SUSSEX BANCORP
Form 10-Q
November 13, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

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FORM 10-Q

(Mark One)

[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 0-29030

SUSSEX BANCORP

(Exact name of registrant as specified in its charter)

New Jersey	22-3475473
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 Enterprise Drive, Suite 700, Rockaway, NJ	07866
(Address of principal executive offices)	(Zip Code)

(844) 256-7328

(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 and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Yes No

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

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

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

As of November 6, 2014 there were 4,664,506 shares of common stock, no par value, outstanding.

SUSSEX BANCORP

FORM 10-Q

INDEX

FORWARD-LOOKING STATEMENTS

We may, from time to time, make written or oral “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the “SEC”), our reports to shareholders and in other communications by us. This Report on Form 10-Q contains “forward-looking statements” which may be identified by the use of such words as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

§ changes in the interest rate environment that reduce margins;
§ changes in the regulatory environment;
§ the highly competitive industry and market area in which we operate;
§ general economic conditions, either nationally or regionally, resulting in, among other things, a deterioration in credit quality;
§ changes in business conditions and inflation;
§ changes in credit market conditions;
§ changes in the securities markets which affect investment management revenues;
§ increases in Federal Deposit Insurance Corporation (“FDIC”) deposit insurance premiums and assessments could adversely affect our financial condition;
§ changes in technology used in the banking business;
§ the soundness of other financial services institutions which may adversely affect our credit risk;
§ our controls and procedures may fail or be circumvented;
§ new lines of business or new products and services which may subject us to additional risks;
§ changes in key management personnel which may adversely impact our operations;
§ the effect on our operations of recent legislative and regulatory initiatives that were or may be enacted in response to the ongoing financial crisis;
§ severe weather, natural disasters, acts of war or terrorism and other external events which could significantly impact our business; and
§ other factors detailed from time to time in our filings with the SEC.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

ii

PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

SUSSEX BANCORP
CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Cash and due from banks	$ 2,668	$ 5,521
Interest-bearing deposits with other banks	12,703	7,725
Cash and cash equivalents	15,371	13,246
Interest bearing time deposits with other banks	100	100
Securities available for sale, at fair value	71,677	90,676
Securities held to maturity, at cost (fair value of $5,254 and $6,060 at September 30, 2014 and December 31, 2013, respectively)	5,106	6,074
Federal Home Loan Bank Stock, at cost	2,747	2,705
Loans receivable, net of unearned income	442,731	392,402
Less: allowance for loan losses	5,709	5,421
Net loans receivable	437,022	386,981
Foreclosed real estate	2,854	2,926
Premises and equipment, net	8,616	6,892
Accrued interest receivable	1,749	1,642
Goodwill	2,820	2,820
Bank-owned life insurance	12,132	11,889
Other assets	7,839	7,960
Total Assets	$ 568,033	$ 533,911
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 72,620	$ 58,210
Interest bearing	381,921	372,087
Total deposits	454,541	430,297
Long-term borrowings	46,000	41,000
Accrued interest payable and other liabilities	4,189	3,302

Junior subordinated debentures	12,887	12,887
Total Liabilities	517,617	487,486
Stockholders' Equity:		
Preferred stock, no par value, 1,000,000 shares authorized; none issued	-	-
Common stock, no par value, 10,000,000 shares authorized; 4,675,689 and 4,640,296 shares issued and 4,664,506 and 4,629,113 shares outstanding at September 30, 2014 and December 31, 2013, respectively	35,479	35,249
Treasury stock, at cost, 11,183 shares	(59)	(59)
Retained earnings	14,983	13,386
Accumulated other comprehensive income (loss)	13	(2,151)
Total Stockholders' Equity	50,416	46,425
Total Liabilities and Stockholders' Equity	$ 568,033	$ 533,911

