NATIONAL BANKSHARES INC
Form 10-Q
November 03, 2014
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 September 30, 2014
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________

Commission File Number 0-15204

NATIONAL BANKSHARES, INC.

(Exact name of registrant as specified in its charter)

Virginia	54-1375874
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Hubbard Street

P. O. Box 90002

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

(540) 951-6300

(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). [x] 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 [x] Non-accelerated filer [ ] Smaller reporting company [ ]
(Do not check if a smaller reporting company)

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

[ ] Yes [x] 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 October 31, 2014
Common Stock, $1.25 Par Value	6,950,474

(This report contains 56 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

Form 10-Q

Index

Part I

Item1. Financial Statements Financial Information
National Bankshares, Inc. and Subsidiaries

Consolidated Balance Sheets

$ in thousands, except per share data	(Unaudited) September 30, 2014	December 31, 2013
Assets		
Cash and due from banks	**$ 12,815**	$ 13,283
Interest-bearing deposits	**87,621**	98,066
Securities available for sale, at fair value	**205,020**	181,712
Securities held to maturity (fair value approximates $167,409 at September 30, 2014 and $159,337 at December 31, 2013)	**162,457**	163,983
Restricted stock, at cost	**1,089**	1,414
Mortgage loans held for sale	**725**	1,276
Loans:		
Loans, net of unearned income and deferred fees	**595,801**	595,690
Less allowance for loan losses	**(8,031)**	(8,227)
Loans, net	**587,770**	587,463
Premises and equipment, net	**9,445**	9,951
Accrued interest receivable	**5,708**	5,949
Other real estate owned, net	**5,145**	4,712
Intangible assets and goodwill	**7,492**	8,299
Bank-owned life insurance	**21,643**	21,181
Other assets	**9,329**	13,341
Total assets	**$ 1,116,259**	$ 1,110,630
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	**$ 153,118**	$ 142,645
Interest-bearing demand deposits	**492,005**	501,541
Savings deposits	**79,870**	74,141
Time deposits	**223,930**	241,709
Total deposits	**948,923**	960,036
Accrued interest payable	**67**	92
Other liabilities	**4,447**	4,610
Total liabilities	**953,437**	964,738
Commitments and contingencies	**---**	---
Stockholders' Equity		
Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	**---**	---
Common stock of $1.25 par value. Authorized 10,000,000 shares; issued and outstanding 6,950,474 shares at September 30, 2014 and 6,947,974 at December 31, 2013	**8,688**	8,685
Retained earnings	**163,181**	154,171

Accumulated other comprehensive loss, net	**(9,047)**	(16,964)
Total stockholders' equity	**162,822**	145,892
Total liabilities and stockholders' equity	**$ 1,116,259**	$ 1,110,630

See accompanying notes to consolidated financial statements.

3

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended September 30, 2014 and 2013

(Unaudited)

$ in thousands, except per share data	**September 30, 2014**	**September 30, 2013**
Interest Income		
Interest and fees on loans	**$7,766**	$8,196
Interest on interest-bearing deposits	**64**	45
Interest on securities – taxable	**1,718**	1,722
Interest on securities – nontaxable	**1,436**	1,581
Total interest income	**10,984**	11,544
Interest Expense		
Interest on time deposits of $100 or more	**139**	196
Interest on other deposits	**1,008**	1,192
Total interest expense	**1,147**	1,388
Net interest income	**9,837**	10,156
Provision for loan losses	**356**	303
Net interest income after provision for loan losses	**9,481**	9,853
Noninterest Income		
Service charges on deposit accounts	**634**	709
Other service charges and fees	**42**	37
Credit card fees	**929**	834
Trust income	**296**	267
BOLI income	**174**	182
Other income	**163**	183
Realized securities gains (losses), net	**4**	(62)
Total noninterest income	**2,242**	2,150
Noninterest Expense		
Salaries and employee benefits	**2,948**	3,031
Occupancy and furniture and fixtures	**408**	394
Data processing and ATM	**426**	477
FDIC assessment	**147**	136
Credit card processing	**673**	656
Intangible assets amortization	**269**	269
Net costs of other real estate owned	**98**	52
Franchise taxes	**308**	280
Other operating expenses	**859**	848

