HMN FINANCIAL INC
Form 10-Q
August 05, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 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 0-24100

HMN FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	41-1777397
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1016 Civic Center Drive N.W., Rochester, MN	55901
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code:	(507) 535-1200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

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

Yes No

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

Class	Outstanding at July 27, 2016
Common stock, $0.01 par value	4,488,923

HMN FINANCIAL, INC.

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Part I – FINANCIAL INFORMATION

Item 1: Financial Statements

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollars in thousands)	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Cash and cash equivalents	$ 18,880	39,782
Securities available for sale:		
Mortgage-backed and related securities (amortized cost $1,606 and $2,237)	1,641	2,283
Other marketable securities amortized cost $74,011 and $110,092)	73,924	109,691
	75,565	111,974
Loans held for sale	3,159	3,779
Loans receivable, net	530,425	463,185
Accrued interest receivable	2,411	2,254
Real estate, net	1,421	2,045
Federal Home Loan Bank stock, at cost	770	691
Mortgage servicing rights, net	1,479	1,499
Premises and equipment, net	8,079	7,469
Goodwill	802	0
Core deposit intangible	503	393
Prepaid expenses and other assets	1,338	1,417
Deferred tax asset, net	8,553	8,673
Total assets	$ 653,385	643,161
Liabilities and Stockholders' Equity		
Deposits	$ 563,060	559,387
Other borrowings	9,000	9,000
Accrued interest payable	233	242
Customer escrows	1,976	830
Accrued expenses and other liabilities	5,779	4,057
Total liabilities	580,048	573,516
Commitments and contingencies		
Stockholders' equity:		
Serial preferred stock ($.01 par value): authorized 500,000 shares; issued shares 0	0	0
Common stock ($.01 par value): authorized 16,000,000; issued shares 9,128,662	91	91
Additional paid-in capital	50,391	50,388

Retained earnings, subject to certain restrictions	83,788	80,536
Accumulated other comprehensive loss	(32)	(214)
Unearned employee stock ownership plan shares	(2,320)	(2,417)
Treasury stock, at cost 4,639,739 and 4,645,769 shares	(58,581)	(58,739)
Total stockholders' equity	73,337	69,645
Total liabilities and stockholders' equity	$ 653,385	643,161

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Interest income:				
Loans receivable	$6,774	4,537	12,868	8,891
Securities available for sale:				
Mortgage-backed and related	16	24	36	52
Other marketable	351	501	723	987
Cash equivalents	17	7	55	22
Other	1	1	2	2
Total interest income	7,159	5,070	13,684	9,954
Interest expense:				
Deposits	246	226	472	474
Advances and other borrowings	149	165	297	243
Total interest expense	395	391	769	717
Net interest income	6,764	4,679	12,915	9,237
Provision for loan losses	381	(183)	(351)	(183)
Net interest income after provision for loan losses	6,383	4,862	13,266	9,420
Non-interest income:				
Fees and service charges	873	844	1,652	1,626
Loan servicing fees	271	257	532	516
Losses on sales of investments	(9)	0	(9)	0
Gain on sales of loans	705	530	1,192	815
Other	262	236	490	504
Total non-interest income	2,102	1,867	3,857	3,461
Non-interest expense:				
Compensation and benefits	3,598	3,540	7,293	6,986
(Gains) losses on real estate owned	(75)	65	(424)	(47)
Occupancy and equipment	1,006	926	1,996	1,805
Data processing	281	268	554	499
Professional services	368	293	619	509
Other	855	708	1,686	1,479
Total non-interest expense	6,033	5,800	11,724	11,231
Income before income tax expense	2,452	929	5,399	1,650
Income tax expense	974	344	2,147	604
Net income	1,478	585	3,252	1,046
Preferred stock dividends	0	0	0	(108)
Net income available to common shareholders	1,478	585	3,252	938

Other comprehensive income (loss), net of tax	44	(189)	182	206
Comprehensive income available to common shareholders	$1,522	396	3,434	1,144
Basic earnings per common share	$0.35	0.14	0.78	0.23
Diluted earnings per common share	$0.31	0.13	0.69	0.20

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

For the Six-Month Period Ended June 30, 2016

(unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2015	$ 91	50,388	80,536	(214)	(2,417)	(58,739)	69,645
Net income			3,252				3,252
Other comprehensive income				182			182
Stock compensation expense		39					39
Restricted stock awards		(158)				158	0
Amortization of restricted stock awards		92					92
Earned employee stock ownership plan shares		30			97		127
Balance, June 30, 2016	$ 91	50,391	83,788	(32)	(2,320)	(58,581)	73,337

See accompanying notes to consolidated financial statements.

