FIRST UNITED CORP/MD/
Form 10-Q
August 10, 2017

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 quarterly period ended June 30, 2017

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _______________ to ________________

Commission file number 0-14237

First United Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1380770
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

19 South Second Street, Oakland, Maryland	21550-0009
(Address of principal executive offices)	(Zip Code)

(800) 470-4356

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 7,067,425 shares of common stock, par value $.01 per share, as of July 31, 2017.

INDEX TO QUARTERLY REPORT

FIRST UNITED CORPORATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST UNITED CORPORATION

Consolidated Statement of Financial Condition

(In thousands, except per share and percentage data)

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Cash and due from banks	$71,405	$ 60,707
Interest bearing deposits in banks	1,557	2,603
Cash and cash equivalents	72,962	63,310
Investment securities – available-for-sale (at fair value)	129,198	140,000
Investment securities – held to maturity (fair value $100,365 at June 30, 2017 and $97,981 at December 31, 2016)	98,354	97,169
Restricted investment in bank stock, at cost	5,204	5,209
Loans	895,955	891,926
Allowance for loan losses	(9,922)	(9,918)
Net loans	886,033	882,008
Premises and equipment, net	28,955	27,160
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	41,568	40,968
Deferred tax assets	17,969	19,337
Other real estate owned	11,556	10,910
Accrued interest receivable and other assets	22,882	21,115
Total Assets	$1,325,685	$ 1,318,190
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$253,986	$ 219,158
Interest bearing deposits	783,726	795,071
Total deposits	1,037,712	1,014,229
Short-term borrowings	25,224	36,000
Long-term borrowings	120,929	131,737
Accrued interest payable and other liabilities	23,259	22,526
Total Liabilities	1,207,124	1,204,492

Shareholders' Equity:		
Preferred stock – no par value;Authorized 2,000 shares of which 30 shares of Series A, $1,000 per share liquidation preference, 9% cumulative, issued and outstanding 10 shares at June 30, 2017 and 20 shares at December 31, 2016	10,000	20,000
Common Stock – par value $.01 per share; Authorized 25,000 shares; issued and outstanding 7,067 shares at June 30, 2017 and 6,269 at December 31, 2016	71	63
Surplus	31,446	22,178
Retained earnings	96,446	92,922
Accumulated other comprehensive loss	(19,402)	(21,465)
Total Shareholders' Equity	118,561	113,698
Total Liabilities and Shareholders' Equity	$1,325,685	$ 1,318,190

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Six months ended June 30,	
	2017	2016
	(Unaudited)	
Interest income		
Interest and fees on loans	$19,517	$19,339
Interest on investment securities		
Taxable	2,743	2,925
Exempt from federal income tax	454	436
Total investment income	3,197	3,361
Other	304	195
Total interest income	23,018	22,895
Interest expense		
Interest on deposits	1,577	1,589
Interest on short-term borrowings	34	28
Interest on long-term borrowings	2,109	2,490
Total interest expense	3,720	4,107
Net interest income	19,298	18,788
Provision for loan losses	908	1,914
Net interest income after provision for loan losses	18,390	16,874
Other operating income		
Net gains	14	280
Service charges	1,508	1,613
Trust department	3,050	2,934
Debit card income	1,119	1,035
Bank owned life insurance	600	835
Brokerage commissions	426	507
Other	231	223
Total other income	6,934	7,147
Total other operating income	6,948	7,427
Other operating expenses		
Salaries and employee benefits	10,865	10,444
FDIC premiums	268	674
Equipment	1,236	1,209
Occupancy	1,219	1,246
Data processing	1,640	1,346
Professional Services	537	589
Other real estate owned	212	250
Other	3,327	3,678

Total other operating expenses	19,304	19,436
Income before income tax expense	6,034	4,865
Provision for income tax expense	1,745	1,290
Net Income	4,289	3,575
Accumulated preferred stock dividends	(765)	(1,125)
Net Income Available to Common Shareholders	$3,524	$2,450
Basic and diluted net income per common share	$0.52	$0.39
Weighted average number of basic and diluted shares outstanding	6,796	6,259

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Operations

(In thousands, except per share data)

	Three Months Ended June 30,	
	2017	2016
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 9,865	$ 9,781
Interest on investment securities		
Taxable	1,443	1,370
Exempt from federal income tax	223	201
Total investment income	1,666	1,571
Other	160	105
Total interest income	11,691	11,457
Interest expense		
Interest on deposits	809	785
Interest on short-term borrowings	18	15
Interest on long-term borrowings	935	1,278
Total interest expense	1,762	2,078
Net interest income	9,929	9,379
Provision for loan losses	299	1,346
Net interest income after provision for loan losses	9,630	8,033
Other operating income		
Net gains	9	64
Service charges	773	847
Trust department	1,535	1,517
Debit card income	575	560
Bank owned life insurance	291	516
Brokerage commissions	213	220
Other	95	99
Total other income	3,482	3,759
Total other operating income	3,491	3,823
Other operating expenses		
Salaries and employee benefits	5,525	5,133
FDIC premiums	184	260
Equipment	596	574
Occupancy	598	607
Data processing	875	697
Professional Services	284	289
Other real estate owned	38	166
Other	1,760	1,813

Total other operating expenses	9,860	9,539
Income before income tax expense	3,261	2,317
Provision for income tax expense	952	613
Net Income	2,309	1,704
Accumulated preferred stock dividends	(225)	(450)
Net Income Available to Common Shareholders	$ 2,084	$ 1,254
Basic and diluted net income per common share	$ 0.30	$ 0.20
Weighted average number of basic and diluted shares outstanding	7,062	6,264

