

NATIONAL BANKSHARES INC
Form 10-Q
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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

For the transition period from _____ to _____

Commission File Number 0-15204

NATIONAL BANKSHARES, INC.

(Exact name of registrant as specified in its charter)

Virginia

54-1375874

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

101 Hubbard Street

P. O. Box 90002

Blacksburg, VA 24062-9002
(Address of principal executive offices) (Zip Code)

(540) 951-6300

(Registrant's telephone number, including area code)

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

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

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

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

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

Yes No

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

<u>Class</u>	<u>Outstanding at August 3, 2016</u>
Common Stock, \$1.25 Par Value	6,957,974

(This report contains 58 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

Form 10-Q

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Part I
Item 1. Financial Statements **Financial Information**
National Bankshares, Inc. and Subsidiaries
Consolidated Balance Sheets

\$ in thousands, except per share data	(Unaudited) June 30, 2016	December 31, 2015
Assets		
Cash and due from banks	\$ 14,320	\$ 12,152
Interest-bearing deposits	75,892	130,811
Securities available for sale, at fair value	303,242	236,131
Securities held to maturity (fair value of \$146,241 at June 30, 2016 and \$158,032 at December 31, 2015)	138,424	152,028
Restricted stock, at cost	1,170	1,129
Loans held for sale	663	634
Loans:		
Loans, net of unearned income and deferred fees	630,916	619,008
Less allowance for loan losses	(8,195)	(8,297)
Loans, net	622,721	610,711
Premises and equipment, net	8,718	9,020
Accrued interest receivable	5,259	5,769
Other real estate owned, net	3,425	4,165
Intangible assets and goodwill	6,046	6,224
Bank-owned life insurance	22,699	22,401
Other assets	7,720	8,564
Total assets	\$ 1,210,299	\$ 1,199,739
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 171,350	\$ 166,453
Interest-bearing demand deposits	575,364	569,787
Savings deposits	95,484	90,236
Time deposits	179,540	192,383
Total deposits	1,021,738	1,018,859
Accrued interest payable	56	56
Other liabilities	8,577	8,710
Total liabilities	1,030,371	1,027,625
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	---	---
Common stock of \$1.25 par value. Authorized 10,000,000 shares; issued and outstanding 6,957,974 shares at June 30, 2016 and at December 31, 2015	8,697	8,697

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Retained earnings	175,170	171,353
Accumulated other comprehensive loss, net	(3,939)	(7,936)
Total stockholders' equity	179,928	172,114
Total liabilities and stockholders' equity	\$ 1,210,299	\$ 1,199,739

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended June 30, 2016 and 2015

(Unaudited)

\$ in thousands, except per share data	June 30, 2016	June 30, 2015
Interest Income		
Interest and fees on loans	\$7,289	\$7,600
Interest on interest-bearing deposits	150	55
Interest on securities – taxable	1,567	1,712
Interest on securities – nontaxable	1,286	1,357
Total interest income	10,292	10,724
Interest Expense		
Interest on time deposits	253	315
Interest on other deposits	810	736
Total interest expense	1,063	1,051
Net interest income	9,229	9,673
Provision for loan losses	654	355
Net interest income after provision for loan losses	8,575	9,318
Noninterest Income		
Service charges on deposit accounts	569	570
Other service charges and fees	46	48
Credit card fees	969	976
Trust income	354	299
BOLI income	151	150
Other income	455	419
Realized securities gain, net	74	5
Total noninterest income	2,618	2,467
Noninterest Expense		
Salaries and employee benefits	2,907	3,232
Occupancy and furniture and fixtures	448	420
Data processing and ATM	595	408
FDIC assessment	145	135
Credit card processing	712	675

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Intangible assets amortization	68	269
Net costs of other real estate owned	39	43
Franchise taxes	322	322
Other operating expenses	1,002	861
Total noninterest expense	6,238	6,365
Income before income taxes	4,955	5,420
Income tax expense	1,090	1,310

Net Income	\$3,865	\$4,110
Basic net income per common share	\$0.56	\$0.59
Fully diluted net income per common share	\$0.56	\$0.59
Weighted average number of common shares outstanding – basic	6,957,974	6,952,540
Weighted average number of common shares outstanding – diluted	6,957,974	6,956,039
Dividends declared per common share	\$0.55	\$0.53

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

Three Months Ended June 30, 2016 and 2015

(Unaudited)