Total noninterest expense	**6,136**	6,143
Income before income taxes	**5,587**	5,860
Income tax expense	**1,324**	1,343
Net Income	**$4,263**	$4,517
Basic net income per common share	**$0.61**	$0.65
Fully diluted net income per common share	**$0.61**	$0.65
Weighted average number of common shares outstanding – basic	**6,948,681**	6,947,974
Weighted average number of common shares outstanding – diluted	**6,956,777**	6,972,769
Dividends declared per common share	**$---**	$---

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

Three Months Ended September 30, 2014 and 2013

(Unaudited)

$ in thousands	**September 30, 2014**	**September 30, 2013**
Net Income	**$ 4,263**	$ 4,517
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gains (losses) on available for sale securities net of tax of $919 and ($2,048) for the periods ended September 30, 2014 and 2013, respectively	**1,708**	(3,804)
Reclassification adjustment, net of tax of ($1) and $24 for the periods ended September 30, 2014 and 2013, respectively	**(3)**	44
Other comprehensive income (loss), net of tax of $918 and ($2,024) for the periods ended September 30, 2014 and 2013, respectively	**1,705**	(3,760)
Total Comprehensive Income	**$ 5,968**	$ 757

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Nine Months Ended September 30, 2014 and 2013

(Unaudited)

$ in thousands, except per share data	**September 30, 2014**	**September 30, 2013**
Interest Income		
Interest and fees on loans	**$23,520**	$24,707
Interest on interest-bearing deposits	**193**	161
Interest on securities – taxable	**5,068**	4,928
Interest on securities – nontaxable	**4,410**	4,847
Total interest income	**33,191**	34,643
Interest Expense		
Interest on time deposits of $100 or more	**437**	694
Interest on other deposits	**3,320**	3,921
Total interest expense	**3,757**	4,615
Net interest income	**29,434**	30,028
Provision for loan losses	**1,160**	1,329
Net interest income after provision for loan losses	**28,274**	28,699
Noninterest Income		
Service charges on deposit accounts	**1,833**	1,922
Other service charges and fees	**145**	139
Credit card fees	**2,687**	2,427
Trust income	**921**	867
BOLI income	**526**	546
Other income	**669**	687
Realized securities gains (losses), net	**5**	(44)
Total noninterest income	**6,786**	6,544
Noninterest Expense		
Salaries and employee benefits	**8,954**	8,963
Occupancy and furniture and fixtures	**1,265**	1,230
Data processing and ATM	**1,183**	1,288
FDIC assessment	**411**	408
Credit card processing	**1,887**	1,854
Intangible assets amortization	**807**	809
Net costs of other real estate owned	**259**	192
Franchise taxes	**874**	803
Other operating expenses	**2,738**	2,697

Total noninterest expense	**18,378**	18,244
Income before income taxes	**16,682**	16,999
Income tax expense	**3,906**	3,831
Net Income	**$12,776**	$13,168
Basic net income per common share	**$1.84**	$1.90
Fully diluted net income per common share	**$1.84**	$1.89
Weighted average number of common shares outstanding – basic	**6,948,212**	6,947,974
Weighted average number of common shares outstanding – diluted	**6,960,444**	6,970,063
Dividends declared per common share	**$0.55**	$0.54

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

Nine Months Ended September 30, 2014 and 2013

(Unaudited)

$ in thousands	**September 30, 2014**	**September 30, 2013**
Net Income	**$ 12,776**	$ 13,168
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gains (losses) on available for sale securities net of tax of $4,264 and ($7,142) for the periods ended September 30, 2014 and 2013, respectively	**7,920**	(13,263)
Reclassification adjustment, net of tax of ($1) and $18 for the periods ended September 30, 2014 and 2013, respectively	**(3)**	32
Other comprehensive income (loss), net of tax of $4,263 and ($7,123) for the periods ended September 30, 2014 and 2013, respectively	**7,917**	(13,231)
Total Comprehensive Income (Loss)	**$ 20,693**	$ (63)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Nine Months September 30, 2014 and 2013

(Unaudited)

