ORRSTOWN FINANCIAL SERVICES INC
Form 10-Q
May 06, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10 – Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 001-34292

ORRSTOWN FINANCIAL SERVICES, INC.
(Exact Name of Registrant as Specified in its Charter)

Pennsylvania	23-2530374
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

77 East King Street, P. O. Box 250, Shippensburg, Pennsylvania 17257
(Address of Principal Executive Offices) (Zip Code)
Registrant’s Telephone Number, Including Area Code: (717) 532-6114

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 ¨
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 x 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 “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.). Yes ¨ No x
Number of shares outstanding of the registrant’s Common Stock as of April 29, 2016: 8,283,144.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements
Consolidated Balance Sheets (Unaudited)
ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

(Dollars in thousands, except per share data)	March 31, 2016	December 31, 2015
Assets		
Cash and due from banks	$ 12,281	$ 11,412
Interest bearing deposits with banks	54,634	16,928
Cash and cash equivalents	66,915	28,340
Restricted investments in bank stocks	6,270	8,720
Securities available for sale	327,590	394,124
Loans held for sale	3,499	5,917
Loans	804,703	781,713
Less: Allowance for loan losses	(13,347)	(13,568)
Net loans	791,356	768,145
Premises and equipment, net	29,689	23,960
Cash surrender value of life insurance	31,438	31,224
Intangible assets	155	207
Accrued interest receivable	3,582	3,845
Other assets	26,785	28,334
Total assets	$ 1,287,279	$ 1,292,816
Liabilities		
Deposits:		
Non-interest bearing	$ 146,094	$ 131,390
Interest bearing	902,282	900,777
Total deposits	1,048,376	1,032,167
Short-term borrowings	62,693	89,156
Long-term debt	24,413	24,495
Accrued interest and other liabilities	13,550	13,937
Total liabilities	1,149,032	1,159,755
Shareholders' Equity		
Preferred stock, $1.25 par value per share; 500,000 shares authorized; no shares issued or outstanding	0	0
Common stock, no par value—$0.05205 stated value per share 50,000,000 shares authorized; 8,348,441 and 8,320,479 shares issued; 8,288,793 and 8,272,591 shares outstanding	437	435
Additional paid - in capital	124,548	124,317
Retained earnings	9,855	7,939
Accumulated other comprehensive income	4,434	1,199
Treasury stock—common, 59,648 and 47,888 shares, at cost	(1,027)	(829)
Total shareholders' equity	138,247	133,061
Total liabilities and shareholders' equity	$ 1,287,279	$ 1,292,816

The Notes to Consolidated Financial Statements are an integral part of these statements.

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Consolidated Statements of Income (Unaudited)
ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

(Dollars in thousands, except per share data)	Three Months Ended March 31, 2016	March 31, 2015
Interest and dividend income		
Interest and fees on loans	$7,991	$ 7,327
Interest and dividends on investment securities		
Taxable	1,464	1,820
Tax-exempt	441	55
Short-term investments	65	26
Total interest and dividend income	9,961	9,228
Interest expense		
Interest on deposits	1,139	777
Interest on short-term borrowings	66	60
Interest on long-term debt	106	76
Total interest expense	1,311	913
Net interest income	8,650	8,315
Provision for loan losses	0	0
Net interest income after provision for loan losses	8,650	8,315
Noninterest income		
Service charges on deposit accounts	1,303	1,193
Other service charges, commissions and fees	160	173
Trust department income	1,336	1,247
Brokerage income	449	437
Mortgage banking activities	642	520
Earnings on life insurance	268	229
Other income	87	40
Investment securities gains	1,420	1,529
Total noninterest income	5,665	5,368
Noninterest expenses		
Salaries and employee benefits	6,183	5,900
Occupancy expense	526	624
Furniture and equipment	786	743
Data processing	635	511
Telephone and communication	176	190
Automated teller and interchange fees	161	206
Advertising and bank promotions	456	245
FDIC insurance	232	246
Legal	181	213
Other professional services	339	299
Directors compensation	231	157
Collection and problem loan	52	96
Real estate owned expenses	43	25
Taxes other than income	155	226
Intangible asset amortization	51	51
Other operating expenses	914	774
Total noninterest expenses	11,121	10,506

Income before income taxes	3,194	3,177
Income tax expense	614	715
Net income	$2,580	$ 2,462
Per share information:		
Basic earnings per share	$0.32	$ 0.30
Diluted earnings per share	0.32	0.30
Dividends per share	0.08	0.00

The Notes to Consolidated Financial Statements are an integral part of these statements.

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Consolidated Statements of Comprehensive Income (Unaudited)
ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

(Dollars in thousands)	Three Months Ended March 31, 2016	March 31, 2015
Net income	$2,580	$ 2,462
Other comprehensive income, net of tax:		
Unrealized gains on securities available for sale arising during the period	6,396	4,523
Reclassification adjustment for gains realized in net income	(1,420)	(1,529)
Net unrealized gains	4,976	2,994
Tax effect	(1,741)	(1,048)
Total other comprehensive income, net of tax and reclassification adjustments	3,235	1,946
Total comprehensive income	$5,815	$ 4,408

The Notes to Consolidated Financial Statements are an integral part of these statements.

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Consolidated Statements of Changes in Shareholders’ Equity (Unaudited)
ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

	Three Months Ended March 31, 2016 and 2015					
(Dollars in thousands, except per share data)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders’ Equity
Balance, January 1, 2015	$430	$123,392	$1,887	$ 1,576	$(20)	$ 127,265
Net income	0	0	2,462	0	0	2,462
Total other comprehensive income, net of taxes	0	0	0	1,946	0	1,946
Stock-based compensation plans:						
Issuance of stock (31,358 shares), including compensation expense of $134	0	181	0	0	0	181
Issuance of stock through dividend reinvestment plan (10 shares)	0	0	0	0	0	0
Balance, March 31, 2015	$430	$123,573	$4,349	$ 3,522	$(20)	$ 131,854
Balance, January 1, 2016	$435	$124,317	$7,939	$ 1,199	$(829)	$ 133,061
Net income	0	0	2,580	0	0	2,580
Total other comprehensive income, net of taxes	0	0	0	3,235	0	3,235
Cash dividends ($0.08 per share)	0	0	(664)	0	0	(664)
Stock-based compensation plans:						
Issuance of stock (27,962 shares), including compensation expense of $237	2	235	0	0	0	237
Issuance of treasury stock (2,461 shares), including compensation expense of $3	0	(4)	0	0	47	43
Acquisition of treasury stock (14,221 shares)	0	0	0	0	(245)	(245)
Balance, March 31, 2016	$437	$124,548	$9,855	$ 4,434	$(1,027)	$ 138,247

The Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Cash Flows (Unaudited)
ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