\$ in thousands	June 30, 2016	June 30, 2015
Net Income	\$3,865	\$4,110
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gain (loss) on available for sale securities net of tax of \$368 and (\$3,048) for the periods ended June 30, 2016 and 2015, respectively	684	(5,665)
Reclassification adjustment for gain included in net income, net of tax of (\$16) and (\$2) for the periods ended June 30, 2016 and 2015, respectively	(30)	(3)
Other comprehensive income (loss), net of tax of \$352 and (\$3,050) for the periods ended June 30, 2016 and 2015, respectively	654	(5,668)
Total Comprehensive Income (Loss)	\$4,519	\$(1,558)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Six Months Ended June 30, 2016 and 2015

(Unaudited)

	June 30,	June 30,
\$ in thousands, except per share data	2016	2015
Interest Income		
Interest and fees on loans	\$14,623	\$15,210
Interest on interest-bearing deposits	312	119
Interest on securities – taxable	3,244	3,446
Interest on securities – nontaxable	2,597	2,743
Total interest income	20,776	21,518
Interest Expense		
Interest on time deposits	527	642
Interest on other deposits	1,604	1,496
Total interest expense	2,131	2,138
Net interest income	18,645	19,380
Provision for loan losses	857	556
Net interest income after provision for loan losses	17,788	18,824
Noninterest Income		
Service charges on deposit accounts	1,129	1,105
Other service charges and fees	118	119
Credit card fees	1,839	1,871
Trust income	677	588
BOLI income	298	299
Other income	800	733
Realized securities gain, net	98	3
Total noninterest income	4,959	4,718
Noninterest Expense		
Salaries and employee benefits	6,475	6,283
Occupancy and furniture and fixtures	925	869
Data processing and ATM	1,006	843
FDIC assessment	286	270
Credit card processing	1,334	1,285
Intangible assets amortization	178	538

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Net costs of other real estate owned	108	507
Franchise taxes	653	630
Other operating expenses	1,957	1,820
Total noninterest expense	12,922	13,045
Income before income taxes	9,825	10,497
Income tax expense	2,181	2,421
Net Income	\$7,644	\$8,076
Basic net income per common share	\$1.10	\$1.16
Fully diluted net income per common share	\$1.10	\$1.16
Weighted average number of common shares outstanding – basic	6,957,974	6,951,513
Weighted average number of common shares outstanding – diluted	6,957,974	6,955,093
Dividends declared per common share	\$0.55	\$0.53

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries
 Consolidated Statements of Comprehensive Income
 Six Months Ended June 30, 2016 and 2015
 (Unaudited)

\$ in thousands	June 30, 2016	June 30, 2015
Net Income	\$7,644	\$8,076
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gain (loss) on available for sale securities net of tax of \$2,171 and (\$1,728) for the periods ended June 30, 2016 and 2015, respectively	4,031	(3,213)
Reclassification adjustment for gain included in net income, net of tax of (\$18) for the period ended June 30, 2016 and (\$1) for the period ended June 30, 2015	(34)	(2)
Other comprehensive income (loss), net of tax of \$2,153 and (\$1,729) for the periods ended June 30, 2016 and 2015, respectively	3,997	(3,215)
Total Comprehensive Income	\$11,641	\$4,861

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Six Months Ended June 30, 2016 and 2015

(Unaudited)

\$ in thousands	Accumulated			Total
	Common Stock	Retained Earnings	Other Comprehensive Loss	
Balances at December 31, 2014	\$ 8,688	\$ 163,287	\$ (5,672)) \$ 166,303
Net income	---	8,076	---	8,076
Dividends \$0.53 per share	---	(3,686)	---	(3,686)
Exercise of stock options	5	87	---	92
Other comprehensive loss, net of tax of (\$1,729)	---	---	(3,215)) (3,215)
Balances at June 30, 2015	\$ 8,693	\$ 167,764	\$ (8,887)) \$ 167,570
Balances at December 31, 2015	\$ 8,697	\$ 171,353	\$ (7,936)) \$ 172,114
Net income	---	7,644	---	7,644
Dividends \$0.55 per share	---	(3,827)	---	(3,827)
Other comprehensive income, net of tax of \$2,153	---	---	3,997	3,997
Balances at June 30, 2016	\$ 8,697	\$ 175,170	\$ (3,939)) \$ 179,928

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Six Months Ended June 30, 2016 and 2015

(Unaudited)