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

	Six months ended June 30,	
	2017	2016
Comprehensive Income (in thousands)	(Unaudited)	
Net Income	$ 4,289	$ 3,575
Other comprehensive income, net of tax and reclassification adjustments:		
Net unrealized gains on investments with OTTI	32	197
Net unrealized gains on all other AFS securities	1,786	253
Net unrealized gains on HTM securities	104	365
Net unrealized losses on cash flow hedges	(98)	(637)
Net unrealized gains/(losses) on pension	196	(295)
Net unrealized gains on SERP	43	30
Other comprehensive income/(loss), net of tax	2,063	(87)
Comprehensive income	$ 6,352	$ 3,488

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Comprehensive Income

(In thousands)

Comprehensive Income (in thousands)	Three months ended June 30, 2017 (Unaudited)	2016
Net Income	$ 2,309	$ 1,704
Other comprehensive income, net of tax and reclassification adjustments:		
Net unrealized (losses)/gains on investments with OTTI	(66)	1,118
Net unrealized gains/(losses) on all other AFS securities	1,708	(181)
Net unrealized gains on HTM securities	43	222
Net unrealized losses on cash flow hedges	(150)	(306)
Net unrealized gains/(losses) on pension	2	(82)
Net unrealized gains on SERP	21	15
Other comprehensive income, net of tax	1,558	786
Comprehensive income	$ 3,867	$ 2,490

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	(Unaudited)					
Balance at January 1, 2016	$30,000	$ 63	$21,986	$87,666	$ (18,944)	$ 120,771
Net income				7,281		7,281
Other comprehensive loss					(2,521)	(2,521)
Stock based compensation			192			192
Preferred stock redemption	(10,000)					(10,000)
Preferred stock dividends paid				(2,025)		(2,025)
Balance at December 31, 2016	20,000	63	22,178	92,922	(21,465)	113,698
Net income				4,289		4,289
Other comprehensive income					2,063	2,063
Stock based compensation			85			85
Common stock issued		8	9,183			9,191
Preferred stock redemption	(10,000)					(10,000)
Preferred stock dividends paid				(765)		(765)
Balance at June 30, 2017	$10,000	$ 71	$31,446	$96,446	$ (19,402)	$ 118,561

See accompanying notes to the consolidated financial statements

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FIRST UNITED CORPORATION

Consolidated Statement of Cash Flows

(In thousands)

	Six months ended June 30,	
	2017	2016
	(Unaudited)	
Operating activities		
Net income	$4,289	$3,575
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	908	1,914
Depreciation	921	843
Stock compensation	85	96
Gain on sales of other real estate owned	(74)	(131)
Write-downs of other real estate owned	93	97
Gain on loan sales	(32)	(48)
Losses/(gains) on disposal of fixed assets	1	(5)
Net amortization of investment securities discounts and premiums- AFS	123	146
Net amortization of investment securities discounts and premiums- HTM	30	15
Losses/(gains) on sales of investment securities – available-for-sale	17	(227)
Amortization of deferred loan fees	(297)	(255)
Increase in accrued interest receivable and other assets	(2,626)	(478)
Decrease/(increase) in deferred tax benefit	1,368	(18)
Increase/(decrease) in accrued interest payable and other liabilities	642	(201)
Earnings on bank owned life insurance	(600)	(835)
Net cash provided by operating activities	4,848	4,488
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	14,192	27,383
Proceeds from maturities/calls of investment securities held-to-maturity	2,973	11,350
Proceeds from sales of investment securities available-for-sale	18,530	25,591
Purchases of investment securities available-for-sale	(19,047)	(29,137)
Purchases of investment securities held-to-maturity	(4,188)	(3,535)
Proceeds from sales of other real estate owned	538	1,247
Proceeds from loan sales	3,900	6,330
Proceeds from disposal of fixed assets	1	261
Proceeds from BOLI death benefit	0	608
Net decrease in FHLB stock	5	23
Net increase in loans	(9,707)	(51,167)
Purchases of premises and equipment	(2,718)	(1,995)
Net cash provided by/(used in) by investing activities	4,479	(13,041)
Financing activities		
Net increase in deposits	23,483	6,474

Preferred stock dividends paid	(765)	(1,125)
Preferred stock redemption	(10,000)	(10,000)
Proceeds from sale of common stock	9,349	0
Rights Offering costs	(158)	0
Net decrease in short-term borrowings	(10,776)	(15,471)
Payments on long-term borrowings	(10,808)	(781)
Net cash provided by/(used in) financing activities	325	(20,903)
Increase/(decrease) in cash and cash equivalents	9,652	(29,456)
Cash and cash equivalents at beginning of the year	63,310	52,141
Cash and cash equivalents at end of period	$72,962	$22,685
Supplemental information		
Interest paid	$3,672	$4,104
Non-cash investing activities:		
Transfers from loans to other real estate owned	$1,203	$3,753

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION

NoteS to Consolidated Financial Statements (UNAUDITED)

Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of First United Corporation and its consolidated subsidiaries, including First United Bank & Trust (the "Bank"), have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information, as required by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 270, *Interim Reporting*, and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all the information and footnotes required for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring items, have been included. Operating results for the six- and three-month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the full year or for any future interim period. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2016. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2017 presentation. Such reclassifications had no impact on net income or equity.

As used in these notes, the term "the Corporation" refers to First United Corporation and, unless the context clearly requires otherwise, its consolidated subsidiaries.

Note 2 – Earnings Per Common Share

Basic earnings per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is derived by dividing net income available to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. There were no common stock equivalents at June 30, 2017 or June 30, 2016.