(Dollars in thousands)	Three Months Ended March 31, 2016	March 31, 2015
Cash flows from operating activities		
Net income	$2,580	$2,462
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premiums on securities available for sale	1,372	1,534
Depreciation and amortization	741	741
Provision for loan losses	0	0
Stock-based compensation	240	134
Gain on sales of loans originated for sale	(547)	(415)
Mortgage loans originated for sale	(18,041)	(16,023)
Proceeds from sales of loans originated for sale	20,839	14,420
Net gain on disposal of other real estate owned	(55)	(7)
Writedown of other real estate owned	51	0
Net loss on disposal of premises and equipment	25	0
Deferred income taxes	728	726
Investment securities gains	(1,420)	(1,529)
Earnings on cash surrender value of life insurance	(268)	(229)
Decrease in accrued interest receivable	263	48
Increase in accrued interest payable and other liabilities	(387)	(116)
Other, net	(1,037)	(986)
Net cash provided by operating activities	5,084	760
Cash flows from investing activities		
Proceeds from sales of available for sale securities	64,743	41,382
Maturities, repayments and calls of available for sale securities	6,816	7,838
Purchases of available for sale securities	0	(19,859)
Net redemptions of restricted investments in bank stocks	2,450	672
Net increase in loans	(23,262)	(23,842)
Purchases of bank premises and equipment	(6,321)	(126)
Improvements to other real estate owned	(35)	0
Proceeds from disposal of other real estate owned	305	253
Net cash provided by investing activities	44,696	6,318
Cash flows from financing activities		
Net increase (decrease) in deposits	16,209	(3,948)
Net decrease in short term purchased funds	(26,463)	(11,470)
Proceeds from long-term debt	0	20,000
Payments on long-term debt	(82)	(10,078)
Dividends paid	(664)	0
Net proceeds from issuance of common stock	0	47
Acquisition of treasury stock	(245)	0
Issuance of treasury stock	40	0
Net cash (used in) financing activities	(11,205)	(5,449)
Net increase in cash and cash equivalents	38,575	1,629
Cash and cash equivalents at beginning of period	28,340	31,409
Cash and cash equivalents at end of period	$66,915	$33,038

Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,301	$ 923
Income taxes	0	0
Supplemental schedule of noncash investing activities:		
Other real estate acquired in settlement of loans	$ 51	$ 745

The Notes to Consolidated Financial Statements are an integral part of these statements.

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Notes to Consolidated Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations – Orrstown Financial Services, Inc. (the "Company") is a bank holding company (that has elected status as a financial holding company with the Board of Governors of the Federal Reserve System (the "FRB")) whose primary activity consists of supervising its wholly-owned subsidiary, Orrstown Bank (the "Bank"). The Company operates through its office in Shippensburg, Pennsylvania. The Bank provides services through its network of 21 offices in Cumberland, Franklin, Lancaster, and Perry Counties of Pennsylvania and in Washington County, Maryland. The Bank engages in lending services for commercial, residential, commercial mortgages, construction, municipal, and various forms of consumer lending. Deposit services include checking, savings, time, and money market deposits. The Bank also provides investment and brokerage services through its Orrstown Financial Advisors division. The Company and the Bank are subject to the regulation of certain federal and state agencies and undergo periodic examinations by such regulatory authorities.

Basis of Presentation – The unaudited condensed consolidated financial statements of the Company and its subsidiary are presented for the three months ended March 31, 2016 and 2015 and have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. However, unaudited information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, considered necessary for a fair presentation of the financial position, results of operations and cash flows for the interim period. Information presented at December 31, 2015 is condensed from audited year-end financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto, included in the Annual Report on Form 10-K for the year ended December 31, 2015. The consolidated financial statements include the accounts of the Company and the Bank. Operating results for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. All significant intercompany transactions and accounts have been eliminated.

Use of Estimates – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Subsequent Events – GAAP establishes standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The subsequent events principle sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and specifies the disclosures that should be made about events or transactions that occur after the balance sheet date.

Concentration of Credit Risk – The Company generally grants commercial, residential, construction, municipal, and various forms of consumer lending to customers in its market area. Although the Company maintains a diversified loan portfolio, a significant portion of its customers' ability to honor their contracts is dependent upon economic sectors for commercial real estate, including office space, retail strip centers, multi-family and hospitality, residential building operators, sales finance, sub-dividers and developers. Management evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if collateral is deemed necessary by the Company upon the extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but generally includes real estate and equipment.

The types of securities the Company invests in are included in Note 2, "Securities Available for Sale" and the type of lending the Company engages in are included in Note 3, "Loans Receivable and Allowance for Loan Losses."

Cash and Cash Equivalents – For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash, balances due from banks, federal funds sold and interest bearing deposits due on demand, all of which have original maturities of 90 days or less. Net cash flows are reported for customer loan and deposit transactions, loans held for sale and redemption (purchases) of restricted investments in bank stocks, and short-term borrowings.

Restricted Investments in Bank Stocks – Restricted investments in bank stocks, which represents required investments in the common stock of correspondent banks, is carried at cost as of March 31, 2016 and December 31, 2015, and consists of common stock of the Federal Reserve Bank of Philadelphia ("Federal Reserve Bank"), Atlantic Community Bankers Bank and the Federal Home Loan Bank of Pittsburgh ("FHLB").

Management evaluates the restricted investment in bank stocks for impairment in accordance with Accounting Standard Codification (ASC) Topic 942, Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or

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Finance the Activities of Others. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the correspondent bank as compared to the capital stock amount for the correspondent bank and the length of time this situation has persisted, (2) commitments by the correspondent bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of the correspondent bank, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the correspondent bank.

Management believes no impairment charge is necessary related to the restricted investments in bank stocks as of March 31, 2016. However, security impairment analysis is completed quarterly and the determination that no impairment had occurred as of March 31, 2016 is no assurance that impairment may not occur in the future.

Securities – Certain 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. "Trading" securities are recorded at fair value with changes in fair value included in earnings. As of March 31, 2016 and December 31, 2015, the Company had no held to maturity or trading securities. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities and approximate the level yield method. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

The Company had no debt securities it deemed to be other than temporarily impaired at March 31, 2016 or December 31, 2015.

The Company's securities are exposed to various risks, such as interest rate risk, market risk, and credit risks. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment assets reported in the consolidated financial statements.

Loans Held for Sale – Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value (LOCM). Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in non-interest income.

Loans – The Company grants commercial, residential, commercial mortgage, construction, municipal, mortgage and various forms of consumer loans to its customers located principally in south-central Pennsylvania and northern Maryland. The ability of the Company's debtors to honor their contracts is dependent largely upon the real estate 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 amortized as a yield adjustment over the respective term of the loan.

For all classes of loans, the accrual of interest income on loans, including impaired loans, generally ceases when principal or interest is past due 90 days or more or immediately if, in the opinion of management, full collection is unlikely. Interest will continue to accrue on loans past due 90 days or more if the collateral is adequate to cover principal and interest, and the loan is in the process of collection. Interest accrued, but not collected, as of the date of placement on nonaccrual status, is reversed and charged against current interest income, unless fully collateralized. Subsequent payments received are either applied to the

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outstanding principal balance or recorded as interest income, depending upon management's assessment of the ultimate collectability of principal. Loans are returned to accrual status, for all loan classes, when all the principal and interest amounts contractually due are brought current, the loan has performed in accordance with the contractual terms of the note for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is reasonably assured. Past due status is based on contractual terms of the loan.

Loans, the terms of which are modified, are classified as troubled debt restructurings ("TDRs") if a concession was granted in connection with the modification, for legal or economic reasons, related to the debtor's financial difficulties. Concessions granted under a TDR typically involve a temporary deferral of scheduled loan payments, an extension of a loan's stated maturity date, a temporary reduction in interest rates, or granting of an interest rate below market rates given the risk of the transaction. If a modification occurs while the loan is on accruing status, it will continue to accrue interest under the modified terms. Nonaccrual TDRs may be restored to accrual status if scheduled principal and interest payments, under the modified terms, are current for six months after modification, and the borrower continues to demonstrate its ability to meet the modified terms. TDRs are evaluated individually for impairment on a quarterly basis including monitoring of performance according to their modified terms.

Allowance for Loan Losses – The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability 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.

See Note 3, "Loans Receivable and Allowance for Loan Losses," for additional details.