\$ in thousands	June 30, 2016	June 30, 2015
Cash Flows from Operating Activities		
Net income	\$7,644	\$8,076
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	857	556
Depreciation of bank premises and equipment	393	376
Amortization of intangibles	178	538
Amortization of premiums and accretion of discounts, net	48	60
Loss on disposal of premises and equipment	---	6
Gain on sales and calls of securities available for sale, net	(52)	(3)
Gain on calls of securities held to maturity, net	(46)	---
Loss and write-down on other real estate owned, net	55	392
Increase in cash value of bank-owned life insurance	(298)	(299)
Originations of mortgage loans held for sale	(6,431)	(7,458)
Proceeds from sale of mortgage loans held for sale	6,508	7,008
Gain on sale of mortgage loans held for sale	(106)	(112)
Net change in:		
Accrued interest receivable	510	(109)
Other assets	(1,308)	(627)
Accrued interest payable	---	(7)
Other liabilities	(133)	552
Net cash provided by operating activities	7,819	8,949
Cash Flows from Investing Activities		
Net change interest-bearing deposits	54,919	18,730
Proceeds from calls, principal payments, sales and maturities of securities available for sale	122,457	32,342
Proceeds from calls, principal payments and maturities of securities held to maturity	13,591	5,682
Purchases of securities available for sale	(183,355)	(32,957)
Net change in restricted stock	(41)	(40)
Purchases of loan participations	(1,446)	---
Collections of loan participations	584	1,943
Loan originations and principal collections, net	(12,097)	(24,814)

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Proceeds from sale of other real estate owned	685	531
Recoveries on loans charged off	92	88
Proceeds from sale and purchases of premises and equipment, net	(92)	(129)
Net cash provided by (used in) investing activities	(4,703)	1,376
Cash Flows from Financing Activities		
Net change in time deposits	(12,843)	(13,676)
Net change in other deposits	15,722	5,404
Cash dividends paid	(3,827)	(3,686)
Stock options exercised	---	92
Net cash used in financing activities	(948)	(11,866)
Net change in cash and due from banks	2,168	(1,541)
Cash and due from banks at beginning of period	12,152	12,894
Cash and due from banks at end of period	\$14,320	\$11,353
Supplemental Disclosures of Cash Flow Information		
Interest paid on deposits and borrowed funds	\$2,131	\$2,145
Income taxes paid	2,250	2,560
Supplemental Disclosure of Noncash Activities		
Loans charged against the allowance for loan losses	\$1,051	\$776
Loans transferred to other real estate owned	---	620
Unrealized net gain (loss) on securities available for sale	6,150	(4,944)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2016

(Unaudited)

\$ in thousands, except per share data

Note 1: General

The consolidated financial statements of National Bankshares, Inc. (“NBI”) and its wholly-owned subsidiaries, The National Bank of Blacksburg (“NBB”) and National Bankshares Financial Services, Inc. (“NBFS”) (collectively, the “Company”), conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the six month period ended June 30, 2016 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to consolidated financial statements included in the Company’s 2015 Form 10-K. The Company posts all reports required to be filed under the Securities and Exchange Act of 1934 on its web site at www.nationalbankshares.com.

Note 2: Stock-Based Compensation

The Company’s 1999 Stock Option Plan was terminated on March 9, 2009. Incentive stock options were granted annually to key employees of NBI and its subsidiaries from 1999 to 2005 and none have been granted since 2005. All un-exercised stock options expired in November 2015. There were 4,000 stock options exercised during the six months ended June 30, 2015.

**Weighted-
Weighted- Average Aggregate**

Options	Shares	Average Exercise Price	Remaining Contractual Term	Intrinsic Value
Outstanding at January 1, 2015	20,500	\$ 23.00		
Exercised	(4,000)	23.00		
Forfeited or expired	---	---		
Outstanding at June 30, 2015	16,500	\$ 23.00	0.359	\$ 103
Exercisable at June 30, 2015	16,500	\$ 23.00	0.359	\$ 103

Note 3: Loan Portfolio

The loan portfolio, excluding loans held for sale, was comprised of the following.

	June 30, 2016	December 31, 2015
Real estate construction	\$42,334	\$48,251
Consumer real estate	147,588	143,504
Commercial real estate	321,043	309,378
Commercial non real estate	41,727	37,571
Public sector and IDA	47,046	51,335
Consumer non real estate	32,027	29,845
Gross loans	631,765	619,884
Less unearned income and deferred fees	(849)	(876)
Loans, net of unearned income and deferred fees	\$630,916	\$619,008

Note 4: Allowance for Loan Losses, Nonperforming Assets and Impaired Loans

The allowance for loan losses methodology incorporates individual evaluation of impaired loans and collective evaluation of groups of non-impaired loans. The Company performs ongoing analysis of the loan portfolio to determine credit quality and to identify impaired loans. Credit quality is rated based on the loan's payment history, the borrower's current financial situation and the value of the underlying collateral.