$ in thousands	**Common Stock**	**Retained Earnings**	**Accumulated Other Comprehensive Loss**	**Total**
Balances at December 31, 2012	$ 8,685	$ 144,162	$ (2,738)	$ 150,109
Net income	---	13,168	---	13,168
Dividends $0.54 per share	---	(3,752)	---	(3,752)
Other comprehensive loss, net of tax($7,123)	---	---	(13,231)	(13,231)
Balances at September 30, 2013	$ 8,685	$ 153,578	$ (15,969)	$ 146,294
Balances at December 31, 2013	$ 8,685	$ 154,171	$ (16,964)	$ 145,892
Net income	---	12,776	---	12,776
Dividends $0.55 per share	---	(3,821)	---	(3,821)
Exercise of stock options	3	55		58
Other comprehensive income, net of tax $4,263	---	---	7,917	7,917
Balances at September 30, 2014	**$ 8,688**	**$ 163,181**	**$ (9,047)**	**$ 162,822**

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2014 and 2013

(Unaudited)

$ in thousands	**September 30, 2014**	**September 30, 2013**
Cash Flows from Operating Activities		
Net income	**$ 12,776**	$ 13,168
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**1,160**	1,329
Depreciation of bank premises and equipment	**541**	546
Amortization of intangibles	**807**	809
Amortization of premiums and accretion of discounts, net	**109**	130
Losses on disposal of fixed assets	**94**	---
(Gains) losses on sales and calls of securities available for sale, net	**(4)**	50
Gains on calls of securities held to maturity, net	**(1)**	(6)
Losses and write-downs on other real estate owned, net	**76**	92
Increase in cash value of bank-owned life insurance	**(462)**	(497)
Net change in:		
Mortgage loans held for sale	**551**	2,179
Accrued interest receivable	**241**	203
Other assets	**(252)**	1,089
Accrued interest payable	**(25)**	(42)
Other liabilities	**(163)**	167
Net cash provided by operating activities	**15,448**	19,217
Cash Flows from Investing Activities		
Net change interest-bearing deposits	**10,445**	33,809
Proceeds from calls, principal payments, sales and maturities of securities available for sale	**8,774**	60,933
Proceeds from calls, principal payments and maturities of securities held to maturity	**7,808**	9,176
Purchases of securities available for sale	**(19,906)**	(83,993)
Purchases of securities held to maturity	**(6,381)**	(13,484)
Net change in restricted stock	**325**	275
Purchases of loan participations	**---**	(900)
Collections of loan participations	**1,513**	127
Loan originations and principal collections, net	**(4,030)**	113
Proceeds from disposal of other real estate owned	**329**	848
Recoveries on loans charged off	**212**	92
Proceeds from sale and purchases of bank premises and equipment, net	**(129)**	(170)
Net cash provided by (used in) investing activities	**(1,040)**	6,826
Cash Flows from Financing Activities		

Net change in time deposits	**(17,779)**	(29,164)
Net change in other deposits	**6,666**	5,896
Cash dividends paid	**(3,821)**	(3,752)
Stock options exercised	**58**	---
Net cash used in financing activities	**(14,876)**	(27,020)
Net change in cash and due from banks	**(468)**	(977)
Cash and due from banks at beginning of period	**13,283**	14,783
Cash and due from banks at end of period	**$ 12,815**	$ 13,806
Supplemental Disclosures of Cash Flow Information		
Interest paid on deposits and borrowed funds	**$ 3,782**	$ 4,657
Income taxes paid	**3,892**	3,610
Supplemental Disclosure of Noncash Activities		
Loans charged against the allowance for loan losses	**$ 1,568**	$ 1,680
Loans transferred to other real estate owned	**838**	478
Unrealized net gains (losses) on securities available for sale	**12,180**	(20,356)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2014

(Unaudited)

$ in thousands, except per share data

Note 1: General

The consolidated financial statements of National Bankshares, Inc. ("NBI") and its wholly-owned subsidiaries, The National Bank of Blacksburg ("NBB") and National Bankshares Financial Services, Inc. ("NBFS") (collectively, the "Company"), conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the nine months ended September 30, 2014 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to consolidated financial statements included in the Company's 2013 Form 10-K. The Company posts all reports required to be filed under the Securities and Exchange Act of 1934 on its web site at www.nationalbankshares.com.