Loan Commitments and Related Financial Instruments – Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loans Serviced – The Bank administers secondary market mortgage programs available through the FHLB and the Federal National Mortgage Association and offers residential mortgage products and services to customers. The Bank originates single-family residential mortgage loans for immediate sale in the secondary market, and retains the servicing of those loans. At March 31, 2016 and December 31, 2015, the balance of loans serviced for others was $324,221,000 and $317,793,000.

Transfers of Financial Assets – Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Cash Surrender Value of Life Insurance – The Company has purchased life insurance policies on certain employees. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Premises and Equipment – Buildings, improvements, equipment, furniture and fixtures are carried at cost less accumulated depreciation and amortization. Land is carried at cost. Depreciation and amortization has been provided generally on the straight-line method and is computed over the estimated useful lives of the various assets as follows: buildings and improvements, including leasehold improvements – 10 to 40 years; and furniture and equipment – 3 to 15 years. Repairs and maintenance are charged to operations as incurred, while major additions and improvements are capitalized. Gain or loss on retirement or disposal of individual assets is recorded as income or expense in the period of retirement or disposal.

Intangible Assets – Intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. The Company's intangible assets have finite lives and are amortized, on a straight line basis, over their estimated lives, generally 10 years for deposit premiums and 15 years for customer lists.

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Mortgage Servicing Rights – The estimated fair value of mortgage servicing rights (MSRs) related to loans sold and serviced by the Company is recorded as an asset upon the sale of such loans. MSRs are amortized as a reduction to servicing income over the estimated lives of the underlying loans. MSRs are evaluated periodically for impairment, by comparing the carrying amount to estimated fair value. Fair value is determined periodically through a discounted cash flows valuation performed by a third party. Significant inputs to the valuation include expected servicing income, net of expense, the discount rate and the expected life of the underlying loans. To the extent the amortized cost of the MSRs exceeds their estimated fair values, a valuation allowance is established for such impairment through a charge against servicing income on the consolidated statement of income. If the Company determines, based on subsequent valuations, that impairment no longer exists or is reduced, the valuation allowance is reduced through a credit to earnings. The balance of mortgage servicing rights was $2,710,000 and $2,672,000 as of March 31, 2016 and December 31, 2015, and is included in other assets.

Foreclosed Real Estate – Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell the underlying collateral. Capitalized costs include any costs that significantly improve the value of the properties. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less estimated costs to sell. Foreclosed real estate totaled $495,000 and $710,000 as of March 31, 2016 and December 31, 2015 and is included in other assets.

Investments in Real Estate Partnerships – The Company currently has a 99% limited partner interest in several real estate partnerships in central Pennsylvania. These investments are affordable housing projects which entitle the Company to tax deductions and credits that expire through 2025. The Company accounts for its investments in affordable housing projects under the proportional amortization method when the criteria is met, which is limited to one investment entered into in 2015. Investments prior to 2015 did not meet the criteria, and are accounted for under the equity method of accounting. The recorded investment in these real estate partnerships, included in other assets in the balance sheet, totaled $5,328,000 and $5,450,000 as of March 31, 2016 and December 31, 2015, of which $2,150,000 and $2,205,000 will be accounted for under the proportional amortization method, respectively. Losses of $89,000 and $85,000 were recorded for the three months ended March 31, 2016 and 2015 and are included in other noninterest income. Losses on the investments accounted for under the proportional amortization method of $33,000, net of federal income tax benefit, is netted against income tax expense for the three months ended March 31, 2016. During the three months ended 2016 and 2015, the Company recognized federal tax credits from the projects totaling $184,000, and $119,000, which is included in income tax expense.

Advertising – The Company follows the policy of charging costs of advertising to expense as incurred. Advertising expense was $151,000 and $112,000 for the three months ended March 31, 2016 and 2015.

Securities Sold Under Agreements to Repurchase (“Repurchase Agreements”) – The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities which are included in short-term borrowings. Under these Repurchase Agreements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these Repurchase Agreements are accounted for as collateralized financing arrangements (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 Company’s consolidated balance sheet, 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 Company 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 Company be in default (e.g., fails to make an interest payment to the counterparty). For the Repurchase Agreements, the collateral is held by the Company in a segregated custodial account under a third party agreement. Repurchase agreements are secured by U.S. Government Sponsored Enterprises mortgage-backed securities and mature overnight.

Stock Compensation Plans – The Company has stock compensation plans that cover employees and non-employee directors. Stock compensation accounting guidance (Financial Accounting Standards Board ("FASB") ASC 718, Compensation – Stock Compensation) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost is measured based on the grant date fair value of the stock award, including a Black-Scholes model for stock options. Compensation cost for all stock awards is calculated and recognized over the employees' service period, generally defined as the vesting period.

Income Taxes – The Company accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, Income Taxes). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management’s judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Company recognizes interest and penalties, if any, on income taxes as a component of income tax expense.

Loss Contingencies – Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Treasury Stock – Common stock shares repurchased are recorded as treasury stock at cost.

Earnings Per Share – Basic earnings per share represent net income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Restricted stock awards are included in weighted average common shares outstanding as they are earned. Diluted earnings per share reflect the additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company related solely to outstanding stock options and restricted stock awards.

Treasury shares are not deemed outstanding for earnings per share calculations.

Comprehensive Income – Comprehensive income consists of net income and other comprehensive income. Other comprehensive income is limited to unrealized gains on securities available for sale for all years presented. The component of accumulated other comprehensive income, net of taxes, at March 31, 2016 and December 31, 2015 consisted of unrealized gains on securities available for sale and totaled $4,434,000 and $1,199,000.

Fair Value of Financial Instruments – Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 9. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Segment Reporting – The Company only operates in one significant segment – Community Banking. The Company’s non-banking activities are insignificant to the consolidated financial statements.

Reclassification – Certain amounts in the 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Recent Accounting Pronouncements – In May 2014, the FASB issued ASU 2014-9, Revenue from Contracts with Customers (Topic 606). ASU 2014-9, as amended, creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. These amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period.

The Company is evaluating the impact of this standard on its financial position and results of operations.
In April 2015, the FASB issued ASU No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, as subsequently amended by ASU No. 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. The update simplifies the presentation of debt issuance costs by requiring that debt issuance costs be presented in the balance sheet as a direct deduction from the

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carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this update. Further, the amendment indicates the SEC would not object to a ratable amortization of debt issuance costs on line-of-credit arrangements. These amendments were effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The Company's adoption of this standard on January 1, 2016 did not have a significant impact on the Company's operating results or financial condition.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The update provides updated accounting and reporting requirements for both public and non-public entities. The most significant provisions that will impact the Company is: 1) equity securities available for sale will be measured at fair value, with the changes in fair value recognized in the income statement; 2) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments at amortized cost on the balance sheet; 3) utilization of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 4) require separate presentation of both financial assets and liabilities by measurement category and form of financial asset on the balance sheet or accompanying notes to the financial statements. The update will be effective for interim and annual periods beginning after December 15, 2017, using a cumulative-effect adjustment to the balance sheet as of the beginning of the year of adoption. Early adoption is not permitted. The Company is evaluating the impact of this standard on its financial position and results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The update provides updated accounting and reporting requirements, which, among other things, requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. The Company anticipates that the impact on the balance sheet will result in an increase in assets and liabilities for its right of use assets and related lease liabilities for those leases that are outstanding at the date of adoption, however, it does not anticipate it will have a material impact on its results of operations. We are currently evaluating the other effects of adoption of this new standard on our financial position, including regulatory capital.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting (Topic 718). The update will require recognition of the income tax effects of share-based awards in the income statement when the awards vest or are settled, eliminating the additional paid-in-capital pools. The guidance will be effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company does not anticipate this update will have a material impact on its financial position or results of operations.