HMN FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited)

	Six Months Ended June 30,	
(Dollars in thousands)	2016	2015
Cash flows from operating activities:		
Net income	$3,252	1,046
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	(351)	(183)
Depreciation	399	333
Amortization of (discounts) premiums, net	(9)	(2)
Amortization of deferred loan fees	(802)	(207)
Amortization of core deposit intangible	43	0
Amortization of other purchased fair value adjustments	(253)	0
Amortization of mortgage servicing rights and servicing costs	278	275
Capitalized mortgage servicing rights	(258)	(219)
Losses on sales of investments	9	0
Gain on sales of real estate	(424)	(47)
Gain on sales of loans	(1,192)	(815)
Proceeds from sale of loans held for sale	40,870	30,873
Disbursements on loans held for sale	(31,244)	(31,660)
Amortization of restricted stock awards	92	327
Amortization of unearned ESOP shares	97	96
Earned employee stock ownership shares priced above original cost	30	31
Stock option compensation expense	39	0
Increase in accrued interest receivable	(50)	(66)
(Decrease) increase in accrued interest payable	(13)	150
Decrease in other assets	239	290
Increase in other liabilities	1,635	273
Other, net	23	15
Net cash provided by operating activities	12,410	510
Cash flows from investing activities:		
Principal collected on securities available for sale	628	736
Proceeds collected on maturities of securities available for sale	96,020	76,070
Purchases of securities available for sale	(59,968)	(64,070)
Purchase of Federal Home Loan Bank Stock	(1,079)	(119)
Redemption of Federal Home Loan Bank Stock	1,000	205
Proceeds from sales of real estate	1,623	385
Net increase in loans receivable	(62,447)	(4,920)
Acquisition payment (net of cash acquired)	6,080	0
Purchases of premises and equipment	(1,009)	(358)
	(19,152)	7,929

Net cash (used) provided by investing activities		
Cash flows from financing activities:		
Decrease in deposits	(15,288)	(15,274)
Redemption of preferred stock	0	(10,000)
Dividends to preferred stockholders	0	(225)
Proceeds from borrowings	25,000	41,000
Repayment of borrowings	(25,000)	(31,000)
Increase (decrease) in customer escrows	1,128	(17)
Net cash used by financing activities	(14,160)	(15,516)
Decrease in cash and cash equivalents	(20,902)	(7,077)
Cash and cash equivalents, beginning of period	39,782	46,634
Cash and cash equivalents, end of period	$18,880	39,557
Supplemental cash flow disclosures:		
Cash paid for interest	$777	567
Cash paid for income taxes	156	135
Supplemental noncash flow disclosures:		
Loans transferred to loans held for sale	7,891	2,313
Transfer of loans to real estate	591	0

See accompanying notes to consolidated financial statements.

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HMN FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(unaudited)

(1*) HMN Financial, Inc.*

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

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

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

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

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statement of stockholders' equity and consolidated statements of cash flows in conformity with U.S. generally accepted accounting principles (GAAP). However, all normal recurring adjustments which are, in the opinion of management, necessary for the fair presentation of the interim financial statements have been included. The results of operations for the six-month period ended June 30, 2016 are not necessarily indicative of the results which may be expected for the entire year.

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

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

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

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

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

(4) *Fair Value Measurements*

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

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

<u>Level 2</u> - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant

assumptions are observable in the market.

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

The following table summarizes the assets and liabilities of the Company for which fair values are determined on a recurring basis as of June 30, 2016 and December 31, 2015.

	Carrying value at June 30, 2016			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Securities available for sale	$75,565	0	75,565	0
Mortgage loan commitments	196	0	196	0
Total	$75,761	0	75,761	0

	Carrying value at December 31, 2015			
(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Securities available for sale	$111,974	0	111,974	0
Mortgage loan commitments	36	0	36	0
Total	$112,010	0	112,010	0

There were no transfers between Levels 1, 2, or 3 during the three or six month periods ended June 30, 2016.