The following tables set forth the calculation of basic and diluted earnings per common share for the six- and three-month periods ended June 30, 2017 and 2016:

	Six months ended June 30,					
	2017			2016		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$4,289			$3,575		
Preferred stock dividends	(765)			(1,125)		
Net income available to common shareholders	$3,524	6,796	$ 0.52	$2,450	6,259	$ 0.39

	Three months ended June 30,					
	2017			2016		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$2,309			$1,704		
Preferred stock dividends	(225)			(450)		
Net income available to common shareholders	$2,084	7,062	$ 0.30	$1,254	6,264	$ 0.20

Note 3 – Net Gains

The following table summarizes the gain/(loss) activity for the six- and three-month periods ended June 30, 2017 and 2016:

	Six months ended June 30,		Three months ended June 30,	
(in thousands)	2017	2016	2017	2016
Net gains/(losses):				
Available-for-sale securities:				
Realized gains	$ 52	$ 415	$ 44	$ 138
Realized losses	(69)	(188)	(52)	(117)
Gain on sale of consumer loans	32	48	17	36
(Loss)/gain on disposal of fixed assets	(1)	5	0	7
Net gains	$ 14	$ 280	$ 9	$ 64

Note 4 – Cash and Cash Equivalents

Cash and due from banks, which represents vault cash in the retail offices and invested cash balances at the Federal Reserve and other correspondent banks, is carried at cost which approximates fair value.

(in thousands)	June 30, 2017	December 31, 2016
Cash and due from banks, weighted average interest rate of 0.60% (at June 30, 2017)	$71,405	$ 60,707

Interest bearing deposits in banks, which represent funds invested at a correspondent bank, are carried at cost which approximates fair value and, as of June 30, 2017 and December 31, 2016, consisted of daily funds invested at the Federal Home Loan Bank ("FHLB") of Atlanta and Merchants and Traders ("M&T").

(in thousands)	June 30, 2017	December 31, 2016
FHLB daily investments, interest rate of 0.97% (at June 30, 2017)	$ 543	$ 1,590
M&T daily investments, interest rate of 0.15% (at June 30, 2017)	1,014	1,013
	$ 1,557	$ 2,603

Note 5 – Investments

The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The amortized cost of debt securities classified as available-for-sale is adjusted for the amortization of premiums to the first call date, if applicable, or to maturity, and for the accretion of discounts to maturity, or, in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from investments. Interest and dividends are included in interest income from investments. Gains and losses on the sale of securities are recorded using the specific identification method.

The following table shows a comparison of amortized cost and fair values of investment securities at June 30, 2017 and December 31, 2016:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCL
June 30, 2017					
Available for Sale:					
U.S. government agencies	$ 25,000	$ 0	$ 576	$ 24,424	$ 0
Commercial mortgage-backed agencies	42,854	7	518	42,343	0
Collateralized mortgage obligations	29,416	5	400	29,021	0
Obligations of states and political subdivisions	18,714	419	70	19,063	0
Collateralized debt obligations	19,762	0	5,415	14,347	(3,908)
Total available for sale	$ 135,746	$ 431	$ 6,979	$ 129,198	$ (3,908)
Held to Maturity:					
U.S. government agencies	$ 15,806	$ 574	$ 0	$ 16,380	$ 0
Residential mortgage-backed agencies	52,064	181	385	51,860	0
Commercial mortgage-backed agencies	17,437	410	0	17,847	0
Collateralized mortgage obligations	4,537	0	61	4,476	0
Obligations of states and political subdivisions	8,510	1,301	9	9,802	0
Total held to maturity	$ 98,354	$ 2,466	$ 455	$ 100,365	$ 0
December 31, 2016					
Available for Sale:					
U.S. government agencies	$ 25,000	$ 0	$ 747	$ 24,253	$ 0
Commercial mortgage-backed agencies	52,978	1	757	52,222	0
Collateralized mortgage obligations	19,953	13	399	19,567	0
Obligations of states and political subdivisions	23,700	255	251	23,704	0
Collateralized debt obligations	27,930	0	7,676	20,254	(3,961)
Total available for sale	$ 149,561	$ 269	$ 9,830	$ 140,000	$ (3,961)
Held to Maturity:					
U.S. government agencies	$ 15,738	$ 512	$ 0	$ 16,250	$ 0
Residential mortgage-backed agencies	50,384	160	279	50,265	0
Commercial mortgage-backed agencies	17,584	248	0	17,832	0
Collateralized mortgage obligations	4,833	0	149	4,684	0
Obligations of states and political subdivisions	8,630	490	170	8,950	0
Total held to maturity	$ 97,169	$ 1,410	$ 598	$ 97,981	$ 0

Proceeds from sales of available for sale securities and the realized gains and losses are as follows:

	Six months ended	Three months ended

(in thousands)	June 30, 2017	2016	June 30, 2017	2016
Proceeds	$ 18,530	$ 25,591	$ 14,700	$ 14,820
Realized gains	52	415	44	138
Realized losses	69	188	52	117