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NOTE 2. SECURITIES AVAILABLE FOR SALE

At March 31, 2016 and December 31, 2015, the investment securities portfolio was comprised exclusively of securities classified as "available for sale," resulting in investment securities being carried at fair value. The amortized cost and fair values of investment securities available for sale at March 31, 2016 and December 31, 2015 were:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2016				
U.S. Government Agencies	$ 45,072	$ 188	$ 121	$45,139
States and political subdivisions	124,302	5,246	367	129,181
U.S. Government Sponsored Enterprises (GSE) residential mortgage-backed securities	129,219	1,556	0	130,775
GSE residential collateralized mortgage obligations (CMOs)	14,040	384	20	14,404
Private label CMOs	8,086	0	68	8,018
Total debt securities	320,719	7,374	576	327,517
Equity securities	50	23	0	73
Totals	$ 320,769	$ 7,397	$ 576	$327,590
December 31, 2015				
U.S. Government Agencies	$ 47,209	$ 200	$ 182	$47,227
States and political subdivisions	124,421	2,483	943	125,961
GSE residential mortgage-backed securities	132,389	229	269	132,349
GSE residential CMOs	15,668	215	40	15,843
GSE commercial CMOs	63,598	735	563	63,770
Private label CMOs	8,944	0	43	8,901
Total debt securities	392,229	3,862	2,040	394,051
Equity securities	50	23	0	73
Totals	$ 392,279	$ 3,885	$ 2,040	$394,124

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The following table shows gross unrealized losses and fair value of the Company's available for sale securities that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position at March 31, 2016 and December 31, 2015:

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2016						
U.S. Government Agencies	$19,951	$ 121	$0	$ 0	$19,951	$ 121
States and political subdivisions	1,205	2	5,313	365	6,518	367
GSE residential collateralized mortgage obligations (CMOs)	0	0	2,555	20	2,555	20
Private label CMOs	8,018	68	0	0	8,018	68
Total temporarily impaired securities	$29,174	$ 191	$7,868	$ 385	$37,042	$ 576
December 31, 2015						
U.S. Government Agencies	$27,640	$ 182	$0	$ 0	$27,640	$ 182
States and political subdivisions	30,252	373	14,139	570	44,391	943
GSE residential mortgage-backed securities	82,911	269	0	0	82,911	269
GSE residential CMOs	0	0	4,237	40	4,237	40
GSE commercial CMOs	33,606	563	0	0	33,606	563
Private label CMOs	8,901	43	0	0	8,901	43
Total temporarily impaired securities	$183,310	$ 1,430	$18,376	$ 610	$201,686	$ 2,040

The Company had 11 securities and 53 securities at March 31, 2016 and December 31, 2015 in which the amortized cost exceed their values, as discussed below.

U.S. Agencies and Government Sponsored Enterprises (GSE). Six U.S. Agencies and GSE securities, including mortgage-backed securities and collateralized mortgage obligations, have amortized costs which exceed their fair values, four of which are in the less than 12 months, and two have amortized costs which exceed their fair value for more than 12 months at March 31, 2016. At December 31, 2015, the Company had 29 U.S. Government Agencies and GSE securities, including mortgage-backed and collateralized mortgage obligations with unrealized losses, 25 GSE securities have amortized costs which exceed their fair values for less than 12 months, and four have amortized costs which exceed their fair values for more than 12 months. These unrealized losses have been caused by a rise in interest rates or widening of spreads from the time the securities were purchased. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the par value basis of the investments. Because the Company did not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2016 or at December 31, 2015.

State and Political Subdivisions. Two state and political subdivision securities have amortized costs which exceeded their fair values, one in the less than 12 months, and one in the more than 12 months category at March 31, 2016. At December 31, 2015, 21 state and political subdivision securities have an amortized cost which exceeds their fair value, 16 of which are in the less than 12 months category, and five have amortized costs which exceed their fair value for more than 12 months. These unrealized losses have been caused by a rise in interest rates or a widening of spreads from the time the securities were purchased. Management considers the investment rating, the state of the issuer of the security and other credit support in determining whether the security is other-than-temporarily impaired. Because the Company did not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2016 or at December 31, 2015.

Private Label. Three private label collateralized mortgage obligations have unrealized losses, all of which were in the less than 12 months category at March 31, 2016. At December 31, 2015, three private label securities have an amortized cost which exceeds their fair value for less than 12 months. These unrealized losses have been caused by a rise in interest rates from the time the securities were purchased. Because the Company does not intend to sell the investments and it is not more likely than

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not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2016 or at December 31, 2015.

The amortized cost and fair values of securities available for sale at March 31, 2016 by contractual maturity are shown below. Contractual maturities will differ from expected maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$365	$366
Due after one year through five years	3,232	3,381
Due after five years through ten years	62,821	65,147
Due after ten years	102,956	105,426
Mortgage-backed securities and collateralized mortgage obligations	151,345	153,197
Total debt securities	320,719	327,517
Equity securities	50	73
	$320,769	$327,590

Gross gains on the sales of securities were $1,468,000 and $1,553,000 for the three months ended March 31, 2016 and 2015. Gross losses on securities available for sale were $48,000 and $24,000 for the three months ended March 31, 2016 and 2015.

Securities with a fair value of $254,252,000 and $250,397,000 at March 31, 2016 and December 31, 2015 were pledged to secure public funds and for other purposes as required or permitted by law.

NOTE 3. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The Company's loan portfolio is broken down into segments to an appropriate level of disaggregation to allow management to monitor the performance by the borrower and to monitor the yield on the portfolio. Consistent with ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses, the segments were further broken down into classes, to allow for differing risk characteristics within a segment.

The risks associated with lending activities differ among the various loan classes, and are subject to the impact of changes in interest rates, market conditions of collateral securing the loans, and general economic conditions. All of these factors may adversely impact the borrower's ability to repay its loans, and impact the associated collateral.

The Company has various types of commercial real estate loans which have differing levels of credit risk associated with them. Owner-occupied commercial real estate loans are generally dependent upon the successful operation of the borrower's business, with the cash flows generated from the business being the primary source of repayment of the loan. If the business suffers a downturn in sales or profitability, the borrower's ability to repay the loan could be in jeopardy.

Non-owner occupied and multi-family commercial real estate loans and non-owner occupied residential loans present a different credit risk to the Company than owner-occupied commercial real estate loans, as the repayment of the loan is dependent upon the borrower's ability to generate a sufficient level of occupancy to produce rental income that exceeds debt service requirements and operating expenses. Lower occupancy or lease rates may result in a reduction in cash flows, which hinders the ability of the borrower to meet debt service requirements, and may result in lower collateral values. The Company generally recognizes that greater risk is inherent in these credit relationships as compared to owner-occupied loans mentioned above.

Acquisition and development loans consist of 1-4 family residential construction and commercial and land development loans. The risk of loss on these loans is largely dependent on the Company's ability to assess the property's value at the completion of the project, which should exceed the property's construction costs. During the construction phase, a number of factors could potentially negatively impact the collateral value, including cost overruns, delays in completing the project, competition, and real estate market conditions which may change based on the supply of similar properties in the area. In the

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event the collateral value at the completion of the project is not sufficient to cover the outstanding loan balance, the Company must rely upon other repayment sources, including the guarantors of the project or other collateral securing the loan.