The Company may also be required, from time to time, to measure certain other financial assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held at June 30, 2016 and December 31, 2015, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related individual assets or portfolios at June 30, 2016 and December 31, 2015.

	Carrying value at June 30, 2016					
(Dollars in thousands)	Total	Level 1	Level 2	Level 3	Three months ended June 30, 2016	Six months ended June 30, 2016

					Total Gains (Losses)	Total Gains (Losses)
Loans held for sale	$3,159	0	3,159	0	32	48
Mortgage servicing rights	1,479	0	1,479	0	0	0
Loans (1)	3,842	0	3,842	0	(116)	(182)
Real estate, net (2)	1,421	0	1,421	0	0	(253)
Total	$9,901	0	9,901	0	(84)	(387)

	Carrying value at December 31, 2015				Year ended
(Dollars in thousands)	Total	Level 1	Level 2	Level 3	December 31, 2015 Total Gains (Losses)
Loans held for sale	$3,779	0	3,779	0	3
Mortgage servicing rights, net	1,499	0	1,499	0	0
Loans(1)	4,790	0	4,790	0	(373)
Real estate, net(2)	2,045	0	2,045	0	(262)
Total	$12,113	0	12,113	0	(632)

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

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

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

GAAP requires interim reporting period disclosure about the fair value of financial instruments, including assets, liabilities and off-balance sheet items for which it is practicable to estimate fair value. The fair value hierarchy level for each asset and liability, as defined in note 4, have been included in the following table for June 30, 2016 and December 31, 2015. The fair value estimates are made based upon relevant market information, if available, and upon the characteristics of the financial instruments themselves. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based upon judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. The estimated fair value of the Company's financial instruments as of June 30, 2016 and December 31, 2015 are shown in the following table.

	June 30, 2016						December 31, 2015					
			Fair value hierarchy						Fair value hierarchy			
(Dollars in thousands)	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3	Contract amount	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3	Contract amount
Financial assets:												
Cash and cash equivalents	$18,880	18,880	18,880				39,782	39,782	39,782			
Securities available for sale	75,565	75,565		75,565			111,974	111,974		111,974		
Loans held for sale	3,159	3,159		3,159			3,779	3,779		3,779		
Loans receivable, net	530,425	532,418		532,418			463,185	458,539		458,539		
Federal Home Loan Bank stock	770	770		770			691	691		691		
Accrued interest receivable	2,411	2,411		2,411			2,254	2,254		2,254		
Financial liabilities:												
Deposits	563,060	562,933		562,933			559,387	558,731		558,731		
Other borrowings	9,000	10,075		10,075			9,000	9,000		9,000		
Accrued interest payable	233	233		233			242	242		242		

Off-balance sheet financial instruments:						
Commitments to extend credit	196	196	221,019	36	36	165,949
Commitments to sell loans	(119)	(119)	12,071	(26)	(26)	8,071

Cash and Cash Equivalents

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

Securities Available for Sale

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

Loans Held for Sale

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

Loans Receivable, net

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

Federal Home Loan Bank stock

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

Accrued Interest Receivable

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

Deposits

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

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

Other Borrowings

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

Accrued Interest Payable

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

Commitments to Extend Credit

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

Commitments to Sell Loans

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

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

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

(Dollars in thousands)	For the three months ended June 30, 2016			2015		
Securities available for sale:	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Gross unrealized gains (losses) arising during the period	$64	26	38	(315)	(126)	(189)
Less reclassification of net losses included in net income	(9)	(3)	(6)	0	0	0
Net unrealized gains (losses) arising during the period	73	29	44	(315)	(126)	(189)
Other comprehensive income (loss)	$73	29	44	(315)	(126)	(189)

(Dollars in thousands)	For the six months ended June 30, 2016			2015		
Securities available for sale:	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Gross unrealized gains arising during the period	$294	118	176	340	134	206
Less reclassification of net losses included in net income	(9)	(3)	(6)	0	0	0
Net unrealized gains arising during the period	303	121	182	340	134	206
Other comprehensive income	$303	121	182	340	134	206

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

The following table shows the gross unrealized losses and fair value for the securities available for sale portfolio, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2016 and December 31, 2015.