Impaired loans are those loans that have been modified in a troubled debt restructure ("TDR" or "restructure") and larger, non-homogeneous loans that are in nonaccrual or exhibit payment history or financial status that indicate the probability that collection will not occur when due according to the loan's original terms. Generally, impaired loans are given risk ratings that indicate higher risk, such as "classified" or "other assets especially mentioned." Impaired loans are individually evaluated to determine appropriate reserves and are measured at the lower of the invested amount or the fair value. Impaired loans that are not troubled debt restructures and for which fair value measurement indicates an impairment loss are designated nonaccrual. A restructured loan that maintains current status for at least six months may be in accrual status. Please refer to Note 1 of the Company's 2015 Form 10-K, "Summary of Significant Accounting Policies" for additional information on evaluation of impaired loans and associated specific reserves, and policies regarding nonaccruals, past due status and charge-offs.

Troubled debt restructures impact the estimation of the appropriate level of the allowance for loan losses. If the restructuring included forgiveness of a portion of principal, the charge-off is included in the historical charge-off rates applied to the collective evaluation methodology. Further, restructured loans are individually evaluated for impairment and any amount of book value that exceeds fair value is accrued in the allowance for loan losses. TDRs that experience a payment default are examined to determine whether the default indicates collateral dependency or a decline in estimates of cash flow used in the fair value measurement. TDRs that are determined to be collateral-dependent, as well as all impaired loans that are determined to be collateral dependent, are charged down to fair value net of estimated costs to sell. Deficiencies indicated by impairment measurements for TDRs that are not collateral dependent may be accrued in the allowance for loan losses or charged off if deemed uncollectible.

The Company evaluated characteristics in the loan portfolio and determined major segments and smaller classes within each segment. These characteristics include collateral type, repayment sources, and (if applicable) the borrower's business model. The methodology for calculating reserves for collectively-evaluated loans is applied at the class level.

Portfolio Segments and Classes

The segments and classes used in determining the allowance for loan losses are as follows.

Real Estate Construction
Construction, residential

Commercial Non Real Estate
Commercial and industrial

Construction, other	
Consumer Real Estate	Public Sector and IDA
Equity lines	Public sector and IDA
Residential closed-end first liens	Consumer Non Real Estate
Residential closed-end junior liens	Credit cards
Investor-owned residential real estate	Automobile
	Other consumer loans
Commercial Real Estate	
Multifamily real estate	
Commercial real estate, owner-occupied	
Commercial real estate, other	

Historical Loss Rates

The Company’s allowance methodology for collectively-evaluated loans applies historical loss rates by class to current class balances as part of the process of determining required reserves. Class loss rates are calculated as the net charge-offs for the class as a percentage of average class balance. The Company averages loss rates for the most recent 8 quarters to determine the historical loss rate for each class.

Two loss rates for each class are calculated: total net charge-offs for the class as a percentage of average class loan balance (“class loss rate”), and total net charge-offs for the class as a percentage of average classified loans in the class (“classified loss rate”). Classified loans are those with risk ratings of “substandard”, “doubtful” or “loss”. Net charge-offs in both calculations include charge-offs and recoveries of classified and non-classified loans as well as those associated with impaired loans. Class historical loss rates are applied to non-classified loan balances at the reporting date, and classified historical loss rates are applied to classified loan balances that are not individually evaluated at the reporting date.

Risk Factors

In addition to historical loss rates, risk factors pertinent to credit risk for each class are analyzed to estimate reserves for collectively-evaluated loans. Factors include changes in national and local economic and business conditions, the nature and volume of classes within the portfolio, loan quality, loan officers' experience, lending policies and the Company's loan review system.

The analysis of certain factors results in standard allocations to all segments and classes. These factors include loan officers' average years of experience, the risk from changes in loan review, unemployment levels, bankruptcy rates, the interest rate environment, and the competitive, legal and regulatory environments.

Factors analyzed for each class, with resultant allocations based upon the level of risk assessed for each class, include the risk from changes in lending policies, levels of past due loans, nonaccrual loans, current class balance as a percentage of total loans, and the percentage of high risk loans within the class. Additionally, factors specific to each segment are analyzed and result in allocations to the segment. Please refer to the Company's 2015 10-K, Note 1: Summary of Significant Accounting Policies for a discussion of risk factors pertinent to each class.

Real estate construction loans are subject to general risks from changing commercial building and housing market trends and economic conditions that may impact demand for completed properties and the costs of completion. These risks are measured by market-area unemployment rates, bankruptcy rates, housing market trends, and interest rates.

The credit quality of consumer real estate is subject to risks associated with the borrower's repayment ability and collateral value, measured generally by analyzing local unemployment and bankruptcy trends, local housing market trends, and interest rates.