Commercial and industrial loans include advances to local and regional businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit or term loans. Although commercial and industrial loans may be unsecured for our highest-rated borrowers, the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment. In a significant number of these loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. Commercial and industrial loans present credit exposure to the Company, as they are more susceptible to risk of loss during a downturn in the economy, as borrowers may have greater difficulty in meeting their debt service requirements and the value of the collateral may decline. The Company attempts to mitigate this risk through its underwriting standards, including evaluating the credit worthiness of the borrower and, to the extent available, credit ratings on the business. Additionally, monitoring of the loans through annual renewals and meetings with the borrowers are typical. However, these procedures cannot eliminate the risk of loss associated with commercial and industrial lending.

Municipal loans consist of extensions of credit to municipalities and school districts within the Company's market area. These loans generally present a lower risk than commercial and industrial loans, as they are generally secured by the municipality's full taxing authority, by revenue obligations, or by its ability to raise assessments on its customers for a specific utility.

The Company originates loans to its retail customers, including fixed-rate and adjustable rate first lien mortgage loans with the underlying 1-4 family owner-occupied residential property securing the loan. The Company's risk exposure is minimized in these types of loans through the evaluation of the credit worthiness of the borrower, including credit scores and debt-to-income ratios, and underwriting standards which limit the loan-to-value ratio to generally no more than 80% upon loan origination, unless the borrower obtains private mortgage insurance.

Home equity loans, including term loans and lines of credit, present a slightly higher risk to the Company than 1-4 family first liens, as these loans can be first or second liens on 1-4 family owner occupied residential property, but can have loan-to-value ratios of no greater than 90% of the value of the real estate taken as collateral. The credit worthiness of the borrower is considered including credit scores and debt-to-income ratios, which generally cannot exceed 43%.

Installment and other loans' credit risk are mitigated through prudent underwriting standards, including the evaluation of the credit worthiness of the borrower through credit scores and debt-to-income ratios, and if secured, the collateral value of the assets. As these loans can be unsecured or secured by assets the value of which may depreciate quickly or may fluctuate, they typically present a greater risk to the Company than 1-4 family residential loans.

The loan portfolio, excluding residential loans held for sale, broken out by class, as of March 31, 2016 and December 31, 2015 was as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015
Commercial real estate:		
Owner-occupied	$106,464	$103,578
Non-owner occupied	154,731	145,401
Multi-family	37,664	35,109
Non-owner occupied residential	54,834	54,175
Acquisition and development:		
1-4 family residential construction	7,270	9,364
Commercial and land development	42,245	41,339
Commercial and industrial	77,277	73,625
Municipal	62,302	57,511
Residential mortgage:		
First lien	125,706	126,022

Home equity - term	16,578	17,337
Home equity - lines of credit	111,770	110,731
Installment and other loans	7,862	7,521
	$804,703	$781,713

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In order to monitor ongoing risk associated with its loan portfolio and specific loans within the segments, management uses an internal grading system. The first several rating categories, representing the lowest risk to the Bank, are combined and given a “Pass” rating. Management generally follows regulatory definitions in assigning criticized ratings to loans, including special mention, substandard, doubtful or loss. The “Special Mention” category includes loans that have potential weaknesses that may, if not monitored or corrected, weaken the asset or inadequately protect the Bank’s position at some future date. These assets pose elevated risk, but their weakness does not yet justify a more severe, or classified rating. “Substandard” loans are classified as they have a well-defined weakness, or weaknesses that jeopardize liquidation of the debt. These loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. “Substandard” loans include loans that management has determined not to be impaired, as well as loans considered to be impaired. A “Doubtful” loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification of loss is deferred. “Loss” assets are considered uncollectible, as the underlying borrowers are often in bankruptcy, have suspended debt repayments, or have ceased business operations. Once a loan is classified as “Loss,” there is little prospect of collecting the loan’s principal or interest and it is generally written off.

The Bank has a loan review policy and program which is designed to identify and manage risk in the lending function. The Enterprise Risk Management (“ERM”) Committee, comprised of executive officers and loan department personnel, is charged with the oversight of overall credit quality and risk exposure of the Bank’s loan portfolio. This includes the monitoring of the lending activities of all Bank personnel with respect to underwriting and processing new loans and the timely follow-up and corrective action for loans showing signs of deterioration in quality. The loan review program provides the Bank with an independent review of the Bank’s loan portfolio on an ongoing basis. Generally, consumer and residential mortgage loans are included in the “Pass” categories unless a specific action, such as extended delinquencies, bankruptcy, repossession or death of the borrower occurs, which heightens awareness as to a possible credit event.

Internal loan reviews are completed annually on all commercial relationships with a committed loan balance in excess of $500,000, which includes confirmation of risk rating by the appropriate credit authority, including Credit Administration for loans in excess of $1,000,000. In addition, all relationships greater than $250,000 rated Substandard, Doubtful or Loss are reviewed and corresponding risk ratings are reaffirmed by the Bank's Problem Loan Committee, with subsequent reporting to the ERM Committee.

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The following summarizes the Bank's ratings based on its internal risk rating system as of March 31, 2016 and December 31, 2015:

(Dollars in thousands)	Pass	Special Mention	Non-Impaired Substandard	Impaired - Substandard	Doubtful	Total
March 31, 2016						
Commercial real estate:						
Owner-occupied	$98,959	$1,771	$ 3,705	$ 2,029	$ 0	$106,464
Non-owner occupied	134,518	12,419	108	7,686	0	154,731
Multi-family	34,863	1,763	813	225	0	37,664
Non-owner occupied residential	51,490	1,282	1,231	792	39	54,834
Acquisition and development:						
1-4 family residential construction	7,270	0	0	0	0	7,270
Commercial and land development	41,105	215	922	3	0	42,245
Commercial and industrial	74,651	1,352	560	714	0	77,277
Municipal	62,302	0	0	0	0	62,302
Residential mortgage:						
First lien	120,882	0	44	4,780	0	125,706
Home equity - term	16,478	0	1	99	0	16,578
Home equity - lines of credit	110,850	251	102	567	0	111,770
Installment and other loans	7,846	0	0	9	7	7,862
	$761,214	$19,053	$ 7,486	$ 16,904	$ 46	$804,703
December 31, 2015						
Commercial real estate:						
Owner-occupied	$96,715	$1,124	$ 3,630	$ 2,109	$ 0	$103,578
Non-owner occupied	125,043	12,394	108	7,856	0	145,401
Multi-family	31,957	1,779	1,140	233	0	35,109
Non-owner occupied residential	50,601	1,305	1,374	895	0	54,175
Acquisition and development:						
1-4 family residential construction	9,364	0	0	0	0	9,364
Commercial and land development	40,181	219	934	5	0	41,339
Commercial and industrial	70,967	1,380	544	734	0	73,625
Municipal	57,511	0	0	0	0	57,511
Residential mortgage:						
First lien	121,214	0	0	4,808	0	126,022
Home equity - term	17,234	0	0	103	0	17,337
Home equity - lines of credit	109,731	230	180	590	0	110,731
Installment and other loans	7,504	0	0	17	0	7,521
	$738,022	$18,431	$ 7,910	$ 17,350	$ 0	$781,713

Classified loans may also be evaluated for impairment. For commercial real estate, acquisition and development and commercial and industrial loans, a loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal 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 interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Generally, loans that are more than 90 days past due are deemed 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 to determine if the loan should be placed on nonaccrual status. Nonaccrual loans in the commercial and

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commercial real estate portfolios and any TDRs are, by definition, deemed to be impaired. Impairment is measured on a loan-by-loan basis for commercial, construction and restructured loans by either the present value of the 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 loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. For loans that are deemed to be impaired for extended periods of time, periodic updates on fair values are obtained, which may include updated appraisals. The updated fair values are incorporated into the impairment analysis as of the next reporting period.