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The following table shows the Corporation's investment securities with gross unrealized losses and fair values at June 30, 2017 and December 31, 2016, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months		12 months or more	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017				
Available for Sale:				
U.S. government agencies	$ 24,424	$ 576	$ 0	$ 0
Commercial mortgage-backed agencies	22,827	187	9,801	331
Collateralized mortgage obligations	24,556	346	3,707	54
Obligations of states and political subdivisions	2,090	20	2,795	50
Collateralized debt obligations	0	0	14,347	5,415
Total available for sale	$ 73,897	$ 1,129	$ 30,650	$ 5,850
Held to Maturity:				
Residential mortgage-backed agencies	$ 24,580	$ 283	$ 3,781	$ 102
Collateralized mortgage obligations	4,476	61	0	0
Obligations of states and political subdivisions	2,376	9	0	0
Total held to maturity	$ 31,432	$ 353	$ 3,781	$ 102
December 31, 2016				
Available for Sale:				
U.S. government agencies	$ 24,253	$ 747	$ 0	$ 0
Commercial mortgage-backed agencies	51,604	757	0	0
Collateralized mortgage obligations	14,706	399	0	0
Obligations of states and political subdivisions	8,079	160	2,934	91
Collateralized debt obligations	0	0	20,254	7,676
Total available for sale	$ 98,642	$ 2,063	$ 23,188	$ 7,767
Held to Maturity:				
Residential mortgage-backed agencies	$ 20,899	$ 279	$ 0	$ 0
Commercial mortgage-backed agencies	4,684	149	0	0
Obligations of states and political subdivisions	2,335	170	0	0
Total held to maturity	$ 27,918	$ 598	$ 0	$ 0

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320 (ASC Section 320-10-35), management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other than temporary impairment

(“OTTI”) losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). Further discussion about the evaluation of securities for impairment can be found in Item 2 of Part I of this report under the heading “*Investment Securities*”.

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of the Corporation's consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for the Corporation's collateralized debt obligation ("CDO") portfolio consisting of pooled trust preferred securities. Based on management's review of the assumptions and results of the third-party review, it believes that the valuations are adequate at June 30, 2017.

U.S. Government Agencies – Available for Sale – There were four U.S. government agencies in an unrealized loss position for less than 12 months as of June 30, 2017. The securities are of investment grade and the Corporation does not intend to sell them, and it is not more than likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017. There were no U.S. government agency investments in an unrealized loss position for more than 12 months as of June 30, 2017.

Commercial Mortgage-Backed Agencies – Available for Sale – There were five commercial mortgage-backed agencies in an unrealized loss position for less than 12 months as of June 30, 2017. There were two commercial mortgage-backed agencies in an unrealized loss position for more than 12 months as of June 30, 2017. The securities are of the highest investment grade and the Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

Collateralized Mortgage Obligations – Available for Sale – There were four collateralized mortgage obligations in an unrealized loss position for less than 12 months as of June 30, 2017. There was one collateralized mortgage obligation in an unrealized loss position for more than 12 months as of June 30, 2017. The securities are of the highest investment grade and the Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

Obligations of State and Political Subdivisions – Available for Sale – There were three obligations of state and political subdivisions that have been in an unrealized loss position for less than 12 months and two securities that have been in an unrealized loss position for 12 months or more at June 30, 2017. These investments are of investment grade as determined by the major rating agencies and management reviews the ratings of the underlying issuers and performs an in-depth credit analysis on the securities. Management believes that this portfolio is well-diversified throughout the United States, and all bonds continue to perform according to their contractual terms. The Corporation does not intend to sell these investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

Collateralized Debt Obligations – Available for Sale - The $5.4 million in unrealized losses greater than 12 months at June 30, 2017 relates to 10 pooled trust preferred securities that are included in the CDO portfolio. See Note 9 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during the first six months of 2017. The unrealized losses on the remaining securities in the portfolio are primarily attributable to continued depression in marketability, liquidity and the current economic environment.

U.S. Government Agencies – Held to Maturity – There were no U.S. government agencies in an unrealized loss position as of June 30, 2017.

Residential Mortgage-Backed Agencies – Held to Maturity - Nineteen residential mortgage-backed agencies have been in an unrealized loss position for less than 12 months as of June 30, 2017. There were three mortgage-backed agency investments in an unrealized loss position for more than 12 months as of June 30, 2017. The securities are of the highest investment grade and the Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

Commercial Mortgage-Backed Agencies – Held to Maturity - There were no collateralized mortgage-backed agency investments in an unrealized loss position as of June 30, 2017.

Collateralized Mortgage Obligations – Held to Maturity – There was one collateralized mortgage obligation in an unrealized loss position for less than 12 months as of June 30, 2017. The security is of the highest investment grade and the Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at June 30, 2017. There were no collateralized mortgage obligations in a loss position for more than 12 months as of June 30, 2017.

Obligations of State and Political Subdivisions – Held to Maturity –There was one obligation of state and political subdivisions that has been in an unrealized loss for less than 12 months. This bond is a Tax Increment Fund (TIF) bond. Management performs an in-depth credit analysis on this security. The Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at June 30, 2017. No obligations of state and political subdivisions securities have been in an unrealized loss position for more than 12 months as of June 30, 2017.

The following tables present a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the six- and three-month periods ended June 30, 2017 and 2016:

	Six months ended June 30,	
(in thousands)	2017	2016
Balance of credit-related OTTI at January 1	$ 3,124	$ 3,133
Decreases for previously recognized credit-related OTTI due to transfer	0	(3,045)
Additions for decreases in cash flows expected to be collected	0	33
Reduction for increases in cash flows expected to be collected	(57)	(5)
Balance of credit-related OTTI at June 30	$ 3,067	$ 116

	Three months ended June 30,	
(in thousands)	2017	2016
Balance of credit-related OTTI at April 1	$ 3,122	$ 3,097
Decreases for previously recognized credit-related OTTI due to transfer	0	(3,045)
Additions for decreases in cash flows expected to be collected	0	66
Reduction for increases in cash flows expected to be collected	(55)	(2)
Balance of credit-related OTTI at June 30	$ 3,067	$ 116