See Notes to Unaudited Consolidated Financial Statements

1

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

(Dollars in thousands except per share data)	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
INTEREST INCOME				
Loans receivable, including fees	$ 4,940	$ 4,599	$ 14,363	$ 13,360
Securities:				
Taxable	208	130	639	410
Tax-exempt	231	254	740	762
Interest bearing deposits	4	2	11	9
Total Interest Income	5,383	4,985	15,753	14,541
INTEREST EXPENSE				
Deposits	424	419	1,229	1,410
Borrowings	363	293	1,072	828
Junior subordinated debentures	54	54	159	163
Total Interest Expense	841	766	2,460	2,401
Net Interest Income	4,542	4,219	13,293	12,140
PROVISION FOR LOAN LOSSES	378	500	1,231	2,342
Net Interest Income after Provision for Loan Losses	4,164	3,719	12,062	9,798
OTHER INCOME				
Service fees on deposit accounts	255	283	784	840
ATM and debit card fees	182	181	534	519
Bank-owned life insurance	78	85	243	267
Insurance commissions and fees	741	756	2,410	2,245
Investment brokerage fees	11	37	79	136
Net gain on sales of securities	164	-	258	399
Other	70	92	242	276
Total Other Income	1,501	1,434	4,550	4,682
OTHER EXPENSES				
Salaries and employee benefits	2,631	2,387	7,490	6,943
Occupancy, net	375	342	1,225	1,083
Data processing	549	341	1,361	1,008
Furniture and equipment	184	137	460	434
Advertising and promotion	89	63	211	198

Professional fees	153	153	517	536
Director fees	137	106	379	299
FDIC assessment	183	176	534	523
Insurance	70	65	218	204
Stationary and supplies	64	43	171	143
Loan collection costs	53	37	299	251
Net expenses and write-downs related to foreclosed real estate	12	317	273	1,325
Amortization of intangible assets	-	-	-	1
Other	359	268	926	754
Total Other Expenses	4,859	4,435	14,064	13,702
Income before Income Taxes	806	718	2,548	778
EXPENSE (BENEFIT) FOR INCOME TAXES	214	143	671	(29)
Net Income	592	575	1,877	807
OTHER COMPREHENSIVE INCOME (LOSS):				
Unrealized gains (losses) on available for sale securities arising during the period	511	430	3,864	(3,327)
Reclassification adjustment for net gain on securities transactions included in net income	(164)	-	(258)	(399)
Income tax (expense) benefit related to items of other comprehensive income (loss)	(138)	(173)	(1,442)	1,490
Other comprehensive income (loss), net of income taxes	209	257	2,164	(2,236)
Comprehensive income (loss)	$ 801	$ 832	$ 4,041	$ (1,429)
EARNINGS PER SHARE				
Basic	$ 0.13	$ 0.14	$ 0.41	$ 0.23
Diluted	$ 0.13	$ 0.14	$ 0.41	$ 0.23

See Notes to Unaudited Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Nine Months Ended September 30, 2014 and 2013
(Unaudited)

(Dollars in Thousands)	Number of Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance December 31, 2012	3,397,873	$ 28,117	$ 11,958	$ 356	$ (59)	$ 40,372
Net income	-	-	807	-	-	807
Other comprehensive loss	-	-	-	(2,236)	-	(2,236)
Restricted stock granted	32,940	-	-	-	-	-
Stock issued in rights offering	1,198,300	6,896	-	-	-	6,896
Compensation expense related to stock option and restricted stock grants	-	174	-	-	-	174
Balance September 30, 2013	4,629,113	$ 35,187	$ 12,765	$ (1,880)	$ (59)	$ 46,013
Balance December 31, 2013	4,629,113	$ 35,249	$ 13,386	$ (2,151)	$ (59)	$ 46,425
Net income	-	-	1,877	-	-	1,877
Other comprehensive income	-	-	-	2,164	-	2,164
Restricted stock granted	36,043	-	-	-	-	-
Restricted stock forfeited	(650)	-	-	-	-	-
Compensation expense related to stock option and restricted stock grants	-	230	-	-	-	230
Dividends on common stock ($0.03 per share)		-	(280)	-	-	(280)
Balance September 30, 2014	4,664,506	$ 35,479	$ 14,983	$ 13	$ (59)	$ 50,416

See Notes to Unaudited Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,			
(Dollars in thousands)	2014		2013	
Cash Flows from Operating Activities				
Net income	$	1,877	$	807
Adjustments to reconcile net income to net cash provided by operating activities:				
Provision for loan losses		1,231		2,342
Depreciation and amortization		508		510
Net amortization of securities premiums and discounts		1,313		2,496
Net realized gain on sale of securities		(258)		(399)
Net realized gain on sale of foreclosed real estate		(8)		(50)
Write-downs of and provisions for foreclosed real estate		110		995
Deferred income taxes		(919)		648
Earnings on bank-owned life insurance		(243)		(267)
Compensation expense for stock options and stock awards		230		174
(Increase) decrease in assets:				
Accrued interest receivable		(107)		46
Other assets		(402)		(142)
Decrease (increase) in accrued interest payable and other liabilities		887		(27)
Net Cash Provided by Operating Activities		4,219		7,133
Cash Flows from Investing Activities				
Securities available for sale:				
Purchases		(1,160)		(28,745)
Sales		13,261		13,029
		9,484		33,431