Loan charge-offs, which may include partial charge-offs, are taken on an impaired loan that is collateral dependent if the loan's carrying balance exceeds its collateral's appraised value; the loan has been identified as uncollectible; and it is deemed to be a confirmed loss. Typically, impaired loans with a charge-off or partial charge-off will continue to be considered impaired, unless the note is split into two, and management expects the performing note to continue to perform and is adequately secured. The second, or non-performing note, would be charged-off. Generally, an impaired loan with a partial charge-off may continue to have an impairment reserve on it after the partial charge-off, if factors warrant.

As of March 31, 2016 and December 31, 2015, nearly all of the Company's impaired loans' extent of impairment were measured based on the estimated fair value of the collateral securing the loan, except for TDRs. By definition, TDRs are considered impaired. All restructured loan impairments were determined based on discounted cash flows for those loans classified as TDRs and still accruing interest. For real estate loans, collateral generally consists of commercial real estate, but in the case of commercial and industrial loans, it would also consist of accounts receivable, inventory, equipment or other business assets. Commercial and industrial loans may also have real estate collateral.

According to policy, updated appraisals are generally required every 18 months for classified loans in excess of $250,000. The "as is value" provided in the appraisal is often used as the fair value of the collateral in determining impairment, unless circumstances, such as subsequent improvements, approvals, or other circumstances dictate that another value provided by the appraiser is more appropriate.

Generally, impaired loans secured by real estate are measured at fair value using certified real estate appraisals that had been completed within the last year. Appraised values are further discounted for estimated costs to sell the property and other selling considerations to arrive at the property's fair value. In those situations in which it is determined an updated appraisal is not required for loans individually evaluated for impairment, fair values are based on one or a combination of the following approaches. In those situations in which a combination of approaches is considered, the factor that carries the most consideration will be the one management believes is warranted. The approaches are as follows:

- Original appraisal – if the original appraisal provides a strong loan-to-value ratio (generally 70% or lower) and, after consideration of market conditions and knowledge of the property and area, it is determined by the Credit Administration staff that there has not been a significant deterioration in the collateral value, the original certified appraised value may be used. Discounts as deemed appropriate for selling costs are factored into the appraised value in arriving at fair value.
- Discounted cash flows – in limited cases, discounted cash flows may be used on projects in which the collateral is liquidated to reduce the borrowings outstanding, and is used to validate collateral values derived from other approaches.

Collateral on certain impaired loans is not limited to real estate, and may consist of accounts receivable, inventory, equipment or other business assets. Estimated fair values are determined based on borrowers' financial statements, inventory ledgers, accounts receivable agings or appraisals from individuals with knowledge in the business. Stated balances are generally discounted for the age of the financial information or the quality of the assets. In determining fair value, liquidation discounts are applied to this collateral based on existing loan evaluation policies.

The Company distinguishes Substandard loans on both an impaired and non-impaired basis, as it places less emphasis on a loan's classification, and increased reliance on whether the loan was performing in accordance with the contractual terms. A "Substandard" classification does not automatically meet the definition of "impaired." A "Substandard" loan is one that is inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Extensions of credit so classified have well-defined weaknesses which may jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual extensions of credit classified as "Substandard." As a result, the Company’s methodology includes an evaluation of certain accruing commercial real estate, acquisition and development and commercial and industrial loans rated “Substandard” to be collectively evaluated for impairment as opposed to evaluating these loans individually for impairment. Although we believe these loans have well defined weaknesses and meet the definition of “Substandard,” they are generally performing and management has concluded

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that it is likely it will be able to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement.

Larger groups of smaller balance homogeneous loans are collectively evaluated for impairment. Generally, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

The following table summarizes impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not required as of March 31, 2016 and December 31, 2015. The recorded investment in loans excludes accrued interest receivable due to insignificance. Related allowances established generally pertain to those loans in which loan forbearance agreements were in the process of being negotiated or updated appraisals were pending, and the partial charge-off will be recorded when final information is received.

	Impaired Loans with a Specific Allowance			Impaired Loans with No Specific Allowance	
(Dollars in thousands)	Recorded Investment (Book Balance)	Unpaid Principal Balance (Legal Balance)	Related Allowance	Recorded Investment (Book Balance)	Unpaid Principal Balance (Legal Balance)
March 31, 2016					
Commercial real estate:					
Owner-occupied	$0	$ 0	$ 0	$ 2,029	$ 3,301
Non-owner occupied	0	0	0	7,686	8,521
Multi-family	0	0	0	225	381
Non-owner occupied residential	39	39	39	792	1,080
Acquisition and development:					
Commercial and land development	0	0	0	3	18
Commercial and industrial	0	0	0	714	768
Residential mortgage:					
First lien	1,357	1,392	103	3,423	4,133
Home equity - term	0	0	0	99	106
Home equity - lines of credit	0	0	0	567	712
Installment and other loans	7	8	7	9	35
	$1,403	$ 1,439	$ 149	$ 15,547	$ 19,055
December 31, 2015					
Commercial real estate:					
Owner-occupied	$0	$ 0	$ 0	$ 2,109	$ 3,344
Non-owner occupied	0	0	0	7,856	8,600
Multi-family	0	0	0	233	385
Non-owner occupied residential	0	0	0	895	1,211
Acquisition and development:					
Commercial and land development	0	0	0	5	19
Commercial and industrial	0	0	0	734	780
Residential mortgage:					
First lien	1,952	1,984	271	2,856	3,369
Home equity - term	0	0	0	103	110
Home equity - lines of credit	22	23	10	568	688
Installment and other loans	8	9	8	9	35
	$1,982	$ 2,016	$ 289	$ 15,368	$ 18,541

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The following tables summarize the average recorded investment in impaired loans and related interest income recognized on loans deemed impaired, generally on a cash basis, for the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	2016 Average Impaired Balance	2016 Interest Income Recognized	2015 Average Impaired Balance	2015 Interest Income Recognized
Commercial real estate:				
Owner-occupied	$2,069	$ 0	$3,159	$ 0
Non-owner occupied	7,771	0	1,658	0
Multi-family	229	0	521	0
Non-owner occupied residential	875	0	1,303	0
Acquisition and development:				
Commercial and land development	4	0	392	2
Commercial and industrial	724	0	2,346	0
Residential mortgage:				
First lien	4,776	9	5,241	9
Home equity - term	101	0	93	0
Home equity - lines of credit	589	0	512	0
Installment and other loans	17	0	25	0
	$17,155	$ 9	$15,250	$ 11

The following table presents impaired loans that are TDRs, with the recorded investment as of March 31, 2016 and December 31, 2015.

(Dollars in thousands)	March 31, 2016 Number of Contracts	March 31, 2016 Recorded Investment	December 31, 2015 Number of Contracts	December 31, 2015 Recorded Investment
Accruing:				
Residential mortgage:				
First lien	9	$ 1,044	8	$ 793
	9	1,044	8	793
Nonaccruing:				
Residential mortgage:				
First lien	12	1,128	12	1,153
Installment and other loans	1	9	1	10
	13	1,137	13	1,163
	22	$ 2,181	21	$ 1,956

The loans presented above were considered TDRs as the result of the Company agreeing to below market interest rates for the risk of the transaction, allowing the loan to remain on interest-only status, or a reduction in interest rates, in order to give the borrowers an opportunity to improve their cash flows. For TDRs in default of their original terms, impairment is generally determined on a collateral-dependent approach, except for accruing residential mortgage TDRs, which are generally on the discounted cash flow approach.