The commercial real estate segment includes loans secured by multifamily residential real estate, commercial real estate occupied by the owner/borrower, and commercial real estate leased to non-owners. Loans in the commercial real estate segment are impacted by economic risks from changing commercial real estate markets, rental markets for multi-family housing and commercial buildings, business bankruptcy rates, local unemployment and interest rate trends that would impact the businesses housed by the commercial real estate.

Commercial non real estate loans are secured by collateral other than real estate, or are unsecured. Credit risk for commercial non real estate loans is subject to economic conditions, generally monitored by local business bankruptcy trends, and interest rates.

Public sector and IDA loans are extended to municipalities and related entities. Credit risk is based upon the entity's ability to repay and interest rate trends.

Consumer non real estate includes credit cards, automobile and other consumer loans. Credit cards and certain other consumer loans are unsecured, while collateral is obtained for automobile loans and other consumer loans. Credit risk stems primarily from the borrower's ability to repay, measured by average unemployment, average personal bankruptcy rates and interest rates.

Factor allocations applied to each class are increased for loans rated special mention and increased to a greater extent for loans rated classified. The Company allocates additional reserves for "high risk" loans. High risk loans include junior

liens, interest only and high loan to value loans.

A detailed analysis showing the allowance roll-forward by portfolio segment and related loan balance by segment follows.

Activity in the Allowance for Loan Losses for the Six Months Ended June 30, 2016

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2015	\$ 576	\$ 1,866	\$ 4,109	\$ 655	\$ 436	\$ 627	\$ 28	\$ 8,297
Charge-offs	(29)	(89)	(125)	(708)	---	(100)	---	(1,051)
Recoveries	---	1	59	1	---	31	---	92
Provision for loan losses	(32)	(2)	(574)	1,537	(55)	(3)	(14)	857
Balance, June 30, 2016	\$ 515	\$ 1,776	\$ 3,469	\$ 1,485	\$ 381	\$ 555	\$ 14	\$ 8,195

Activity in the Allowance for Loan Losses for the Six Months Ended June 30, 2015

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2014	\$612	\$ 1,662	\$ 3,537	\$ 1,475	\$ 327	\$ 602	\$ 48	\$8,263
Charge-offs	---	(201)	(116)	(330)	---	(129)	---	(776)
Recoveries	---	1	24	---	---	63	---	88
Provision for loan losses	(136)	375	373	(204)	159	(22)	11	556
Balance, June 30, 2015	\$476	\$ 1,837	\$ 3,818	\$ 941	\$ 486	\$ 514	\$ 59	\$8,131

Activity in the Allowance for Loan Losses for the year ended December 31, 2015

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2014	\$ 612	\$ 1,662	\$ 3,537	\$ 1,475	\$ 327	\$ 602	\$ 48	\$ 8,263
Charge-offs	---	(205)	(1,114)	(490)	---	(311)	---	(2,120)
Recoveries	---	2	49	1	---	93	---	145
Provision for loan losses	(36)	407	1,637	(331)	109	243	(20)	2,009
Balance, December 31, 2015	\$ 576	\$ 1,866	\$ 4,109	\$ 655	\$ 436	\$ 627	\$ 28	\$ 8,297

Allowance for Loan Losses as of June 30, 2016

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$ ---	\$ 20	\$ 51	\$ ---	\$ ---	\$ ---	\$ ---	\$ 71
Collectively evaluated for impairment	515	1,756	3,418	1,485	381	555	14	8,124
Total	\$ 515	\$ 1,776	\$ 3,469	\$ 1,485	\$ 381	\$ 555	\$ 14	\$ 8,195

Allowance for Loan Losses as of December 31, 2015

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$ ---	\$ 22	\$ 23	\$ ---	\$ ---	\$ ---	\$ ---	\$ 45
Collectively evaluated for impairment	576	1,844	4,086	655	436	627	28	8,252
Total	\$ 576	\$ 1,866	\$ 4,109	\$ 655	\$ 436	\$ 627	\$ 28	\$ 8,297

Loans as of June 30, 2016

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$678	\$934	\$8,773	\$315	\$---	\$---	\$---	\$10,700
Collectively evaluated for impairment	41,656	146,654	312,270	41,412	47,046	32,027	---	621,065
Total loans	\$42,334	\$147,588	\$321,043	\$41,727	\$47,046	\$32,027	\$---	\$631,765

Loans as of December 31, 2015

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$718	\$962	\$12,575	\$1,091	\$---	\$---	\$---	\$15,346
Collectively evaluated for impairment	47,533	142,542	296,803	36,480	51,335	29,845	---	604,538
Total	\$48,251	\$143,504	\$309,378	\$37,571	\$51,335	\$29,845	\$---	\$619,884

A summary of ratios for the allowance for loan losses follows.