The amortized cost and estimated fair value of securities by contractual maturity at June 30, 2017 are shown in the following table. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2017	
(in thousands)	Amortized Cost	Fair Value
Contractual Maturity		
Available for sale:		
Due after one year through five years	$10,657	$ 10,544
Due after five years through ten years	18,268	17,872
Due after ten years	34,551	29,418
	63,476	57,834
Commercial mortgage-backed agencies	42,854	42,343
Collateralized mortgage obligations	29,416	29,021
Total available for sale	$135,746	$ 129,198
Held to Maturity:		
Due after five years through ten years	$15,806	$ 16,380
Due after ten years	8,510	9,802
	24,316	26,182
Residential mortgage-backed agencies	$52,064	$ 51,860
Commercial mortgage-backed agencies	17,437	17,847
Collateralized mortgage obligations	4,537	4,476
Total held to maturity	$98,354	$ 100,365

Note 6 – Restricted Investment in Bank Stock

Restricted stock, which represents required investments in the common stock of the FHLB of Atlanta, Atlantic Community Bankers Bank ("ACBB") and Community Bankers Bank ("CBB"), is carried at cost and is considered a long-term investment.

Management evaluates the restricted stock for impairment in accordance with ASC Industry Topic 942, *Financial Services – Depository and Lending-* (ASC Section 942-325-35). Management's evaluation of potential impairment is based on management's assessment of the ultimate recoverability of the cost of the restricted stock rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (a) the significance of the decline in net assets of the issuing bank as compared to the capital stock amount for that bank and the length of time this situation has persisted, (b) commitments by the issuing bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of that bank, and (c) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuing bank. Management has evaluated the restricted stock for impairment and believes that no impairment charge is necessary as of June 30, 2017.

The Corporation recognizes dividends received on its restricted stock investments on a cash basis. For the six months ended June 30, 2017, dividends of $126,489 were recognized in earnings. For the comparable period of 2016, dividends of $137,176 were recognized in earnings. For the three months ended June 30, 2017, dividends of $59,270 were recognized in earnings. For the comparable period of 2016, dividends of $69,417 were recognized in earnings.

Note 7 – Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio at June 30, 2017 and December 31, 2016:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
June 30, 2017						
Individually evaluated for impairment	$ 12,713	$ 2,380	$ 290	$ 3,959	$ 0	$ 19,342
Collectively evaluated for impairment	$ 270,861	$ 109,298	$ 73,401	$ 399,239	$ 23,814	$ 876,613
Total loans	$ 283,574	$ 111,678	$ 73,691	$ 403,198	$ 23,814	$ 895,955
December 31, 2016						
Individually evaluated for impairment	$ 17,210	$ 2,525	$ 290	$ 3,975	$ 0	$ 24,000
Collectively evaluated for impairment	$ 280,749	$ 101,757	$ 72,056	$ 389,441	$ 23,923	$ 867,926
Total loans	$ 297,959	$ 104,282	$ 72,346	$ 393,416	$ 23,923	$ 891,926

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate ("CRE") loan segment is then segregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied, non-farm, and nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The acquisition and development ("A&D") loan segment is segregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. A&D loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan is made. The commercial and industrial ("C&I") loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is segregated into two classes: amortizing term loans, which are primarily first lien loans and home equity lines of credit, which are generally second liens. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

Management uses a 10-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a substandard classification. Loans in the substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of a specific allocation of the allowance for loan losses that management believes is associated with a pending event that could trigger loss in the short-term will be classified in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in the commercial segments at origination and on an ongoing basis. The Bank's experienced Credit Quality and Loan Review Departments perform an annual review of all commercial relationships of $500,000 or greater. Confirmation of the appropriate risk grade is included as part of the review process on an ongoing basis. The Credit Quality and Loan Review Departments continually review and assess loans within the portfolio. In addition, the Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than $1,000,000 and/or criticized non-consumer loans greater than $500,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard within the internal risk rating system at June 30, 2017 and December 31, 2016:

(in thousands)	Pass	Special Mention	Substandard	Total
June 30, 2017				
Commercial real estate				
Non owner-occupied	$134,768	$ 9,050	$ 9,204	$153,022
All other CRE	115,692	3,779	11,081	130,552
Acquisition and development				
1-4 family residential construction	16,309	0	0	16,309
All other A&D	94,128	59	1,182	95,369
Commercial and industrial	72,190	42	1,459	73,691
Residential mortgage				
Residential mortgage - term	320,448	0	7,261	327,709
Residential mortgage - home equity	73,713	0	1,776	75,489
Consumer	23,703	0	111	23,814
Total	$850,951	$ 12,930	$ 32,074	$895,955
December 31, 2016				
Commercial real estate				
Non owner-occupied	$137,181	$ 10,620	$ 9,357	$157,158
All other CRE	125,720	3,121	11,960	140,801
Acquisition and development				
1-4 family residential construction	15,845	0	0	15,845
All other A&D	87,135	65	1,237	88,437
Commercial and industrial	70,613	593	1,140	72,346
Residential mortgage				
Residential mortgage - term	308,734	113	7,618	316,465
Residential mortgage - home equity	75,710	0	1,241	76,951
Consumer	23,794	0	129	23,923
Total	$844,732	$ 14,512	$ 32,682	$891,926

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment remains unpaid 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation’s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

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The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans at June 30, 2017 and December 31, 2016:

(in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and Accruing	Non-Accrual	Total Loans
June 30, 2017							
Commercial real estate							
Non owner-occupied	$146,350	$ 1,601	$ 71	$ 0	$ 1,672	$ 5,000	$ 153,022
All other CRE	127,764	0	0	0	0	2,788	130,552
Acquisition and development							
1-4 family residential construction	16,309	0	0	0	0	0	16,309
All other A&D	95,173	0	65	91	156	40	95,369
Commercial and industrial	73,682	0	1	8	9	0	73,691
Residential mortgage							
Residential mortgage - term	323,351	271	2,104	581	2,956	1,402	327,709
Residential mortgage - home equity	74,167	429	135	516	1,080	242	75,489
Consumer	23,634	104	56	20	180	0	23,814
Total	$880,430	$ 2,405	$ 2,432	$ 1,216	$ 6,053	$ 9,472	$ 895,955
December 31, 2016							
Commercial real estate							
Non owner-occupied	$150,595	$ 182	$ 0	$ 0	$ 182	$ 6,381	$ 157,158
All other CRE	134,931	40	0	0	40	5,830	140,801
Acquisition and development							
1-4 family residential construction	15,845	0	0	0	0	0	15,845
All other A&D	88,353	0	39	0	39	45	88,437
Commercial and industrial	72,324	9	2	11	22	0	72,346
Residential mortgage							
Residential mortgage - term	310,721	517	3,376	312	4,205	1,539	316,465
Residential mortgage - home equity	75,558	974	198	70	1,242	151	76,951
Consumer	23,662	186	48	27	261	0	23,923
Total	$871,989	$ 1,908	$ 3,663	$ 420	$ 5,991	$ 13,946	$ 891,926

Non-accrual loans totaled $9.5 million at June 30, 2017, compared to $13.9 million at December 31, 2016. The decrease in non-accrual balances at June 30, 2017 was primarily due to charge-offs of $2.9 million and the movement of $.8 million to other real estate owned (“OREO”). Non-accrual loans that have been subject to a partial charge-off totaled $5.5 million at June 30, 2017, compared to $11.1 million at December 31, 2016. Loans secured by 1-4 family residential real estate properties in the process of foreclosure were $.3 million at June 30, 2017 and $.5 million at December 31, 2016.

Accruing loans past due 30 days or more increased very slightly to .68% of the loan portfolio at June 30, 2017, compared to .67% at December 31, 2016. The slight increase for the first six months of 2017 was due primarily to increases in the past due loans in the residential mortgage and home equity portfolios.

An allowance for loan losses ("ALL") is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the allocated portion of the Bank's ALL. In the second quarter of 2015, management determined that it would be prudent to establish an unallocated portion of the ALL to protect the Bank from other risks associated with the loan portfolio that may not be specifically identifiable.

The following table summarizes the primary segments of the ALL at June 30, 2017 and December 31, 2016, segregated by the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
June 30, 2017							
Individually evaluated for impairment	$ 187	$ 36	$ 0	$ 86	$ 0	$ 0	$309
Collectively evaluated for impairment	$ 3,462	$ 1,164	$ 836	$ 3,459	$ 192	$ 500	$9,613
Total ALL	$ 3,649	$ 1,200	$ 836	$ 3,545	$ 192	$ 500	$9,922
December 31, 2016							
Individually evaluated for impairment	$ 177	$ 40	$ 0	$ 43	$ 0	$ 0	$260
Collectively evaluated for impairment	$ 3,736	$ 831	$ 858	$ 3,545	$ 188	$ 500	$9,658
Total ALL	$ 3,913	$ 871	$ 858	$ 3,588	$ 188	$ 500	$9,918

Management uses the following methodology for determining impairment on consumer and commercial loans. All nonaccrual loans and all loans designated as “troubled debt restructures” (TDRs) are considered to be impaired. Additionally, an impairment evaluation is performed on any account that meets either of the following criteria: (a) commercial loans that (1) are risk-rated substandard and (2) have a balance of at least $500,000; and (b) commercial loans that are (1) part of a relationship having an amount of $750,000 or more and (2) at least 60 days past-due. For those loans that are not classified as nonaccrual or troubled debt restructures, a judgment is made as to the likelihood that contractual principal and interest will be collected. Loans are considered to be 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 evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. 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.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan’s effective interest rate; (b) the loan’s observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. A valuation grid for impaired loans is used to determine when or how collateral values are to be updated based on size and collateral dependency for commercial loans and foreclosure status for consumer loans. If an updated appraisal has not been received and reviewed in time for the determination of estimated fair value at quarter (or year) end, or if the appraisal is found to be deficient following the Corporation's internal appraisal review process and re-ordered, then the estimated fair value of the collateral is determined by adjusting the existing appraisal by the appropriate percentage from an internally prepared appraisal discount grid. This grid considers the age of a third party appraisal and the geographic region where the collateral is located. The discount rates in the appraisal discount grid are updated periodically to reflect the most current knowledge that management has available, including the results of current appraisals. A specific allocation of the ALL is recorded if there is any deficiency in collateral value determined by comparing the estimated fair value to the recorded investment of the loan. When updated appraisals are received and reviewed, adjustments are made to the specific allocation as needed.