Subsequent events have been considered through the date when the Form 10-Q was issued.

Note 2: Stock-Based Compensation

The Company's 1999 Stock Option Plan was terminated on March 9, 2009. Incentive stock options were granted annually to key employees of NBI and its subsidiaries from 1999 to 2005 and none have been granted since 2005. All of the stock options are vested.

Options	**Shares**	**Weighted Average Exercise Price Per**	**Weighted Average Remaining Contractual**	**Aggregate Intrinsic Value**

		Share	**Term**	
Outstanding at January 1, 2014	46,000	$ 23.96		
Exercised	2,500	23.00		
Forfeited or expired	---	---		
Outstanding September 30, 2014	43,500	$ 24.02	0.58	$ 163
Exercisable at September 30, 2014	43,500	$ 24.02	0.58	$ 163

There were 2,500 shares with an intrinsic value of $15 exercised during the first nine months of 2014. There were no shares exercised during the first nine months of 2013. As of September 30, 2014, there was no unrecognized compensation expense related to stock options.

Note 3: Loan Portfolio

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

	September 30, 2014	December 31, 2013
Real estate construction	**$ 42,067**	$ 45,925
Consumer real estate	**144,312**	145,499
Commercial real estate	**312,937**	311,266
Commercial non real estate	**32,224**	31,262
Public sector and IDA	**36,398**	34,220
Consumer non real estate	**28,735**	28,423
Gross loans	**596,673**	596,595
Less unearned income and deferred fees	**(872)**	(905)
Loans, net of unearned income and deferred fees	**$ 595,801**	$ 595,690

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

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

Impaired loans are those loans that have been modified in a troubled debt restructure ("TDR" or "restructure") and larger, non-homogeneous loans that are in nonaccrual or exhibit payment history or financial status that indicate the probability that collection will not occur according to the loan's original terms. Generally, impaired loans are given risk ratings that indicate higher risk, such as "classified" or "other assets especially mentioned." Impaired loans are individually evaluated to determine appropriate reserves and are measured at the lower of the invested amount or the fair market value. Impaired loans that are not troubled debt restructures and for which fair value measurement indicates an impairment loss are designated nonaccrual. A troubled debt restructure with an impairment loss may accrue interest if the loan shows a satisfactory repayment history for at least six months. Please refer to Note 1 of the Company's 2013 Form 10-K, "Summary of Significant Accounting Policies" for additional information on evaluation of impaired loans and associated specific reserves, and policies regarding nonaccruals, past due status and charge-offs.

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

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

Portfolio Segments and Classes

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

Real Estate Construction

Construction, residential

Construction, other

Consumer Real Estate

Equity lines

Residential closed-end first liens

Residential closed-end junior liens

Investor-owned residential real estate

Commercial Real Estate
Multifamily real estate

Commercial real estate, owner-occupied

Commercial real estate, other

Commercial Non Real Estate

Commercial and Industrial

Public Sector and IDA
Public sector and IDA

Consumer Non Real Estate

Credit cards

Automobile

Other consumder loans

Historical Loss Rates

The Company's allowance methodology for collectively-evaluated loans applies historical loss rates by class to current class balances as part of the process of determining required reserves. Class loss rates are calculated as the net charge-offs for the class as a percentage of average class balance. The loss rate for the current quarter is averaged with that of prior periods to obtain the historical loss rate. Two loss rates for each class are calculated: total net charge-offs for the class as a percentage of average class loan balance ("class loss rate"), and total net charge-offs for the class as a percentage of average classified loans in the class ("classified loss rate"). Classified loans are those with risk ratings of "substandard" or higher. Net charge-offs in both calculations include charge-offs and recoveries of classified and non-classified loans as well as those associated with impaired loans. Class historical loss rates are applied to non-classified loan balances at the reporting date, and classified historical loss rates are applied to classified balances at the reporting date.