	As of the		For the	
	Six Months		Year	
	Ended		Ended	
	June 30,	December	31,	
	2016	2015	2015	
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	1.30 %	1.30 %	1.34	%
Ratio of net charge-offs to average loans, net of unearned income and deferred fees ⁽¹⁾	0.31 %	0.22 %	0.32	%

(1) Net charge-offs are on an annualized basis.

A summary of nonperforming assets follows.

	June 30,		December	
	2016	2015	31,	
			2015	
Nonperforming assets:				
Nonaccrual loans	\$1,751	\$2,870	\$ 2,043	
Restructured loans in nonaccrual	4,454	6,035	4,639	
Total nonperforming loans	6,205	8,905	6,682	
Other real estate owned, net	3,425	4,441	4,165	
Total nonperforming assets	\$9,630	\$13,346	\$ 10,847	
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	1.52 %	2.11 %	1.74	%
Ratio of allowance for loan losses to nonperforming loans ⁽¹⁾	132.07 %	91.31 %	124.17	%

(1) The Company defines nonperforming loans as nonaccrual loans. Loans 90 days or more past due and still accruing and accruing restructured loans are excluded.

A summary of loans past due 90 days or more and impaired loans follows.

	June 30,		December	
	2016	2015	31,	2015
Loans past due 90 days or more and still accruing	\$316	\$80	\$	156
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	0.05	%	0.01	%
Accruing restructured loans	\$4,729	\$5,943	\$	8,814
Impaired loans:				
Impaired loans with no valuation allowance	\$8,902	\$12,182	\$	12,973
Impaired loans with a valuation allowance	1,798	2,503		2,373
Total impaired loans	\$10,700	\$14,685	\$	15,346
Valuation allowance	(71)	(151)	(45)	
Impaired loans, net of allowance	\$10,629	\$14,534	\$	15,301
Average recorded investment in impaired loans ⁽¹⁾	\$14,147	\$15,543	\$	17,297
Interest income recognized on impaired loans, after designation as impaired	\$149	\$172	\$	769
Amount of income recognized on a cash basis	\$---	\$---	\$	---

(1)Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

Nonaccrual loans that meet the Company's balance threshold of \$250 and all TDRs are designated as impaired. No interest income was recognized on nonaccrual loans for the six months ended June 30, 2016 or June 30, 2015 or for the year ended December 31, 2015.

A detailed analysis of investment in impaired loans, associated reserves and interest income recognized, segregated by loan class follows.

	Impaired Loans as of June 30, 2016		Recorded		
	Principal Total	Recorded	Investment⁽¹⁾ for	Investment⁽¹⁾ for	Related
	Balance	Investment⁽¹⁾	Which There is No Related Allowance	Which There is a Related Allowance	Allowance
Real Estate Construction⁽²⁾					
Construction 1-4 family residential	\$ 689	\$ 678	\$ 678	\$ ---	\$ ---
Consumer Real Estate⁽²⁾					
Residential closed-end first liens	696	653	302	351	12
Residential closed-end junior liens	207	207	---	207	4
Investor-owned residential real estate	74	74	---	74	4
Commercial Real Estate⁽²⁾					
Multifamily real estate	1,867	1,594	1,594	---	---
Commercial real estate, owner-occupied	4,453	4,406	3,240	1,166	51
Commercial real estate, other	2,997	2,773	2,773	---	---
Commercial Non Real Estate⁽²⁾					
Commercial and industrial	323	315	315	---	---
Total	\$11,306	\$ 10,700	\$ 8,902	\$ 1,798	\$ 71

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

Impaired Loans as of December 31, 2015
Principal Total Recorded Recorded Related

	Balance	Recorded	Investment⁽¹⁾	Investment⁽¹⁾	Allowance
		Investment⁽¹⁾	for	for	
			Which	Which	
			There is	There is a	
			No Related	Related	
			Allowance	Allowance	
Real Estate Construction⁽²⁾					
Construction 1-4 family residential	\$718	\$ 718	\$ 718	\$ ---	\$ ---
Consumer Real Estate⁽²⁾					
Residential closed-end first liens	713	669	305	364	13
Residential closed-end junior liens	218	218	---	218	5
Investor-owned residential real estate	75	75	---	75	4
Commercial Real Estate⁽²⁾					
Multifamily real estate	1,988	1,728	1,728	---	---
Commercial real estate, owner occupied	5,068	5,020	3,304	1,716	23
Commercial real estate, other	5,990	5,827	5,827	---	---
Commercial Non Real Estate⁽²⁾					
Commercial and industrial	1,099	1,091	1,091	---	---
Total	\$15,869	\$ 15,346	\$ 12,973	\$ 2,373	\$ 45

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

The following tables show the average recorded investment and interest income recognized for impaired loans.