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The following table presents the number of loans modified, and their pre-modification and post-modification investment balances for the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	2016 Number of Contracts	2016 Pre-Modification Recorded Investment	2016 Post Modification Recorded Investment	2015 Number of Contracts	2015 Pre-Modification Recorded Investment	2015 Post Modification Recorded Investment
Three Months Ended March 31,						
Residential mortgage:						
First lien	1	$ 257	$ 0	1	$ 59	$ 59
	1	$ 257	$ 0	1	$ 59	$ 59

Certain loans modified during a period may no longer be outstanding at the end of the period if the loan was paid off. The following table presents restructured loans, included in nonaccrual loans, that were modified as TDRs within the previous 12 months and for which there was a payment default during the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	2016 Number of Contracts	2016 Recorded Investment	2015 Number of Contracts	2015 Recorded Investment
Three Months Ended March 31,				
Residential mortgage:				
First lien	0	$ 0	5	$ 323
	0	$ 0	5	$ 323

No additional commitments have been made to borrowers whose loans are considered TDRs.

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Management further monitors the performance and credit quality of the loan portfolio by analyzing the average length of time a portfolio is past due, by aggregating loans based on its delinquencies. The following table presents the classes of the loan portfolio summarized by aging categories of performing loans and nonaccrual loans as of March 31, 2016 and December 31, 2015:

		Days Past Due					
(Dollars in thousands)	Current	30-59	60-89	90+ (still accruing)	Total Past Due	Non-Accrual	Total Loans
March 31, 2016							
Commercial real estate:							
Owner-occupied	$104,251	$184	$0	$ 0	$ 184	$2,029	$106,464
Non-owner occupied	146,986	59	0	0	59	7,686	154,731
Multi-family	37,439	0	0	0	0	225	37,664
Non-owner occupied residential	53,970	34	0	0	34	830	54,834
Acquisition and development:							
1-4 family residential construction	7,270	0	0	0	0	0	7,270
Commercial and land development	42,241	1	0	0	1	3	42,245
Commercial and industrial	76,563	0	0	0	0	714	77,277
Municipal	62,302	0	0	0	0	0	62,302
Residential mortgage:							
First lien	121,180	746	43	0	789	3,737	125,706
Home equity - term	16,478	0	0	1	1	99	16,578
Home equity - lines of credit	110,902	301	0	0	301	567	111,770
Installment and other loans	7,823	23	0	0	23	16	7,862
	$787,405	$1,348	$43	$ 1	$ 1,392	$15,906	$804,703
December 31, 2015							
Commercial real estate:							
Owner-occupied	$101,395	$74	$0	$ 0	$ 74	$2,109	$103,578
Non-owner occupied	137,545	0	0	0	0	7,856	145,401
Multi-family	34,876	0	0	0	0	233	35,109
Non-owner occupied residential	53,280	0	0	0	0	895	54,175
Acquisition and development:							
1-4 family residential construction	9,364	0	0	0	0	0	9,364
Commercial and land development	41,236	0	98	0	98	5	41,339
Commercial and industrial	72,846	24	21	0	45	734	73,625
Municipal	57,511	0	0	0	0	0	57,511
Residential mortgage:							
First lien	120,119	1,844	44	0	1,888	4,015	126,022
Home equity - term	17,200	34	0	0	34	103	17,337
Home equity - lines of credit	109,740	286	91	24	401	590	110,731
Installment and other loans	7,488	16	0	0	16	17	7,521
	$762,600	$2,278	$254	$ 24	$ 2,556	$16,557	$781,713

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The Company maintains the allowance for loan losses at a level believed to be adequate by management for probable incurred credit losses. The allowance is established and maintained through a provision for loan losses charged to earnings. Quarterly, management assesses the adequacy of the allowance for loan losses utilizing a defined methodology, which considers specific credit evaluation of impaired loans as discussed above, past loan loss historical experience, and qualitative factors. Management believes the approach properly addresses the requirements of ASC Subtopic 310-10-35 for loans individually identified as impaired, and ASC Subtopic 450-20 for loans collectively evaluated for impairment, and other bank regulatory guidance.

In connection with its quarterly evaluation of the adequacy of the allowance for loan losses, management continually reviews its methodology to determine if it continues to properly address the risk in the loan portfolio. For each loan class presented above, general allowances are provided for loans that are collectively evaluated for impairment, which is based on quantitative factors, principally historical loss trends for the respective loan class, adjusted for qualitative factors. In addition, an adjustment to the historical loss factors is made to account for delinquency and other potential risk not elsewhere defined within the Allowance for Loan and Lease Loss methodology.

Prior to December 31, 2015, the look back period for historical losses was 12 quarters, weighted one-half for the most recent four quarters, and one-quarter for each of the two previous four quarter periods in order to appropriately capture the loss history in the loan segment. Effective December 31, 2015, the Company extended the look back period to 16 quarters which will increase to 20 quarters through December 31, 2016. The extended period was on a prospective basis, more heavily weighted to the most recent four quarters. The look back period was extended as it was determined that a longer look back period is more consistent with the duration of an economic cycle. Management considers current economic, business, and real estate conditions, and the trends in historical charge-off percentages that resulted from applying partial charge-offs to impaired loans, and the impact of distressed loan sales during the year in determining the look back period.

In addition to the quantitative analysis, adjustments to the reserve requirements are allocated on loans collectively evaluated for impairment based on additional qualitative factors. As of March 31, 2016 and December 31, 2015, the qualitative factors used by management to adjust the historical loss percentage to the anticipated loss allocation, which may range from a minus 150 basis points to a positive 150 basis points per factor, include:

Nature and Volume of Loans – Loan growth in the current and subsequent quarters based on the Bank's targeted growth and strategic plan, coupled with the types of loans booked based on risk management and credit culture, and the number of exceptions to loan policy, and supervisory loan to value exceptions, etc.

Concentrations of Credit and Changes within Credit Concentrations – Factors considered include the composition of the Bank's overall portfolio and management's evaluation related to concentration risk management and the inherent risk associated with the concentrations identified.

Underwriting Standards and Recovery Practices – Factors considered include changes to underwriting standards and perceived impact on anticipated losses, trends in the number of exceptions to loan policy; supervisory loan to value exceptions; and administration of loan recovery practices.

Delinquency Trends – Factors considered include the delinquency percentages noted in the portfolio relative to economic conditions, severity of the delinquencies, and whether the ratios are trending upwards or downwards.

Classified Loans Trends – Factors considered include the internal loan ratings of the portfolio, the severity of the ratings, and whether the loan segment's ratings show a more favorable or less favorable trend, and underlying market conditions and their impact on the collateral values securing the loans.

Experience, Ability and Depth of Management/Lending staff – Factors considered include the years of experience of senior and middle management and the lending staff and turnover of the staff, and instances of repeat criticisms of ratings.

Quality of Loan Review – Factors include the years of experience of the loan review staff, in-house versus outsourced provider of review, turnover of staff and the perceived quality of their work in relation to other external information.