Risk Factors

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

The analysis of certain factors results in standard allocations to all segments and classes. These factors include loan officers' average years of experience, the risk from changes in lending policies, and the risk from changes in loan review. Factors analyzed for each class, with resultant allocations based upon the level of risk assessed for each class, include levels of past due loans, nonaccrual loans, current class balance as a percentage of total loans, and the percentage of high risk loans (defined to be junior lien mortgages, high loan-to-value loans, and interest only loans) within the class. Additionally, factors specific to each segment are analyzed and result in allocations to the segment.

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

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

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

Commercial non real estate loans are secured by collateral other than real estate, or are unsecured. Credit risk for commercial non real estate loans is subject to economic conditions, generally monitored by local business bankruptcy trends, and interest rates. Public sector and IDA loans are extended to municipalities and related entities. Credit risk is based upon the entity's ability to repay and interest rate trends.

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

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

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

Activity in the Allowance for Loan Losses for the Three Months Ended September 30, 2014

	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Unallocated**	**Total**
Balance, June 30, 2014	**$663**	**$ 1,554**	**$ 3,790**	**$ 1,056**	**$ 278**	**$ 552**	**$ 78**	**$7,971**
Charge-offs	**---**	**(27)**	**(172)**	**---**	**---**	**(125)**	**---**	**(324)**
Recoveries	**---**	**---**	**8**	**1**	**---**	**19**	**---**	**28**
Provision for loan losses	**(79)**	**151**	**49**	**7**	**2**	**163**	**63**	**356**
Balance, September 30, 2014	**$584**	**$ 1,678**	**$ 3,675**	**$ 1,064**	**$ 280**	**$ 609**	**$ 141**	**$8,031**

Activity in the Allowance for Loan Losses for the Nine Months Ended September 30, 2014

	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Unallocated**	**Total**
Balance, December 31, 2013	**$863**	**$ 1,697**	**$ 3,685**	**$ 989**	**$ 132**	**$ 576**	**$ 285**	**$8,227**
Charge-offs	**(2)**	**(97)**	**(1,115)**	**(79)**	**---**	**(275)**	**---**	**(1,568)**
Recoveries	**---**	**---**	**33**	**132**	**---**	**47**	**---**	**212**
Provision for loan losses	**(277)**	**78**	**1,072**	**22**	**148**	**261**	**(144)**	**1,160**
Balance, September 30, 2014	**$584**	**$ 1,678**	**$ 3,675**	**$ 1,064**	**$ 280**	**$ 609**	**$ 141**	**$8,031**

Activity in the Allowance for Loan Losses for the Three Months Ended September 30, 2013

	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Unallocated**	**Total**
Balance, June 30, 2013	$1,032	$ 1,670	$ 3,029	$ 1,481	$ 111	$ 513	$ 116	$7,952
Charge-offs	---	(120)	---	(8)	---	(68)	---	(196)
Recoveries	---	---	8	2	---	21	---	31
Provision for loan losses	(11)	334	553	(472)	(6)	(59)	(36)	303
Balance, September 30, 2013	$1,021	$ 1,884	$ 3,590	$ 1,003	$ 105	$ 407	$ 80	$8,090

Activity in the Allowance for Loan Losses for the Nine Months Ended September 30, 2013

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2012	$1,070	$ 2,263	$ 3,442	$ 959	$ 142	$ 424	$ 49	$8,349
Charge-offs	(184)	(219)	(35)	(968)	---	(274)	---	(1,680)
Recoveries	---	1	12	18	---	61	---	92
Provision for loan losses	135	(161)	171	994	(37)	196	31	1,329
Balance, September 30, 2013	$1,021	$ 1,884	$ 3,590	$ 1,003	$ 105	$ 407	$ 80	$8,090

Allowance for Loan Losses as of September 30, 2014

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	**$---**	**$ 13**	**$ 281**	**$ 2**	**$ ---**	**$ ---**	**$ ---**	**$296**
Collectively evaluated for impairment	**584**	**1,665**	**3,394**	**1,062**	**280**	**609**	**141**	**7,735**
Total	**$584**	**$ 1,678**	**$ 3,675**	**$ 1,064**	**$ 280**	**$ 609**	**$ 141**	**$8,031**