	For the Six Months Ended	
	June 30, 2016	
	Average	Interest
	Recorded	Income
	Investment	Recognized
Real Estate Construction⁽²⁾		
Construction 1-4 family residential	\$678	\$ ---
Consumer Real Estate⁽²⁾		
Residential closed-end first liens	664	20
Residential closed-end junior liens	213	7
Investor-owned residential real estate	75	2
Commercial Real Estate⁽²⁾		
Multifamily real estate	1,595	---
Commercial real estate, owner occupied	4,807	120
Commercial real estate, other	5,203	---
Commercial Non Real Estate⁽²⁾		
Commercial and industrial	912	---
Total	\$14,147	\$ 149

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

	For the Six Months Ended	
	June 30, 2015	
	Average	Interest
	Recorded	Income
	Investment	Recognized
Consumer Real Estate⁽²⁾		
Residential closed-end first liens	\$499	\$ 15

Residential closed-end junior liens	233	8
Investor-owned residential real estate	76	2
Commercial Real Estate⁽²⁾		
Multifamily real estate	2,678	---
Commercial real estate, owner occupied	5,565	57
Commercial real estate, other	5,974	86
Commercial Non Real Estate⁽²⁾		
Commercial and industrial	518	4
Total	\$15,543	\$ 172

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

	For the Year Ended	
	December 31, 2015	
	Average Interest	
	Recorded Income	
	Investment Recognized	
Real Estate Construction⁽²⁾		
Construction 1-4 family residential	\$612	\$ 23
Consumer Real Estate⁽²⁾		
Residential closed-end first liens	681	43
Residential closed-end junior liens	228	15
Investor-owned residential real estate	76	5
Commercial Real Estate⁽²⁾		
Multifamily real estate	2,581	84
Commercial real estate, owner occupied	6,141	251
Commercial real estate, other	5,888	308
Commercial Non Real Estate⁽²⁾		
Commercial and industrial	1,090	40
Total	\$17,297	\$ 769

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

The Company reviews nonaccrual loans on an individual loan basis to determine whether future payments are reasonably assured. To satisfy this criteria, the Company's evaluation must determine that the underlying cause of the original delinquency or weakness that indicated nonaccrual status has been resolved, such as receipt of new guarantees, increased cash flows that cover the debt service or other resolution. Nonaccrual loans that demonstrate reasonable assurance of future payments and that have made at least six consecutive payments in accordance with repayment terms and timeframes may be returned to accrual status.

A restructured loan that maintains current status for at least six months may be returned to accrual status.

An analysis of past due and nonaccrual loans follows.

June 30, 2016

	30 – 89 Days Past Due	90 or More Days Past Due	90 or More Days Past Due and Still Accruing	Nonaccruals (Including Impaired Nonaccruals)
Real Estate Construction⁽¹⁾				
Construction residential	\$---	\$---	\$ ---	\$ 678
Consumer Real Estate⁽¹⁾				
Equity lines	37	48	48	---
Residential closed-end first liens	1,229	216	216	---
Residential closed-end junior liens	21	37	37	---
Investor-owned residential real estate	242	12	---	22
Commercial Real Estate⁽¹⁾				
Multifamily real estate	330	1,594	---	1,594
Commercial real estate, owner-occupied	---	610	---	737
Commercial real estate, other	---	---	---	2,774
Commercial Non Real Estate⁽¹⁾				
Commercial and industrial	45	315	---	400
Consumer Non Real Estate⁽¹⁾				
Credit cards	18	4	4	---
Automobile	237	11	11	---
Other consumer loans	49	---	---	---
Total	\$2,208	\$2,847	\$ 316	\$ 6,205

⁽¹⁾ Only classes with past-due or nonaccrual loans are shown.