Maturities, calls and principal repayments				
Securities held to maturity:				
Purchases		(1,450)		(1,860)
Maturities, calls and principal repayments		2,383		1,222
Net increase in loans		(51,987)		(49,080)
Proceeds from the sale of foreclosed real estate		685		3,897
Purchases of bank premises and equipment		(2,232)		(589)
Increase in Federal Home Loan Bank stock		(42)		(500)
Net Cash Used in Investing Activities		(31,058)		(29,195)
Cash Flows from Financing Activities				
Net increase (decrease) in deposits		24,244		4,538
Increase in borrowed funds		5,000		10,000
Dividends paid, net of reinvestments		(280)		6,896
Net Cash Provided by Financing Activities		28,964		21,434
Net Increase (Decrease) in Cash and Cash Equivalents		2,125		(628)
Cash and Cash Equivalents - Beginning		13,246		11,668
Cash and Cash Equivalents - Ending	$	15,371	$	11,040
Supplementary Cash Flows Information				
Interest paid	$	2,430	$	2,468
Income taxes paid	$	779	$	33
Supplementary Schedule of Noncash Investing and Financing Activities				
Foreclosed real estate acquired in settlement of loans	$	715	$	2,853

See Notes to Unaudited Consolidated Financial Statements

4

NOTE 1 – SUMMARY OF SIGNIFICANT ACOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Sussex Bancorp ("we," "us" or "our") and our wholly owned subsidiary Sussex Bank (the "Bank"). The Bank's wholly owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., ClassicLake Enterprises, LLC, Wheatsworth Properties Corp., PPD Holding Company, LLC, and Tri-State Insurance Agency, Inc. ("Tri-State"), a full service insurance agency located in Sussex County, New Jersey with a satellite office located in Bergen County, New Jersey. Tri-State's operations are considered a separate segment for financial disclosure purposes. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates ten banking offices, eight located in Sussex County, New Jersey, one located in Warren County, New Jersey and one in Orange County, New York.

Sussex Bancorp is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Deposit Insurance Fund ("DIF") of the Federal Deposit Insurance Corporation (the "FDIC") up to applicable limits. The operations of Sussex Bancorp and the Bank are subject to the supervision and regulation of the FRB, the FDIC and the New Jersey Department of Banking and Insurance (the "Department") and the operations of Tri-State are subject to supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by the accounting principles generally accepted in the United States of America ("U.S. GAAP") for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three and nine month periods ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

We have evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2014, for items that should potentially be recognized or disclosed in these unaudited consolidated financial statements. The evaluation was conducted through the date these unaudited consolidated financial statements were issued.

Reclassifications

Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income.

New Accounting Standards

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists. The FASB's objective in issuing this ASU is to eliminate diversity in practice resulting from a lack of guidance on this topic in current U.S. GAAP. This ASU applies to all entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date. For public entities, the guidance is effective for fiscal years beginning after December 15, 2013 and interim periods within those years. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In January 2014, FASB issued ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors, which clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers. The ASU's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In June 2014, FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, to change the accounting for repurchase-to-maturity transactions and certain linked repurchase financings. This will result in accounting for both types of arrangements as secured borrowings on the balance sheet, rather than sales. Additionally, the ASU introduces new disclosures to (i) increase transparency about the types of collateral pledged in secured borrowing transactions and (ii) enable users to better understand transactions in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. For public entities, the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. All other accounting and disclosure amendments in the ASU are effective for public business entities for the first interim or annual period beginning after December 15, 2014. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In June 2014, FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force), to clarify that a performance target in a share-based compensation award that could be achieved after an employee completes the requisite service period should be treated as a performance condition that affects the vesting of the award. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. For all entities, the amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

NOTE 2 – SECURITIES

Available for Sale

The amortized cost and fair value of securities available for sale as of September 30, 2014 and December 31, 2013 are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2014				
U.S. government agencies	$ 4,973	$ -	$ (54)	$ 4,919
State and political subdivisions	21,900	109	(289)	21,720
Mortgage-backed securities -				
U.S. government-sponsored enterprises	44,402	471	(215)	44,658
Equity securities-financial services industry and other	381	19	(20)	380
	$ 71,656	$ 599	$ (578)	$ 71,677
December 31, 2013				
U.S. government agencies	$ 5,421	$ 8	$ (49)	$ 5,380
State and political subdivisions	28,788	3	(2,916)	25,875
Mortgage-backed securities -				
U.S. government-sponsored enterprises	59,640	272	(975)	58,937
Equity securities-financial services industry and other	412	85	(13)	484
	$ 94,261	$ 368	$ (3,953)	$ 90,676