(Dollars in thousands)	Less Than Twelve Months			Twelve Months or More			Total	
	# of Investments	Fair Value	Unrealized Losses	# of Investments	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2016								
Collateralized mortgage obligations:								
Federal National Mortgage Association (FNMA)	1	$ 254	(4)	0	$ 0	0	$ 254	(4)
Other	2	23	(5)	0	0	0	23	(5)
Other marketable securities: Municipal obligations	4	444	(2)	0	0	0	444	(2)
Corporate preferred stock	0	0	0	1	350	(350)	350	(350)
Total temporarily impaired securities	7	$ 721	(11)	1	$ 350	(350)	$ 1,071	(361)

(Dollars in thousands)	Less Than Twelve Months			Twelve Months or More			Total	
	# of Investments	Fair Value	Unrealized Losses	# of Investments	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2015								
Collateralized mortgage obligations:								
FNMA	1	$ 346	(1)	0	$ 0	0	$ 346	(1)
Other	2	34	(8)	0	0	0	34	(8)
Other marketable securities:								
U.S. Government agency obligations	9	44,878	(129)	0	0	0	44,878	(129)
Municipal obligations	12	2,010	(7)	0	0	0	2,010	(7)
Corporate obligations	1	334	(6)	0	0	0	334	(6)
Corporate preferred stock	0	0	0	1	350	(350)	350	(350)
Total temporarily impaired securities	25	$ 47,602	(151)	1	$ 350	(350)	$ 47,952	(501)

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

The unrealized losses reported for corporate preferred stock over twelve months at June 30, 2016 relates to a single trust preferred security that was issued by the holding company of a small community bank. Typical of most trust preferred issuances, the issuer has the ability to defer interest payments for up to five years with interest payable on the deferred balance. In September 2014, the issuer paid all previously deferred interest that was due and all payments were current as of September 30, 2014. Since January 2015, the issuer has deferred its scheduled interest payment as allowed by the terms of the security agreement. The issuer's subsidiary bank has incurred operating losses in the past due to increased provisions for loan losses but has generated a modest amount of net income over the past twelve months and continues to meet the regulatory requirements to be considered "well capitalized" based on its most recent regulatory filing. Based on a review of the issuer, it was determined that the trust preferred security was not other-than-temporarily impaired at June 30, 2016. The Company does not intend to sell the trust preferred security and has the intent and ability to hold it for a period of time sufficient to recover the temporary loss. Management believes that the Company will receive all principal and interest payments contractually due on the security and that the decrease in the market value is primarily due to a lack of liquidity in the market for trust preferred securities and the deferral of interest by the issuer. Management will continue to monitor the credit risk of the issuer and may be required to recognize other-than-temporary impairment charges on this security in future periods.

A summary of securities available for sale at June 30, 2016 and December 31, 2015 is as follows:

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2016				
Mortgage-backed securities:				
Federal Home Loan Mortgage Corporation (FHLMC)	$ 509	19	0	528
Federal National Mortgage Association (FNMA)	491	11	0	502
Collateralized mortgage obligations:				
FNMA	578	14	(4)	588
Other	28	0	(5)	23
	1,606	44	(9)	1,641
Other marketable securities:				
U.S. Government agency obligations	69,980	191	0	70,171
Municipal obligations	2,957	44	(2)	2,999
Corporate obligations	316	18	0	334
Corporate preferred stock	700	0	(350)	350
Corporate equity	58	12	0	70
	74,011	265	(352)	73,924
	$ 75,617	309	(361)	75,565

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2015				
Mortgage-backed securities:				

FHLMC	$ 728	31	0	759
FNMA	725	22	0	747
Collateralized mortgage obligations:				
FNMA	742	2	(1)	743
Other	42	0	(8)	34
	2,237	55	(9)	2,283
Other marketable securities:				
U.S. Government agency obligations	105,003	68	(129)	104,942
Municipal obligations	3,991	18	(7)	4,002
Corporate obligations	340	0	(6)	334
Corporate preferred stock	700	0	(350)	350
Corporate equity	58	5	0	63
	110,092	91	(492)	109,691
	$ 112,329	146	(501)	111,974

The following table indicates amortized cost and estimated fair value of securities available for sale at June 30, 2016 based upon contractual maturity adjusted for scheduled repayments of principal and projected prepayments of principal based upon current economic conditions and interest rates.