Allowance for Loan Losses as of December 31, 2013

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	$---	$ 10	$ 610	$ 4	$ ---	$ ---	$ ---	$624
Collectively evaluated for impairment	863	1,687	3,075	985	132	576	285	7,603
Total	$863	$ 1,697	$ 3,685	$ 989	$ 132	$ 576	$ 285	$8,227

Loans as of September 30, 2014

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	**$---**	**$686**	**$ 13,804**	**$ 697**	**$---**	**$ ---**	$ ---	**$15,187**
Collectively evaluated for impairment	**42,067**	**143,626**	**299,133**	**31,527**	**36,398**	**28,735**	---	**581,486**
Total loans	**$42,067**	**$144,312**	**$ 312,937**	**$ 32,224**	**$36,398**	**$ 28,735**	**$ ---**	**$596,673**

Loans as of December 31, 2013

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	$---	$780	$ 12,079	$ 102	$---	$ 24	$ ---	$12,985
Collectively evaluated for impairment	45,925	144,719	299,187	31,160	34,220	28,399	---	583,610
Total	$45,925	$145,499	$ 311,266	$ 31,262	$34,220	$ 28,423	$ ---	$596,595

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

	Nine Months Ended September 30, 2014	2013	Year Ended December 31, 2013
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	**1.35 %**	1.37 %	1.38 %
Ratio of net charge-offs to average loans, net of unearned income and deferred fees[1]	**0.31 %**	0.36 %	0.28 %

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

14

A summary of nonperforming assets follows.

	September 30,		December 31,
	2014	**2013**	**2013**
Nonperforming assets:			
Nonaccrual loans	**$5,366**	$10,194	$ 5,732
Restructured loans in nonaccrual	**2,360**	1,042	852
Total nonperforming loans	**7,726**	11,236	6,584
Other real estate owned, net	**5,145**	973	4,712
Total nonperforming assets	**$12,871**	$12,209	$ 11,296
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	**2.14 %**	2.06 %	1.88 %
Ratio of allowance for loan losses to nonperforming loans[1]	**103.95 %**	72.00 %	124.95 %

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

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

	September 30,		December 31,
	2014	**2013**	**2013**
Loans past due 90 days or more and still accruing	**$485**	$149	$ 190
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	**0.08 %**	0.03 %	0.03 %
Accruing restructured loans	**$5,947**	$6,545	$ 6,191
Impaired loans:			
Impaired loans with no valuation allowance	**$9,223**	$14,874	$ 10,372
Impaired loans with a valuation allowance	**5,964**	2,172	2,613
Total impaired loans	**$15,187**	$17,046	$ 12,985
Valuation allowance	**(296)**	(631)	(624)
Impaired loans, net of allowance	**$14,891**	$16,415	$ 12,361
Average recorded investment in impaired loans[1]	**$15,974**	$17,357	$ 16,654
Interest income recognized on impaired loans, after designation as impaired	**$384**	$159	$ 267
Amount of income recognized on a cash basis	**$---**	$---	$ ---

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

Nonaccrual loans that meet the Company's balance threshold of $250 and TDRs are designated as impaired. No interest income was recognized on nonaccrual loans for the nine months ended September 30, 2014 or September 30, 2013 or for the year ended December 31, 2013.

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

	Impaired Loans as of September 30, 2014				
	Principal Balance	**(A) Total Recorded Investment(1)**	**Recorded Investment(1) in (A) for Which There is No Related Allowance**	**Recorded Investment(1) in (A) for Which There is a Related Allowance**	**Related Allowance**
Consumer Real Estate(2)					
Residential closed-end first liens	**$392**	**$ 365**	**$ 168**	**$ 197**	**$ 2**
Residential closed-end junior liens	**244**	**244**	**---**	**244**	**6**
Investor-owned residential real estate	**77**	**77**	**---**	**77**	**5**
Commercial Real Estate(2)					
Multifamily real estate	**2,950**	**2,794**	**868**	**1,926**	**224**
Commercial real estate, owner-occupied	**5,036**	**4,942**	**4,483**	**459**	**25**
Commercial real estate, other	**6,068**	**6,068**	**3,094**	**2,974**	**32**
Commercial Non Real Estate(2)					
Commercial and Industrial	**697**	**697**	**610**	**87**	**2**
Consumer Non Real Estate(2)					
Automobile	**---**	**---**	**---**	**---**	**---**
Total	**$15,464**	**$ 15,187**	**$ 9,223**	**$ 5,964**	**$ 296**

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

(2) Only classes with impaired loans are shown.