Securities with a carrying value of approximately $29.2 million and $37.2 million at September 30, 2014 and December 31, 2013, respectively, were pledged to secure public deposits and for other purposes required or permitted by applicable laws and regulations.

The amortized cost and fair value of securities available for sale at September 30, 2014 are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -
Due after one year through five years	501	498
Due after five years through ten years	1,948	1,947
Due after ten years	19,451	19,275
Total bonds and obligations	21,900	21,720
U.S. government agencies	4,973	4,919
Mortgage-backed securities:		
U.S. government-sponsored enterprises	44,402	44,658
Equity securities-financial services industry and other	381	380
Total available for sale securities	$ 71,656	$ 71,677

Gross realized gains on sales of securities available for sale were $242 thousand and gross realized losses were $78 thousand for the three months ended September 30, 2014. There were no sales of securities available for sale for the three months ended September 30, 2013.

Gross realized gains on sales of securities were $360 thousand and $407 thousand and gross losses were $102 thousand and $8 thousand for the nine months ended September 30, 2014 and 2013, respectively.

Temporarily Impaired Securities

The following table shows gross unrealized losses and fair value of securities with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by category and length of time that individual available for sale securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013.

Less Than 12 Months	12 Months or More	Total

(Dollars in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2014						
U.S. government agencies	$ 1,999	$ (4)	$ 2,920	$ (50)	$ 4,919	$ (54)
State and political subdivisions	2,010	(18)	12,756	(271)	14,766	(289)
Mortgage-backed securities - U.S. government-sponsored enterprises	4,672	(42)	11,620	(173)	16,292	(215)
Equity securities-financial services industry and other	-	-	124	(20)	124	(20)
Total temporarily impaired securities	$ 8,681	$ (64)	$ 27,420	$ (514)	$ 36,101	$ (578)
December 31, 2013						
U.S. government agencies	$ 3,246	$ (49)	$ -	$ -	$ 3,246	$ (49)
State and political subdivisions	19,610	(2,046)	6,065	(870)	25,675	(2,916)
Mortgage-backed securities - U.S. government-sponsored enterprises	30,830	(694)	9,147	(281)	39,977	(975)
Equity securities-financial services industry and other	-	-	130	(13)	130	(13)
Total temporarily impaired securities	$ 53,686	$ (2,789)	$ 15,342	$ (1,164)	$ 69,028	$ (3,953)

7

For each security whose fair value is less than their amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred. As of September 30, 2014, we reviewed our available for sale securities portfolio for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt and equity securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position.

U.S. Government Agencies

At September 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our U.S. government agencies securities were primarily due to changes in spreads and market conditions and not credit quality. At September 30, 2014, there were three securities with a fair value of $4.9 million that had an unrealized loss that amounted to $54 thousand. As of September 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of the U.S. government agency securities at September 30, 2014, were deemed to be other-than-temporarily impaired.

At December 31, 2013, there were two securities with a fair value of $3.2 million that had an unrealized loss that amounted to $49 thousand.

State and Political Subdivisions

At September 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our state and political subdivisions securities were caused by changes in interest rates and spreads and were not the result of credit quality. At September 30, 2014, there were 25 securities with a fair value of $14.8 million that had an unrealized loss that amounted to $289 thousand. These securities typically have maturity dates greater than 10 years and the fair values are more sensitive to changes in market interest rates. As of September 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our state and political subdivision securities at September 30, 2014, were deemed to be other-than-temporarily-impaired.

At December 31, 2013, there were 52 securities with a fair value of $25.7 million that had an unrealized loss that amounted to $2.9 million.

Mortgage-Backed Securities

At September 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our mortgage-backed securities guaranteed by U.S. government-sponsored enterprises were primarily due to changes in spreads and market conditions and not credit quality. At September 30, 2014, there were 14 securities with a fair value of $16.3 million that had an unrealized loss that amounted to $215 thousand. As of September 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our mortgage-backed securities at September 30, 2014, were deemed to be other-than-temporarily impaired.