(Dollars in thousands)	Amortized Cost	Fair Value
Due less than one year	$ 55,647	55,814
Due after one year through five years	18,748	18,861
Due after five years through ten years	321	325
Due after ten years	843	495
No stated maturity	58	70
Total	$ 75,617	75,565

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

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

A summary of loans receivable at June 30, 2016 and December 31, 2015 is as follows:

(Dollars in thousands)	June 30, 2016	December 31, 2015
1-4 family	$100,720	90,945
Commercial real estate:		
Real estate rental and leasing	158,439	125,376
Other	133,311	121,977
	291,750	247,353
Consumer	74,462	64,415
Commercial business:		
Transportation industry	10,503	9,349
Other	63,030	60,757
	73,533	70,106
Total loans	540,465	472,819
Less:		
Unamortized discounts	21	16
Net deferred loan costs	(306)	(91)
Allowance for loan losses	10,325	9,709
Total loans receivable, net	$530,425	463,185

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

The allowance for loan losses is summarized as follows:

(Dollars in thousands)	1-4 Family	Commercial Real Estate	Consumer	Commercial Business	Total
For the three months ended June 30, 2016:					
Balance, March 31, 2016	$1,050	5,437	1,395	1,481	9,363
Provision for losses	220	(37)	132	66	381
Charge-offs	0	0	(8)	(44)	(52)
Recoveries	0	427	12	194	633
Balance, June 30, 2016	$1,270	5,827	1,531	1,697	10,325
For the six months ended June 30, 2016:					
Balance, December 31, 2015	$990	6,078	1,200	1,441	9,709
Provision for losses	280	(859)	315	(87)	(351)
Charge-offs	0	0	(15)	(44)	(59)
Recoveries	0	608	31	387	1,026
Balance, June 30, 2016	$1,270	5,827	1,531	1,697	10,325
Allocated to:					
Specific reserves	$223	296	370	120	1,009
General reserves	767	5,782	830	1,321	8,700
Balance, December 31, 2015	$990	6,078	1,200	1,441	9,709
Allocated to:					
Specific reserves	$308	197	378	67	950
General reserves	962	5,630	1,153	1,630	9,375

Balance, June 30, 2016	$1,270	5,827	1,531	1,697	10,325
Loans receivable at December 31, 2015:					
Individually reviewed for impairment	$2,203	2,204	977	415	5,799
Collectively reviewed for impairment	88,742	245,149	63,438	69,691	467,020
Ending balance	$90,945	247,353	64,415	70,106	472,819
Loans receivable at June 30, 2016:					
Individually reviewed for impairment	$1,508	1,815	1,134	335	4,792
Collectively reviewed for impairment	99,212	289,935	73,328	73,198	535,673
Ending balance	$100,720	291,750	74,462	73,533	540,465

(Dollars in thousands)	1-4 Family	Commercial Real Estate	Consumer	Commercial Business	Total
For the three months ended June 30, 2015:					
Balance, March 31, 2015	$1,091	5,122	1,022	1,183	8,418
Provision for losses	(81)	132	143	(377)	(183)
Charge-offs	0	(5)	(9)	0	(14)
Recoveries	1	29	6	145	181
Balance, June 30, 2015	$1,011	5,278	1,162	951	8,402
For the six months ended June 30, 2015:					
Balance, December 31, 2014	$1,096	5,024	1,009	1,203	8,332
Provision for losses	(87)	197	166	(459)	(183)
Charge-offs	0	(5)	(27)	0	(32)
Recoveries	2	62	14	207	285
Balance, June 30, 2015	$1,011	5,278	1,162	951	8,402

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The following table summarizes the amount of classified and unclassified loans at June 30, 2016 and December 31, 2015:

	June 30, 2016						
	Classified					Unclassified	
(Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total	Total	Total Loans
1-4 family	$524	2,367	50	67	3,008	97,712	100,720
Commercial real estate:							
Real estate rental and leasing	0	7,189	0	0	7,189	151,250	158,439
Other	1,986	8,995	0	0	10,981	122,330	133,311
Consumer	0	816	50	269	1,135	73,327	74,462
Commercial business:							
Transportation industry	0	3,884	0	0	3,884	6,619	10,503
Other	2,412	1,385	0	0	3,797	59,233	63,030
	$4,922	24,636	100	336	29,994	510,471	540,465