	Impaired Loans as of December 31, 2013				
	Principal Balance	**(A) Total Recorded Investment(1)**	**Recorded Investment(1) in (A) for Which There is No Related Allowance**	**Recorded Investment(1) in (A) for Which There is a Related Allowance**	**Related Allowance**
Consumer Real Estate(2)					
Residential closed-end first liens	$440	$ 442	$ 232	$ 210	$ 3
Residential closed-end junior liens	259	261	---	261	7
Investor-owned residential real estate	81	82	82	---	---
Commercial Real Estate(2)					
Multifamily real estate	3,278	3,274	3,274	---	---

Commercial real estate, owner occupied	5,643	5,645	3,864	1,781	610
Commercial real estate, other	3,158	3,158	3,158	---	---
Commercial Non Real Estate[2]					
Commercial and Industrial	102	103	1	102	4
Consumer Non Real Estate[2]					
Automobile	24	24	24	---	---
Total	$12,985	$ 12,989	$ 10,635	$ 2,354	$ 624

(1) Recorded investment includes principal net of unearned interest and deferred fees and costs, and accrued interest.

(2) Only classes with impaired loans are shown.

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

	For the Nine Months Ended September 30, 2014	
	Average Recorded Investment[1]	Interest Income Recognized
Consumer Real Estate[2]		
Residential closed-end first liens	**$385**	**$ 19**
Residential closed-end junior liens	**251**	**12**
Investor-owned residential real estate	**78**	**4**
Commercial Real Estate[2]		
Multifamily real estate	**2,807**	**---**
Commercial real estate, owner occupied	**5,606**	**153**
Commercial real estate, other	**6,134**	**164**
Commercial Non Real Estate[2]		
Commercial and Industrial	**713**	**32**
Consumer Non Real Estate[2]		
Automobile	**---**	**---**
Total	**$15,974**	**$ 384**

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

(2) Only classes with impaired loans are shown.

	For the Year Ended December 31, 2013	
	Average Recorded Investment[1]	Interest Income Recognized
Real Estate Construction[2]		
Construction, residential	$40	$ ---
Construction, other	2,885	---
Consumer Real Estate[2]		
Residential closed-end first liens	364	3
Residential closed-end junior liens	280	9
Investor-owned residential real estate	131	6
Commercial Real Estate[2]		
Multifamily real estate	4,172	---
Commercial real estate, owner occupied	5,265	136

Commercial real estate, other	3,369	110
Commercial Non Real Estate[2]		
Commercial and Industrial	117	3
Consumer Non Real Estate[2]		
Automobile	31	---
Total	$16,654	$ 267

(1) Recorded investment includes principal net of unearned interest and deferred fees and costs, and accrued interest.

(2) Only classes with impaired loans are shown.

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

A restructured loan for which impairment measurement does not indicate a loss and that maintains current status for at least six months may be returned to accrual status.

An analysis of past due and nonaccrual loans follows.

September 30, 2014

	30 – 89 Days Past Due	90 or More Days Past Due	90 or More Days Past Due and Still Accruing	Nonaccruals (Including Impaired Nonaccruals)
Real Estate Construction[1]				
Construction, other	$29	$---	$ ---	$ ---
Consumer Real Estate[1]				
Equity lines	46	---	---	---
Residential closed-end first liens	1,605	556	457	176
Residential closed-end junior liens	67	---	---	---
Investor-owned residential real estate	284	---	---	15
Commercial Real Estate[1]				
Multifamily real estate	715	868	---	2,794
Commercial real estate, owner-occupied	350	1,219	---	1,653
Commercial real estate, other	---	---	---	2,974
Commercial Non Real Estate[1]				
Commercial and Industrial	1,102	---	---	114
Consumer Non Real Estate[1]				
Credit cards	12	6	6	---
Automobile	234	20	20	---
Other consumer loans	64	2	2	---
Total	$4,508	$2,671	$ 485	$ 7,726

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

18

An analysis of past due and nonaccrual loans follows.