The evaluation of the need and amount of a specific allocation of the ALL and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary at June 30, 2017 and December 31, 2016:

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
(in thousands)	Recorded Investment	Related Allowances	Recorded Investment	Recorded Investment	Unpaid Principal Balance
June 30, 2017					
Commercial real estate					
Non owner-occupied	$ 129	$ 20	$ 5,249	$ 5,378	$ 10,531
All other CRE	432	167	6,903	7,335	7,948
Acquisition and development					
1-4 family residential construction	0	0	582	582	582
All other A&D	242	36	1,556	1,798	2,072
Commercial and industrial	0	0	290	290	2,504
Residential mortgage					
Residential mortgage - term	769	81	2,948	3,717	4,028
Residential mortgage – home equity	68	5	174	242	242
Consumer	0	0	0	0	0
Total impaired loans	$ 1,640	$ 309	$ 17,702	$ 19,342	$ 27,907
December 31, 2016					
Commercial real estate					
Non owner-occupied	$ 131	$ 23	$ 6,635	$ 6,766	$ 9,372
All other CRE	432	154	10,012	10,444	11,057
Acquisition and development					
1-4 family residential construction	0	0	582	582	628
All other A&D	245	40	1,698	1,943	2,213
Commercial and industrial	0	0	290	290	2,504
Residential mortgage					
Residential mortgage - term	61	43	3,763	3,824	4,249
Residential mortgage – home equity	0	0	151	151	168
Consumer	0	0	0	0	0
Total impaired loans	$ 869	$ 260	$ 23,131	$ 24,000	$ 30,191

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity (full and partial charge-offs, net of full and partial recoveries) at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. Consumer pools currently utilize a rolling 12 quarters, while Commercial pools currently utilize a rolling eight quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. “Pass” pools for commercial and residential real estate are further segmented based upon the geographic location of the underlying collateral. There are seven geographic regions utilized – six that represent the Bank’s lending footprint and a seventh for all out-of-market credits. Different economic environments and resultant credit risks exist in each region that are acknowledged in the assignment of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Management supplements the historical charge-off factor with a number of additional qualitative factors that are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors, which are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources, are: (a) national and local economic trends and conditions; (b) levels of and trends in delinquency rates and non-accrual loans; (c) trends in volumes and terms of loans; (d) effects of changes in lending policies; (e) experience, ability, and depth of lending staff; (f) value of underlying collateral; and (g) concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Residential mortgage and consumer loans are charged off after they are 120 days contractually past due. All other loans are charged off based on an evaluation of the facts and circumstances of each individual loan. When the Bank believes that its ability to collect is solely dependent on the liquidation of the collateral, a full or partial charge-off is recorded promptly to bring the recorded investment to an amount that the Bank believes is supported by an ability to collect on the collateral. The circumstances that may impact the Bank’s decision to charge-off all or a portion of a loan include default or non-payment by the borrower, scheduled foreclosure actions, and/or prioritization of the Bank’s claim in bankruptcy. There may be circumstances where, due to pending events, the Bank will place a specific allocation of the ALL on a loan for which a partial charge-off has been previously recognized. This specific allocation may be either charged off or removed depending upon the outcome of the pending event. Full or partial charge-offs are not recovered until full principal and interest on the loan have been collected, even if a subsequent appraisal supports a higher value. Loans with partial charge-offs generally remain in non-accrual status. Both full and partial charge-offs reduce the recorded investment of the loan and the ALL and are considered to be charge-offs for purposes of all credit loss metrics and trends, including the historical rolling charge-off rates used in the determination of the ALL.

The following tables present the activity in the ALL for the six- and three-month periods ended June 30, 2017 and 2016:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at January 1, 2017	$ 3,913	$ 871	$ 858	$ 3,588	$ 188	$ 500	$9,918
Charge-offs	(2,745)	(18)	(33)	(236)	(143)	0	(3,175)
Recoveries	63	188	1,651	253	116	0	2,271
Provision	2,418	159	(1,640)	(60)	31	0	908
ALL balance at June 30, 2017	$ 3,649	$ 1,200	$ 836	$ 3,545	$ 192	$ 500	$9,922
ALL balance at January 1, 2016	$ 2,580	$ 4,129	$ 722	$ 3,785	$ 206	$ 500	$11,922
Charge-offs	(2,009)	(78)	(259)	(216)	(140)	0	(2,702)
Recoveries	93	1,282	38	54	77	0	1,544
Provision	3,741	(2,215)	236	100	52	0	1,914
ALL balance at June 30, 2016	$ 4,405	$ 3,118	$ 737	$ 3,723	$ 195	$ 500	$12,678

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at April 1, 2017	$ 5,567	$ 883	$ 936	$ 3,502	$ 195	$ 500	$11,583
Charge-offs	(2,316)	0	0	(88)	(59)	0	(2,463)
Recoveries	58	177	196	33	39	0	503
Provision	340	140	(296)	98	17	0	299
ALL balance at June 30, 2017	$ 3,649	$ 1,200	$ 836	$ 3,545	$ 192	$ 500	$9,922
ALL balance at April 1, 2016	$ 3,300	$ 3,747	$ 758	$ 3,759	$ 192	$ 500	$12,256
Charge-offs	(1,798)	(78)	(206)	(126)	(56)	0	(2,264)
Recoveries	93	1,182	8	22	35	0	1,340
Provision	2,810	(1,733)	177	68	24	0	1,346
ALL balance at June 30, 2016	$ 4,405	$ 3,118	$ 737	$ 3,723	$ 195	$ 500	$12,678

The ALL is based on estimates, and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following table presents the average recorded investment in impaired loans by class and related interest income recognized for the periods indicated:

(in thousands)	Six months ended June 30, 2017 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Six months ended June 30, 2016 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$6,037	$ 12	$ 0	$4,513	$ 47	$ 0
All other CRE	8,658	105	0	12,692	80	4
Acquisition and development						
1-4 family residential construction	582	12	0	661	15	0
All other A&D	1,860	45	0	3,257	48	0
Commercial and industrial	290	6	0	1,106	19	0
Residential mortgage						
Residential mortgage - term	3,918	66	7	4,695	78	4
Residential mortgage – home equity	230	0	0	324	0	0
Consumer	0	0	0	0	0	0
Total	$21,575	$ 246	$ 7	$27,248	$ 287	$ 8