	December 31, 2015						
	Classified					Unclassified	
(Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total	Total	Total Loans
1-4 family	$189	2,889	55	0	3,133	87,812	90,945
Commercial real estate:							
Real estate rental and leasing	1,910	4,827	0	0	6,737	118,639	125,376
Other	917	9,473	0	0	10,390	111,587	121,977
Consumer	0	639	52	286	977	63,438	64,415
Commercial business:							
Transportation industry	4,082	18	0	0	4,100	5,249	9,349

Other	841	1,515	0	0	2,356	58,401	60,757
	$7,939	19,361	107	286	27,693	445,126	472,819

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

The aging of past due loans at June 30, 2016 and December 31, 2015 is summarized as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Loans	Total Loans	Loans 90 Days or More Past Due and Still Accruing
June 30, 2016							
1-4 family	$729	111	217	1,057	99,663	100,720	0
Commercial real estate:							
Real estate rental and leasing	0	0	0	0	158,439	158,439	0
Other	0	73	272	345	132,966	133,311	0
Consumer	412	0	261	673	73,789	74,462	0
Commercial business:							
Transportation industry	0	0	0	0	10,503	10,503	0
Other	40	187	157	384	62,646	63,030	0
	$1,181	371	907	2,459	538,006	540,465	0
December 31, 2015							
1-4 family	$490	130	799	1,419	89,526	90,945	0
Commercial real estate:							
Real estate rental and leasing	0	0	0	0	125,376	125,376	0
Other	0	289	0	289	121,688	121,977	0
Consumer							
Commercial business:	330	262	119	711	63,704	64,415	0
Transportation industry							
Other	0	0	0	0	9,349	9,349	0

45	0	0	45	60,712	60,757	0
$865	681	918	2,464	470,355	472,819	0

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Impaired loans include loans that are non-performing (non-accruing) and loans that have been modified in a troubled debt restructuring (TDR). The following table summarizes impaired loans and related allowances as of June 30, 2016 and December 31, 2015:

(Dollars in thousands)	June 30, 2016 Recorded Investment	Unpaid Principal Balance	Related Allowance	December 31, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance
Loans with no related allowance recorded:						
1-4 family	$343	343	0	1,251	1,251	0
Commercial real estate:						
Real estate rental and leasing	42	160	0	44	184	0
Other	26	1,682	0	25	1,706	0
Consumer	589	590	0	475	476	0
Commercial business:						
Other	0	45	0	0	79	0
Loans with an allowance recorded:						
1-4 family	1,165	1,165	308	952	952	223
Commercial real estate:						
Real estate rental and leasing	0	0	0	0	0	0
Other	1,747	1,747	197	2,135	2,135	296
Consumer	545	562	378	502	519	370
Commercial business:						
Other	335	887	67	415	967	120
Total:						

1-4 family	1,508	1,508	308	2,203	2,203	223
Commercial real estate:						
Real estate rental and leasing	42	160	0	44	184	0
Other	1,773	3,429	197	2,160	3,841	296
Consumer	1,134	1,152	378	977	995	370
Commercial business:						
Other	335	932	67	415	1,046	120
	$4,792	7,181	950	5,799	8,269	1,009

The following table summarizes the average recorded investment and interest income recognized on impaired loans for the three and six months ended June 30, 2016 and 2015:

	For the three months ended		For the six months ended	
	June 30, 2016		June 30, 2016	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded:				
1-4 family	$519	4	763	6
Commercial real estate:				
Real estate rental and leasing	43	2	43	3
Other	26	25	26	48
Consumer	546	2	522	4
Commercial business:				
Other	0	0	0	0
Loans with an allowance recorded:				
1-4 family	1,122	3	1,065	8
Commercial real estate:				
Real estate rental and leasing	0	0	0	0
Other	2,002	7	2,046	15
Consumer	542	4	529	6
Commercial business:				
Other	366	4	382	7

