, the Board of Governors of the Federal Reserve exerts considerable influence over the cost and availability of funds for lending and investment. The nature and impact of monetary and fiscal policies on future business and earnings of ACNB cannot be predicted at this time. From time to time, various federal and state legislation is proposed that could result in additional regulation of, and restrictions on, the business of ACNB and the subsidiary bank, or otherwise change the business environment. Management cannot predict whether any of this legislation will have a material effect on the business of ACNB.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management monitors and evaluates changes in market conditions on a regular basis. Based upon the most recent review, management has determined that there have been no material changes in market risks since year-end 2017. For further discussion of year-end information, please refer to the Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

ITEM 4 - CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, the Corporation carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation s disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in periodic SEC filings.

Disclosure controls and procedures are Corporation controls and other procedures that are designed to ensure that information required to be disclosed by the Corporation in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

There were no changes in the Corporation s internal control over financial reporting during the quarterly period ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

PART II - OTHER INFORMATION

ACNB CORPORATION

ITEM 1 - LEGAL PROCEEDINGS

As of September 30, 2018, there were no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which ACNB or its subsidiaries are a party or by which any of their assets are the subject, which could have a material adverse effect on ACNB or its subsidiaries or their results of operations. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiaries by governmental authorities.

ITEM 1A - RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017. There are no material changes in the risk factors as previously disclosed in the Form 10-K.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On November 3, 2008, the Corporation announced a plan to purchase up to 120,000 shares of its outstanding common stock. There were no treasury shares purchased under this plan during the quarter ended September 30, 2018. The maximum number of shares that may yet be purchased under this stock repurchase plan is 57,400.

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, effective as of February 24, 2009, in which awards shall not exceed, in the aggregate, 200,000 shares of common stock. As of September 30, 2018, there were 26,045 shares of common stock granted as restricted stock awards to employees of the subsidiary bank. The maximum number of shares that may yet be granted under the restricted stock plan is 173,955. The Corporation s Registration Statement under the Securities Act of 1933 on Form S-8 for the ACNB Corporation 2009 Restricted Stock Plan was filed with the Securities and Exchange Commission on January 4, 2013.

On May 5, 2009, stockholders approved and adopted the amendment to the Articles of Incorporation of ACNB Corporation to authorize up to 20,000,000 shares of preferred stock, par value $2.50 per share. As of September 30, 2018, there were no issued or outstanding shares of preferred stock.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. As of September 30, 2018, there were 149,476 shares of common stock issued through the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES - NOTHING TO REPORT.

ITEM 4 - MINE SAFETY DISCLOSURES - NOT APPLICABLE.

ITEM 5 - OTHER INFORMATION - NOTHING TO REPORT.

ITEM 6 - EXHIBITS

The following exhibits are included in this report:

Exhibit 2.1	Agreement and Plan of Reorganization by and among ACNB Corporation, ACNB South Acquisition Subsidiary, LLC, ACNB Bank, New Windsor Bancorp, Inc., and New Windsor State Bank dated as of November 21, 2016, as amended. (Incorporated by reference to Annex A of the Registrant s Registration Statement No. 333-215914 on Form S-4, filed with the Commission on February 6, 2017.) Schedules are omitted; the Registrant agrees to furnish copies of Schedules to the Securities and Exchange Commission upon request.
Exhibit 2.2	Amendment No. 2 to Agreement and Plan of Reorganization by and among ACNB Corporation, ACNB South Acquisition Subsidiary, LLC, ACNB Bank, New Windsor Bancorp, Inc., and New Windsor State Bank dated as of April 18, 2017. (Incorporated by reference to Exhibit 2.2 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, filed with the Commission on August 4, 2017.)
Exhibit 3(i)	Amended and Restated Articles of Incorporation of ACNB Corporation. (Incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on May 7, 2018.)
Exhibit 3(ii)	Amended and Restated Bylaws of ACNB Corporation. (Incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on May 7, 2018.)
Exhibit 10.1	ACNB Corporation, ACNB Acquisition Subsidiary LLC, and Russell Insurance Group, Inc. Stock Purchase Agreement. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.2	Amended and Restated Executive Supplemental Life Insurance Plan Applicable to Thomas A. Ritter, James P. Helt, David W. Cathell, Lynda L. Glass and Douglas A. Seibel. (Incorporated by reference to Exhibit 10.3 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Commission on March 6, 2015.)
Exhibit 10.3	Amended and Restated Director Supplemental Life Insurance Plan Applicable to Richard L. Alloway II, Frank Elsner, III, Todd L. Herring, Scott L. Kelley, James J. Lott, Donna M. Newell, J. Emmett Patterson, Daniel W. Potts, Marian B. Schultz, D. Arthur Seibel, Jr., David L. Sites, Alan J. Stock and James E. Williams. (Incorporated by reference to Exhibit 10.4 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Commission on March 6, 2015.)
Exhibit 10.4	Amended and Restated Director Deferred Fee Plan Applicable to Richard L. Alloway II, Frank Elsner, III, Todd L. Herring, Scott L. Kelley, James J. Lott, Donna M. Newell, J. Emmett Patterson, Marian B. Schultz, David L. Sites, Alan J. Stock and James E. Williams. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on January 6, 2012.)
Exhibit 10.5	ACNB Bank Salary Savings Plan. (Incorporated by reference to Exhibit 10.6 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)
Exhibit 10.6	Group Pension Plan for Employees of ACNB Bank. (Incorporated by reference to Exhibit 10.7 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the Commission on May 4, 2012.)
Exhibit 10.7	Amended and Restated Employment Agreement between ACNB Corporation, Adams County National Bank and Thomas A. Ritter dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.9 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)