(in thousands)	Three months ended June 30, 2017 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Three months ended June 30, 2016 Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$5,672	$ 6	$ 0	$5,916	$ 41	$ 0
All other CRE	7,766	52	0	12,568	43	4
Acquisition and development						
1-4 family residential construction	582	6	0	641	7	0
All other A&D	1,818	22	0	2,988	24	0
Commercial and industrial	290	3	0	1,121	10	0
Residential mortgage						
Residential mortgage - term	3,860	33	7	4,885	39	0
Residential mortgage – home equity	269	0	0	348	0	0
Consumer	0	0	0	0	0	0
Total	$20,257	$ 122	$ 7	$28,467	$ 164	$ 4

In the normal course of business, the Bank modifies loan terms for various reasons. These reasons may include as a retention strategy, remaining competitive in the current interest rate environment, and re-amortizing or extending a loan term to better match the loan's payment stream with the borrower's cash flows. A modified loan is considered to be a troubled debt restructuring ("TDR") when the Bank has determined that the borrower is troubled (i.e., experiencing financial difficulties). The Bank evaluates the probability that the borrower will be in payment default on any of its debt obligations in the foreseeable future without modification. To make this determination, the Bank performs a global financial review of the borrower and loan guarantors to assess their current ability to meet their financial obligations.

When the Bank restructures a loan to a troubled borrower, the loan terms (i.e., interest rate, payment amount, amortization period, and/or maturity date) are modified in such a way as to enable the borrower to cover the modified debt service payments based on current financials and cash flow adequacy. If a borrower's hardship is thought to be temporary, then modified terms are only offered for that time period. Where possible, the Bank obtains additional collateral and/or secondary payment sources at the time of the restructure in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. To date, the Bank has not forgiven any principal as a restructuring concession. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default.

All loans designated as TDRs are considered impaired loans and may be in either accruing or non-accruing status. The Bank's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition. Accordingly, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. If the loan was accruing at the time of the modification, then it continues to be in accruing status subsequent to the modification. Non-accrual TDRs may return to accruing status when there has been sufficient payment performance for a period of at least six months. TDRs are considered to be in payment default if, subsequent to modification, the loans are transferred to non-accrual status or to foreclosure. Loans may be removed from being reported as a TDR in the calendar year following the modification if the interest rate at the time of modification was consistent with the interest rate for a loan with comparable credit risk and the loan has performed according to its modified terms for at least six months.

The volume and type of TDR activity is considered in the assessment of the local economic trends' qualitative factor used in the determination of the ALL for loans that are evaluated collectively for impairment.

The following tables present the volume and recorded investment at the time of modification of TDRs by class and type of modification that occurred during the periods indicated:

(in thousands)	Temporary Rate Modification			Extension of Maturity			Modification of Payment and Other Terms		
	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Six months ended June 30, 2017									
Commercial real estate									
Non owner-occupied	0	$	0	0	$	0	0	$	0
All other CRE	0		0	0		0	0		0
Acquisition and development									
1-4 family residential construction	0		0	0		0	0		0
All other A&D	0		0	1		244	0		0
Commercial and industrial	0		0	0		0	0		0
Residential mortgage									
Residential mortgage – term	0		0	1		259	0		0
Residential mortgage – home equity	0		0	0		0	0		0
Consumer	0		0	0		0	0		0
Total	0	$	0	2	$	503	0	$	0

(in thousands)	Temporary Rate Modification			Extension of Maturity			Modification of Payment and Other Terms		
	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Three months ended June 30, 2017									
Commercial real estate									
Non owner-occupied	0	$	0	0	$	0	0	$	0
All other CRE	0		0	0		0	0		0
Acquisition and development									
1-4 family residential construction	0		0	0		0	0		0
All other A&D	0		0	0		0	0		0
Commercial and industrial	0		0	0		0	0		0
Residential mortgage									
Residential mortgage – term	0		0	0		0	0		0
Residential mortgage – home equity	0		0	0		0	0		0
Consumer	0		0	0		0	0		0
Total	0	$	0	0	$	0	0	$	0

During the six months ended June 30, 2017, there were no new TDRs, but two existing TDRs that had reached their original modification maturity were re-modified. These re-modifications did not impact the ALL. During the six months ended June 30, 2017, there were no payment defaults.

During the three months ended June 30, 2017, there were no new TDRs. In addition, no existing TDR that had reached its original modification maturity was re-modified. During the three months ended June 30, 2017, there were no payment defaults.

	Temporary Rate Modification			Extension of Maturity			Modification of Payment and Other Terms		
(in thousands)	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Six months ended June 30, 2016									
Commercial real estate									
Non owner-occupied	0	$	0	0	$	0	0	$	0
All other CRE	0		0	1		203	0		0
Acquisition and development									
1-4 family residential construction	0		0	0		0	0		0
All other A&D	0		0	0		0	0		0
Commercial and industrial	0		0	0		0	1		486
Residential mortgage									
Residential mortgage – term	1		54	0		0	1		72
Residential mortgage – home equity	0		0	0		0	0		0
Consumer	0		0	0		0	0		0
Total	1	$	54	1	$	203	2	$	558

	Temporary Rate Modification			Extension of Maturity			Modification of Payment and Other Terms		
(in thousands)	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Three Months Ended June 30, 2016									
Commercial real estate									
Non owner-occupied	0	$	0	0	$	0	0	$	0
All other CRE	0		0	0		0	0		0
Acquisition and development									
1-4 family residential construction	0		0	0		0	0		0
All other A&D	0		0	0		0	0		0
Commercial and industrial	0		0	0					