Total:				
1-4 family	1,641	7	1,828	14
Commercial real estate:				
Real estate rental and leasing	43	2	43	3
Other	2,028	32	2,072	63
Consumer	1,088	6	1,051	10
Commercial business:				
Other	366	4	382	7
	$5,166	51	5,376	97

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(Dollars in thousands)	For the three months ended June 30, 2015 Average Recorded Investment	Interest Income Recognized	For the six months ended June 30, 2015 Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded:				
1-4 family	$857	3	823	30
Commercial real estate:				
Real estate rental and leasing	47	7	47	14
Other	7,099	96	7,205	191
Consumer	291	1	348	2
Commercial business:				
Other	32	1	47	1
Loans with an allowance recorded:				
1-4 family	1,148	4	1,136	8
Commercial real estate:				
Real estate rental and leasing	0	0	5	0
Other	1,672	10	1,864	18
Consumer	443	9	410	13
Commercial business:				
Other	433	5	447	9
Total:				
1-4 family	2,005	7	1,959	38

Commercial real estate:				
Real estate rental and leasing	47	7	52	14
Other	8,771	106	9,069	209
Consumer	734	10	758	15
Commercial business:				
Other	465	6	494	10
	$12,022	136	12,332	286

At June 30, 2016 and December 31, 2015, non-accruing loans totaled $3.5 million and $4.2 million, respectively, for which the related allowance for loan losses was $0.8 million and $0.7 million, respectively. All of the interest income that was recognized for non-accruing loans was recognized using the cash basis method of income recognition. Non-accruing loans for which no specific allowance has been recorded, because management determined that the value of the collateral was sufficient to repay the loan, totaled $0.8 million and $1.4 million at June 30, 2016 and December 31, 2015, respectively. Non-accrual loans also include certain loans that have had terms modified in a TDR.

The non-accrual loans at June 30, 2016 and December 31, 2015 are summarized as follows:

(Dollars in thousands)	June 30, 2016	December 31, 2015
1-4 family	$1,173	$ 1,655
Commercial real estate:		
Real estate rental and leasing	42	44
Other	1,268	1,650
Consumer	967	786
Commercial business:		
Other	0	46
	$3,450	$ 4,181

At June 30, 2016 and December 31, 2015 there were loans included in loans receivable, net, with terms that had been modified in a TDR totaling $2.3 million and $2.5 million, respectively. For the loans that were restructured in the second quarter of 2016, $0.1 million were non-performing at June 30, 2016. For the loans that were restructured in the second quarter of 2015, $0.5 million were classified but performing and $0.1 million were non-performing at June 30, 2015.

The following table summarizes TDRs at June 30, 2016 and December 31, 2015:

	June 30, 2016			December 31, 2015		
(Dollars in thousands)	Accrual	Non-Accrual	Total	Accrual	Non-Accrual	Total
1-4 family	$336	65	401	547	100	647
Commercial real estate	504	208	712	511	214	725
Consumer	167	642	809	191	541	732
Commercial business	335	0	335	369	46	415
	$1,342	915	2,257	1,618	901	2,519

As of June 30, 2016, the Bank had commitments to lend an additional $0.9 million to a borrower who has TDR and non-accrual loans. These additional funds are for the construction of 1-4 family homes with a maximum loan-to-value ratio of 75%. These loans are secured by the home under construction. At December 31, 2015, there were commitments to lend additional funds of $1.5 million to this same borrower.

TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of real estate or other assets in full or partial satisfaction of the debt. Loan modifications are not reported as TDRs after 12 months if the loan was modified at a market rate of interest for comparable risk loans, and the loan is performing in accordance with the terms of the restructured agreement for the entire 12 month period. All loans classified as TDRs are considered to be impaired.

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the balance sheet, as principal balances may be partially forgiven. The financial effects of TDRs are presented in the following table and represent the difference between the outstanding recorded balance pre-modification and post-modification, for the three month and six month periods ending June 30, 2016 and June 30, 2015.