December 31, 2013

	30 – 89 Days Past Due	90 or More Days Past Due	90 or More Days Past Due and Still Accruing	Nonaccruals (Including Impaired Nonaccruals)
Real Estate Construction[1]				
Construction, residential	$45	$---	$ ---	$ ---
Construction, other	45	---	---	---
Consumer Real Estate[1]				
Residential closed-end first liens	903	252	128	308
Residential closed-end junior liens	10	---	---	---
Investor-owned residential real estate	422	91	---	91
Commercial Real Estate[1]				
Multifamily real estate	430	3,278	---	3,278
Commercial real estate, owner occupied	604	2,519	---	2,756
Commercial real estate, other	32	---	---	---
Commercial Non Real Estate[1]				
Commercial and Industrial	196	43	---	128
Consumer Non Real Estate[1]				
Credit cards	3	13	13	---
Automobile	217	26	2	23
Other consumer loans	49	46	47	---
Total	$2,956	$6,268	$ 190	$ 6,584

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

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

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

Determination of risk grades was completed for the portfolio as of September 30, 2014 and 2013 and December 31, 2013.

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

September 30, 2014

	Pass	Special Mention	Classified (Excluding Impaired)
Real Estate Construction			
Construction, 1-4 family residential	$18,253	$ ---	$ ---
Construction, other	23,786	28	---
Consumer Real Estate			
Equity lines	16,432	15	46
Closed-end first liens	75,550	926	1,946
Closed-end junior liens	4,558	25	97
Investor-owned residential real estate	43,604	99	328
Commercial Real Estate			
Multifamily residential real estate	66,451	---	715
Commercial real estate owner-occupied	138,110	230	936
Commercial real estate, other	91,484	1,186	21
Commercial Non Real Estate			
Commercial and Industrial	30,994	121	412
Public Sector and IDA			
States and political subdivisions	36,398	---	---
Consumer Non Real Estate			
Credit cards	5,903	---	---
Automobile	11,677	128	114
Other consumer	10,904	2	7
Total	$574,104	$ 2,760	$ 4,622

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

December 31, 2013

	Pass	Special Mention (Excluding Impaired)	Classified (Excluding Impaired)
Real Estate Construction			
Construction, 1-4 family residential	$17,702	$ 163	$ 45
Construction, other	27,971	29	15
Consumer Real Estate			
Equity lines	16,146	16	---
Closed-end first liens	82,767	1,007	1,275
Closed-end junior liens	4,813	109	3
Investor-owned residential real estate	38,071	105	407
Commercial Real Estate			
Multifamily residential real estate	67,573	---	958
Commercial real estate owner-occupied	134,137	2,206	701
Commercial real estate, other	89,340	1,209	3,063
Commercial Non Real Estate			
Commercial and Industrial	29,987	878	295
Public Sector and IDA			
States and political subdivisions	34,220	---	---
Consumer Non Real Estate			
Credit cards	6,354	---	---
Automobile	11,428	253	34
Other consumer	10,253	17	60
Total	$570,762	$ 5,992	$ 6,856

<u>Sales, Purchases and Reclassification of Loans</u>

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

Troubled Debt Restructurings

The Company modifies loans in troubled debt restructurings. Total troubled debt restructurings amounted to $8,307 at September 30, 2014, $7,043 at December 31, 2013, and $7,587 at September 30, 2013. The Company did not modify any loans in a troubled debt restructuring during the three months ended September 30, 2014. The following tables present restructurings by class that occurred during the nine month period ended September 30, 2014, and the three and nine month periods ended September 30, 2013.

Note: Only classes with restructured loans are presented.

	Restructurings That Occurred During the Nine Months Ended September 30, 2014		
	Number of Contracts	**Pre-Modification Outstanding Principal Balance**	**Post-Modification Outstanding Principal Balance**
Commercial Real Estate			
Multifamily real estate	**1**		