National and Local Economic Conditions – Ratios and factors considered include trends in the consumer price index (CPI), unemployment rates, housing price index, housing statistics compared to the prior year, bankruptcy rates, regulatory and legal environment risks and competition

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Activity in the allowance for loan losses for the three months ended March 31, 2016 and 2015 was as follows:

(Dollars in thousands)	Commercial Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Consumer Residential Mortgage	Installment and Other	Total	Unallocated	Total
March 31, 2016										
Balance, beginning of period	$7,883	$ 850	$ 1,012	$ 58	$9,803	$2,870	$ 121	$2,991	$ 774	$13,568
Provision for loan losses	33	(111)	37	4	(37)	45	102	147	(110)	0
Charge-offs	0	0	(21)	0	(21)	(244)	(64)	(308)	0	(329)
Recoveries	80	0	2	0	82	6	20	26	0	108
Balance, end of period	$7,996	$ 739	$ 1,030	$ 62	$9,827	$2,677	$ 179	$2,856	$ 664	$13,347
March 31, 2015										
Balance, beginning of period	$9,462	$ 697	$ 806	$ 183	$11,148	$2,262	$ 119	$2,381	$ 1,218	$14,747
Provision for loan losses	(63)	(87)	(137)	(62)	(349)	494	15	509	(160)	0
Charge-offs	(66)	(22)	(26)	0	(114)	(201)	(20)	(221)	0	(335)
Recoveries	13	0	22	0	35	12	2	14	0	49
Balance, end of period	$9,346	$ 588	$ 665	$ 121	$10,720	$2,567	$ 116	$2,683	$ 1,058	$14,461

The following table summarizes the ending loan balances individually evaluated for impairment based upon loan segment, as well as the related allowance for loan losses allocation for each at March 31, 2016 and December 31, 2015:

(Dollars in thousands)	Commercial Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Consumer Residential Mortgage	Installment and Other	Total	Unallocated	Total
March 31, 2016										
Loans allocated by:										
Individually evaluated for impairment	$10,771	$3	$714	$0	$11,488	$5,446	$16	$5,462	$0	$16,950
Collectively evaluated for impairment	342,922	49,512	76,563	62,302	531,299	248,608	7,846	256,454	0	787,753
	$353,693	$49,515	$77,277	$62,302	$542,787	$254,054	$7,862	$261,916	$0	$804,703
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$39	$0	$0	$0	$39	$103	$7	$110	$0	$149
Collectively evaluated for impairment	7,957	739	1,030	62	9,788	2,574	172	2,746	664	13,198
	$7,996	$739	$1,030	$62	$9,827	$2,677	$179	$2,856	$664	$13,347
December 31, 2015										
Loans allocated by:										
Individually evaluated for impairment	$11,093	$5	$734	$0	$11,832	$5,501	$17	$5,518	$0	$17,350
Collectively evaluated for impairment	327,170	50,698	72,891	57,511	508,270	248,589	7,504	256,093	0	764,363
	$338,263	$50,703	$73,625	$57,511	$520,102	$254,090	$7,521	$261,611	$0	$781,713

Allowance for loan losses allocated by:										
Individually evaluated for impairment	$0	$0	$0	$0	$0	$281	$8	$289	$0	$289
Collectively evaluated for impairment	7,883	850	1,012	58	9,803	2,589	113	2,702	774	13,279
	$7,883	$850	$1,012	$58	$9,803	$2,870	$121	$2,991	$774	$13,568

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NOTE 4. INCOME TAXES

The Company files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Pennsylvania. The Bank also files an income tax return in the State of Maryland. The Company is no longer subject to U.S. federal, state or local income tax examination by tax authorities for years before 2012.

The components of income tax expense for the three months ended March 31, 2016 and 2015 are summarized as follows:

(Dollars in thousands)	Three months ended March 31, 2016	2015
Current year provision (benefit):		
Federal	$(112)	$(15)
State	(2)	4
	(114)	(11)
Deferred tax expense		
Federal	722	720
State	6	6
	728	726
Net income tax expense	$614	$715

The provision for income taxes includes $497,000 and $535,000 of applicable income tax expense related to net securities gains for the three months ended March 31, 2016 and 2015.

The components of the net deferred tax asset, included in other assets, are as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015
Deferred tax assets:		
Allowance for loan losses	$ 5,078	$ 5,111
Deferred compensation	546	547
Retirement plans and salary continuation	1,865	1,824
Share-based compensation	417	343
Off balance sheet reserves	224	218
Nonaccrual loan interest	315	246
Goodwill	116	124
Bonus accrual	69	359
Low income housing credit carryforward	1,735	1,652
Alternative minimum tax credit carryforward	2,262	2,195
Charitable contribution carryforward	69	211
Net operating loss carryforward	3,798	4,431
Other	190	182
Total deferred tax assets	16,684	17,443
Deferred tax liabilities:		
Depreciation	771	815
Net unrealized gains on securities available for sale	2,387	646
Mortgage servicing rights	699	669
Purchase accounting adjustments	336	352
Other	180	181
Total deferred tax liabilities	4,373	2,663
Net deferred tax asset	$ 12,311	$ 14,780

The provision for income taxes differs from that computed by applying statutory rates to income before income taxes primarily due to the effects of tax-exempt income, non-deductible expenses and tax credits.

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As of March 31, 2016, the Company had charitable contribution, low-income housing, and net operating loss carryforwards that expire through 2019, 2036 and 2032, respectively.

In assessing whether or not some or all of our deferred tax asset is more likely than not to be realized in the future, management considers all positive and negative evidence, including projected future taxable income, tax planning strategies and recent financial operating results. The ultimate realization of deferred tax assets is dependent upon existence, or generation, of taxable income in the periods when those temporary differences and net operating loss and credit carryforwards are deductible. Management considered projected future taxable income, length of time needed for carryforwards to reverse, available tax planning strategies, and other factors in making its assessment that it was more likely than not the net deferred tax assets would be realized, and that no valuation allowance was required at March 31, 2016 or December 31, 2015.

NOTE 5. SHARE-BASED COMPENSATION PLANS

The Company maintains share-based compensation plans, the purpose of which are to provide officers, employees, and non-employee members of the Board of Directors of the Company and the Bank, with additional incentive to further the success of the Company. In May 2011, the shareholders of the Company approved the 2011 Orrstown Financial Services, Inc. Incentive Stock Plan (the "Plan"). Under the Plan, 381,920 shares of the common stock of the Company were reserved to be issued. As of March 31, 2016, 151,445 shares were available to be issued under the Plan.

Incentive awards under the Plan may consist of grants of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, deferred stock units and performance shares. All employees of the Company and its present or future subsidiaries, and members of the Board of Directors of the Company or any subsidiary of the Company, are eligible to participate in the Plan. The Plan allows for the Compensation Committee of the Board of Directors to determine the type of incentive to be awarded, its term, manner of exercise, vesting of awards and restrictions on shares. Generally, awards are nonqualified under the IRS code, unless the awards are deemed to be incentive awards to employees, at the Compensation Committee's discretion.

A roll forward of the Company's nonvested restricted shares for the three months ended March 31, 2016 is presented below:

	Shares	Weighted Average Grant Date Fair Value
Nonvested shares, beginning of year	197,381	$ 16.17
Granted	29,045	17.69
Forfeited	(1,083)	17.26
Vested	(2,500)	10.43
Nonvested shares, at period end	222,843	$ 16.43

For the three months ended March 31, 2016 and 2015, $237,000 and $131,000 was recognized as expense on the restricted stock awards, with tax benefits recorded of $83,000 and $46,000 for the respective periods. As of March 31, 2016 and December 31, 2015, the unrecognized compensation expense related to the stock awards were $2,495,000 and $2,293,000. The unrecognized compensation expense is expected to be recognized over a weighted-average period of 3.0 years.

A roll forward of the Company's outstanding stock options for the three months ended March 31, 2016 is presented below:

	Shares	Weighted Average Exercise Price

Outstanding at beginning of year	101,460	$ 28.72
Forfeited	(2,050)	26.54
Options outstanding and exercisable, at period end	99,410	$ 28.76

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The exercise price of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is ten years. All options are fully vested upon issuance. Information pertaining to options outstanding and exercisable at March 31, 2016 is as follows:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
\$21.14 - \$24.99			