	Three Months Ended			Six Months Ended		
	June 30, 2016			June 30, 2016		
(Dollars in thousands)	Number of	Pre-	Post-	Number of	Pre-	Post-

	Contracts	modification Outstanding Recorded Investment	modification Outstanding Recorded Investment	Contracts	modification Outstanding Recorded Investment	modification Outstanding Recorded Investment
Troubled debt restructurings:						
1-4 family	1	$ 65	65	1	$ 65	65
Consumer	5	35	35	11	142	143
Total	6	$ 100	100	12	$ 207	208

	Three Months Ended June 30, 2015			Six Months Ended June 30, 2015		
(Dollars in thousands)	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Troubled debt restructurings:						
1-4 family	1	$ 313	313	1	$ 313	313
Consumer	6	302	304	7	311	312
Total	7	$ 615	617	8	$ 624	625

The following table summarizes the loans that were restructured in the 12 months preceding June 30, 2016 and subsequently defaulted during the three and six months ended June 30, 2016.

(Dollars in thousands)	Three Months Ended June 30, 2016 Number of Contracts	Three Months Ended June 30, 2016 Outstanding Recorded Investment	Six Months Ended June 30, 2016 Number of Contracts	Six Months Ended June 30, 2016 Pre modification Outstanding Recorded Investment
Troubled debt restructurings that subsequently defaulted:				
Commercial real estate:				
Other	1	$ 183	1	$ 183
Commercial business:				
Other	1	44	1	44
Total	2	$ 227	2	$ 227

There were no loans restructured in the 12 months preceding June 30, 2015 that defaulted in the three and six months ended June 30, 2015.

The Company considers a loan to have defaulted when it becomes 90 or more days past due under the modified terms, when it is placed in non-accrual status, when it becomes other real estate owned, or when it becomes non-compliant with some other material requirement of the modification agreement. Loans that were non-accrual prior to modification remain on non-accrual status for at least six months following modification. Non-accrual TDR loans that have performed according to the modified terms for six months may be returned to accrual status. Loans that were accruing prior to modification remain on accrual status after the modification as long as the loan continues to perform under the new terms.

TDRs are reviewed for impairment following the same methodology as other impaired loans. For loans that are collateral-dependent, the value of the collateral is reviewed and additional reserves may be added to general reserves as needed. Loans that are not collateral-dependent may have additional reserves established if deemed necessary. The reserves for TDRs were $0.5 million, or 4.5%, of the total $10.3 million in loan loss reserves at June 30, 2016 and $0.5 million, or 5.2%, of the total $9.7 million in loan loss reserves at December 31, 2015.

The following is additional information with respect to loans acquired through acquisitions:

(Dollars in thousands)	Contractual Principal Receivable	Accretable Difference	Net Carrying Amount
Purchased performing loans:			
Balance at March 31, 2016	$ 15,940	(388)	15,552
Loans acquired during the period	11,772	(211)	11,561
Change due to payments/refinances	(3,179)	78	(3,101)
Balance at June 30, 2016	$ 24,533	(521)	24,012

(Dollars in thousands)	Contractual Principal Receivable	Non-Accretable Difference	Net Carrying Amount
Purchased credit impaired loans:			
Balance at March 31, 2016	$ 413	(62)	351
Loans acquired during the period	329	(37)	292
Change due to payments/refinances	(5)	6	1
Balance at June 30, 2016	$ 737	(93)	644

As a result of acquisitions, the Company has loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable at acquisition that all contractually required payments would not be collected. The carrying amount of those loans as of June 30, 2016 was $0.6 million.

No provision for loan losses was recognized during the period ended June 30, 2016 related to acquired loans as there was no significant change to the credit quality of those loans.

(10) ***Intangible Assets***

The Company's intangible assets consist of mortgage servicing rights, core deposit intangibles, and goodwill. A summary of mortgage servicing activity is as follows:

(Dollars in thousands)	Six Months ended June 30, 2016	Twelve Months ended December 31, 2015	Six Months ended June 30, 2015
Balance, beginning of period	$ 1,499	1,507	1,507
Originations	258	547	219
Amortization	(278)	(555)	(275)
Balance, end of period	$ 1,479	1,499	1,451
Fair value of mortgage servicing rights	$ 2,552	2,590	2,608

All of the loans being serviced were single family loans serviced for FNMA under the individual loan sale program. The following is a summary of the risk characteristics of the loans being serviced for FNMA at June 30, 2016.

(Dollars in thousands)	Loan Principal Balance	Weighted Average Interest Rate	Weighted Average Remaining Term (months)	Number of Loans
Original term 30 year fixed rate	$224,331	4.16 %		