Exhibit 10.8	Amended and Restated Employment Agreement between ACNB Corporation, Adams County National Bank and Lynda L. Glass dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.10 of the Registrant_s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.9	Employment Agreement between ACNB Corporation, Russell Insurance Group, Inc. and Frank C. Russell, Jr. dated as of January 13, 2011. (Incorporated by reference to Exhibit 99.1 of the Registrant_s Current Report on Form 8-K, filed with the Commission on January 19, 2011.)
Exhibit 10.10	Employment Agreement between ACNB Corporation, Adams County National Bank and David W. Cathell dated as of April 17, 2009. (Incorporated by reference to Exhibit 99.1 of the Registrant_s Current Report on Form 8-K, filed with the Commission on April 23, 2009.)
Exhibit 10.11	2009 Restricted Stock Plan. (Incorporated by reference to Appendix C of the Registrant_s Proxy Statement on Schedule 14A, filed with the Commission on March 25, 2009.)
Exhibit 10.12	Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.1 of the Registrant_s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.13	Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.2 of the Registrant_s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.14	Salary Continuation Agreement by and between ACNB Bank and David W. Cathell dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.3 of the Registrant_s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.15	Amended and Restated 2001 Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.4 of the Registrant_s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.16	Amended and Restated 1996 Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.5 of the Registrant_s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.17	Salary Continuation Agreement by and between ACNB Bank and James P. Helt dated as of March 28, 2012. (Incorporated by reference to Exhibit 10.20 of the Registrant_s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Commission on March 7, 2014.)
Exhibit 10.18	ACNB Bank Variable Compensation Plan effective January 1, 2014, as amended. (Incorporated by reference to Exhibit 10.21 of the Registrant_s Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Commission on March 9, 2018.)
Exhibit 10.19	Form of ACNB Bank Variable Compensation Plan Restricted Stock Agreement dated as of June 22, 2015. (Incorporated by reference to Exhibit 99.2 of the Registrant_s Current Report on Form 8-K, filed with the Commission on June 25, 2015.)
Exhibit 10.20	Form of ACNB Bank Variable Compensation Plan Restricted Stock Agreement dated as of June 15, 2016. (Incorporated by reference to Exhibit 99.3 of the Registrant_s Current Report on Form 8-K, filed with the Commission on June 21, 2016.)
Exhibit 10.21	First Amendment to the Amended and Restated Employment Agreement by and between ACNB Corporation, ACNB Bank and Lynda L. Glass dated as of December 27, 2016. (Incorporated by reference to Exhibit 99.2 of the Registrant_s Current Report on Form 8-K, filed with the Commission on December 28, 2016.)

Exhibit 10.22	First Amendment to Employment Agreement by and between ACNB Corporation, ACNB Bank and David W. Cathell dated as of December 27, 2016. (Incorporated by reference to Exhibit 99.3 of the Registrant s Current Report on Form 8-K, filed with the Commission on December 28, 2016.)
Exhibit 10.23	Form of ACNB Bank Variable Compensation Plan Restricted Stock Agreement dated as of June 15, 2017. (Incorporated by reference to Exhibit 99.3 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 21, 2017.)
Exhibit 10.24	Employment Agreement by and between ACNB Bank and Douglas A. Seibel dated as of November 15, 2016. (Incorporated by reference to Exhibit 10.28 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Commission on March 9, 2018.)
Exhibit 10.25	Amended and Restated Employment Agreement by and between ACNB Corporation, ACNB Bank and James P. Helt dated as of August 14, 2018.
Exhibit 11	Statement re Computation of Earnings. (Incorporated by reference to page 11 of this Form 10-Q.)
Exhibit 18	Preferability Letter from ParenteBeard LLC dated as of August 3, 2012. (Incorporated by reference to Exhibit 18 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the Commission on August 3, 2012.)
Exhibit 31.1	Chief Executive Officer Certification of Quarterly Report on Form 10-Q.
Exhibit 31.2	Chief Financial Officer Certification of Quarterly Report on Form 10-Q.
Exhibit 32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase.
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase.
Exhibit 101.INS	XBRL Instance Document.
Exhibit 101.SCH	XBRL Taxonomy Extension Schema.
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACNB CORPORATION (Registrant)

Date: November 2, 2018

/s/ James P. Helt
James P. Helt
President & Chief Executive Officer

/s/ David W. Cathell
David W. Cathell
Executive Vice President/Treasurer &
Chief Financial Officer (Principal Financial Officer)