December 31, 2015

	30 – 89 Days Past Due	90 or More Days Past Due	90 or More Days Past Due and Still Accruing	Nonaccruals (Including Impaired Nonaccruals)
Real Estate Construction				
Construction, residential	\$---	\$---	\$ ---	\$ 718
Construction, other	26	---	---	---
Consumer Real Estate				
Equity lines	16	---	---	---
Residential closed-end first liens	1,402	106	106	14
Residential closed-end junior liens	123	39	39	---
Investor-owned residential real estate	248	---	---	---
Commercial Real Estate				
Multifamily real estate	684	1,728	---	1,728
Commercial real estate, owner occupied	---	357	---	494
Commercial real estate, other	---	---	---	2,845
Commercial Non Real Estate				
Commercial and industrial	142	883	---	883
Public Sector and IDA				
Public sector and IDA	---	---	---	---
Consumer Non Real Estate				
Credit cards	5	6	6	---
Automobile	286	5	5	---
Other consumer loans	60	---	---	---
Total	\$2,992	\$3,124	\$ 156	\$ 6,682

The estimate of credit risk for non-impaired loans is obtained by applying allocations for internal and external factors. The allocations are increased for loans that exhibit greater credit quality risk.

Credit quality indicators, which the Company terms risk grades, are assigned through the Company's credit review function for larger loans and selective review of loans that fall below credit review thresholds. Loans that do not indicate heightened risk are graded as "pass." Loans that appear to have elevated credit risk because of frequent or persistent past due status, which is less than 75 days, or that show weakness in the borrower's financial condition are risk graded "special mention." Loans with frequent or persistent delinquency exceeding 75 days or that have a higher level of weakness in the borrower's financial condition are graded "classified." Classified loans have regulatory risk ratings of "substandard" and "doubtful." Allowance for loan loss allocations are increased by 50% and by 100% for loans with grades of "special mention" and "classified," respectively.

Determination of risk grades was completed for the portfolio as of June 30, 2016 and December 31, 2015.

The following displays collectively-evaluated loans by credit quality indicator.

June 30, 2016

	Pass	Special Mention (Excluding Impaired)	Classified (Excluding Impaired)
Real Estate Construction			
Construction, 1-4 family residential	\$12,768	\$ 3,694	\$ ---
Construction, other	25,194	---	---
Consumer Real Estate			
Equity lines	16,544	---	62
Closed-end first liens	80,103	1,366	998
Closed-end junior liens	5,035	---	57
Investor-owned residential real estate	41,708	29	752
Commercial Real Estate			
Multifamily residential real estate	95,897	462	1,245
Commercial real estate owner-occupied	115,472	1,162	929
Commercial real estate, other	97,046	57	---
Commercial Non Real Estate			
Commercial and industrial	40,421	334	657
Public Sector and IDA			
States and political subdivisions	47,046	---	---
Consumer Non Real Estate			
Credit cards	5,929	---	---
Automobile	13,702	82	133
Other consumer	12,142	22	17
Total	\$609,007	\$ 7,208	\$ 4,850

The following displays collectively-evaluated loans by credit quality indicator.

December 31, 2015

	Pass	Special Mention (Excluding Impaired)	Classified (Excluding Impaired)
Real Estate Construction			
Construction, 1-4 family residential	\$ 10,626	\$ 3,694	\$ ---
Construction, other	33,213	---	---
Consumer Real Estate			
Equity lines	16,236	15	87
Closed-end first liens	78,614	708	1,370
Closed-end junior liens	4,983	55	61
Investor-owned residential real estate	39,616	31	766
Commercial Real Estate			
Multifamily residential real estate	77,060	---	1,804
Commercial real estate owner-occupied	121,741	1,165	1,274
Commercial real estate, other	93,701	58	---
Commercial Non Real Estate			
Commercial and industrial	35,652	285	543
Public Sector and IDA			
States and political subdivisions	51,335	---	---
Consumer Non Real Estate			
Credit cards	5,773	---	---
Automobile	12,414	102	138
Other consumer	11,359	31	28
Total	\$ 592,323	\$ 6,144	\$ 6,071

Sales, Purchases and Reclassification of Loans

The Company finances mortgages under “best efforts” contracts with mortgage purchasers. The mortgages are designated as held for sale upon initiation. There have been no reclassifications from portfolio loans to held for sale. There have been no loans held for sale transferred to portfolio loans. Occasionally, the Company purchases or sells participations in loans. All participation loans purchased met the Company’s normal underwriting standards at the time the participation was entered. Participation loans are included in the appropriate portfolio balances to which the allowance methodology is applied.

Troubled Debt Restructurings

From time to time the Company modifies loans in troubled debt restructurings. Total troubled debt restructurings amounted to \$9,183 at June 30, 2016, \$13,453 at December 31, 2015, and \$11,978 at June 30, 2015. The Company did not modify any loans in troubled debt restructures during the three-month period ended June 30, 2015. The following table presents restructurings by class that occurred during the three-month period ended June 30, 2016.

Restructurings That Occurred During the Three Months Ended June 30, 2016	
Pre-Modification	
Number of	Post-Modification Outstanding
Contracts	Principal Balance
Outstanding	Principal Balance
Balance	