At December 31, 2013, there were 32 securities with a fair value of $40.0 million that had an unrealized loss that amounted to $975 thousand.

Equity Securities

Our marketable equity securities portfolio consists primarily of common stock of entities in the financial services industry. At September 30, 2014, there was one security with a fair value of $124 thousand that had an unrealized loss of $20 thousand. This security has been adversely impacted by the effects of the current economic environment on the financial services industry. We evaluated the underlying bank for credit impairment based on its financial condition and performance. Based on our evaluation and expectation that this security will recover within a reasonable period of time, we do not consider it to be other-than-temporarily impaired at September 30, 2014.

At December 31, 2013, there was one security with a fair value of $130 thousand that had an unrealized loss of $13 thousand.

We continue to closely monitor the performance of the securities we own as well as the impact from any further deterioration in the economy or in the banking industry that may adversely affect these securities. We will continue to evaluate them for other-than-temporary impairment, which could result in a future non-cash charge to earnings.

Held to Maturity Securities

The amortized cost and fair value of securities held to maturity as of September 30, 2014 and December 31, 2013, are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2014				
State and political subdivisions	$ 5,106	$ 157	$ (9)	$ 5,254
December 31, 2013				
State and political subdivisions	$ 6,074	$ 78	$ (92)	$ 6,060

The amortized cost and carrying value of securities held to maturity at September 30, 2014 are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 1,189	$ 1,189
Due after one year through five years	-	-
Due after five years through ten years	1,822	1,815
Due after ten years	2,095	2,250
Total held to maturity securities	$ 5,106	$ 5,254

Temporarily Impaired Securities

The following table shows gross unrealized losses and fair value of held to maturity securities with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by category and length of time that individual held to maturity securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013:

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses

September 30, 2014						
State and political subdivisions	$ -	$ -	$ 809	$ (9)	$ 809	$ (9)
December 31, 2013						
State and political subdivisions	$ 2,080	$ (45)	$ 780	$ (47)	$ 2,860	$ (92)

For each security whose fair value is less than their amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred. As of September 30, 2014, we reviewed our held to maturity securities portfolio for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt and equity securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position.

At September 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our state and political subdivisions securities were caused by changes in interest rates and spreads and were not the result of credit quality. At September 30, 2014, there were two securities with a fair value of $809 thousand that had an unrealized loss that amounted to $9 thousand. These securities typically have maturity dates greater than 10 years and the fair values are more sensitive to changes in market interest rates. As of September 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our state and political subdivision securities at September 30, 2014 were deemed to be other-than-temporarily impaired.

At December 31, 2013, there were five securities with a fair value of $2.9 million that had an unrealized loss that amounted to $92 thousand.

NOTE 3 – LOANS

The composition of net loans receivable at September 30, 2014 and December 31, 2013 is as follows:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Commercial and industrial	$ 18,259	$ 15,205
Construction	10,058	7,307
Commercial real estate	305,800	260,664
Residential real estate	107,198	107,992
Consumer and other	1,855	1,617
	443,170	392,785
Unearned net loan origination fees	(439)	(383)
Allowance for loan losses	(5,709)	(5,421)
Net loans receivable	$ 437,022	$ 386,981

Mortgage loans serviced for others are not included in the accompanying balance sheets. The total amount of loans serviced for the benefit of others was approximately $530 thousand and $546 thousand at September 30, 2014 and December 31, 2013, respectively. Mortgage servicing rights were immaterial at September 30, 2014 and December 31, 2013.

NOTE 4 – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY OF FINANCING RECEIVABLES

The following table presents changes in the allowance for loan losses disaggregated by the class of loans receivable for the three and nine months ended September 30, 2014 and 2013:

(Dollars in thousands)	Commercial and Industrial	Construction	Commercial Real Estate	Residential Real Estate	Consumer and Other	Unallocated	Total
Three Months Ended:							
September 30, 2014							
Beginning balance	$ 257	$ 354	$ 3,750	$ 837	$ 13	$ 643	$ 5,854
Charge-offs	-	-	(495)	(33)	(9)	-	(537)
Recoveries	1	-	10	1	2	-	14
Provision	18	(53)	134	14	20	245	378
Ending balance	$ 276	$ 301	$ 3,399	$ 819	$ 26	$ 888	$ 5,709
September 30, 2013							
Beginning balance	$ 249	400	3,472	990	15	521	$ 5,647
Charge-offs	-	(19)	(747)	(89)	(7)	-	(862)
Recoveries	-	-	343	24	3	-	370
Provision	(10)	16	358	(58)	4	190	500
Ending balance	$ 239	$ 397	$ 3,426	$ 867	$ 15	$ 711	$ 5,655
Nine Months Ended:							
September 30, 2014							
Beginning balance	$ 222	$ 308	$ 3,399	$ 941	$ 16	$ 535	$ 5,421
Charge-offs	(1)	-	(853)	(118)	(31)	-	(1,003)
Recoveries	16	-	31	5	8	-	60
Provision	39	(7)	822	(9)	33	353	1,231
Ending balance	$ 276	$ 301	$ 3,399	$ 819	$ 26	$ 888	$ 5,709
September 30, 2013							
Beginning balance	$ 271	223	3,395	869	38	180	$ 4,976
Charge-offs	(6)	(141)	(1,759)	(155)	(22)	-	(2,083)
Recoveries	-	-	387	24	9	-	420
Provision	(26)	315	1,403	129	(10)	531	2,342
Ending balance	$ 239	$ 397	$ 3,426	$ 867	$ 15	$ 711	$ 5,655

The following table presents the balance of the allowance of loan losses and loans receivable by class at September 30, 2014 and December 31, 2013 disaggregated on the basis of our impairment methodology.

	Allowance for Loan Losses			Loans Receivable		
(Dollars in thousands)	Balance	Balance Related to Loans Individually Evaluated for Impairment	Balance Related to Loans Collectively Evaluated for Impairment	Balance	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
September 30, 2014						
Commercial and industrial	$ 276	$ 17	$ 259	$ 18,259	$ 60	$ 18,199
Construction	301	-	301	10,058	-	10,058
Commercial real estate	3,399	170	3,229	305,800	7,220	298,580
Residential real estate	819	82	737	107,198	2,377	104,821
Consumer and other loans	26	1	25	1,855	1	1,854
Unallocated	888	-	-	-	-	-
Total	$ 5,709	$ 270	$ 4,551	$ 443,170	$ 9,658	$ 433,512
December 31, 2013						
Commercial and industrial	$ 222	$ -	$ 222	$ 15,205	$ -	$ 15,205
Construction	308	-	308	7,307	-	7,307
Commercial real estate	3,399	322	3,077	260,664	10,894	249,770
Residential real estate	941	163	778	107,992	2,626	105,366
Consumer and other loans	16	-	16	1,617	-	1,617
Unallocated	535	-	-	-	-	-
Total	$ 5,421	$ 485	$ 4,401	$ 392,785	$ 13,520	$ 379,265

An age analysis of loans receivable, which were past due as of September 30, 2014 and December 31, 2013, is as follows:

	Greater Than	Total Financing	Recorded Investment > 90 Days and

(Dollars in thousands)	30-59 Days Past Due	60-89 days Past Due	90 Days (a)	Total Past Due	Current	Receivables	Accruing
September 30, 2014							
Commercial and industrial	$ -	$ -	$ 60	$ 60	$ 18,199	$ 18,259	$ -
Construction	1,354	-	-	1,354	8,704	10,058	-
Commercial real estate	297	356	6,042	6,695	299,105	305,800	-
Residential real estate	783	60	1,953	2,796	104,402	107,198	-
Consumer and other	5	-	34	39	1,816	1,855	33
Total	$ 2,439	$ 416	$ 8,089	$ 10,944	$ 432,226	$ 443,170	$ 33
December 31, 2013							
Commercial and industrial	$ 13	$ -	$ -	$ 13	$ 15,192	$ 15,205	$ -
Construction	-	-	-	-	7,307	7,307	-
Commercial real estate	2,139	775	9,823	12,737	247,927	260,664	123
Residential real estate	495	247	2,192	2,934	105,058	107,992	-
Consumer and other	7	1	-	8	1,609	1,617	-
Total	$ 2,654	$ 1,023	$ 12,015	$ 15,692	$ 377,093	$ 392,785	$ 123

(a) includes loans greater than 90 days past due and still accruing and non-accrual loans.

Loans for which the accrual of interest has been discontinued at September 30, 2014 and December 31, 2013 were:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Commercial and industrial	$ 60	$ -
Commercial real estate	6,042	9,700
Residential real estate	1,953	2,192
Consumer and other	1	-
Total	$ 8,056	$ 11,892

In determining the adequacy of the allowance for loan losses, we estimate losses based on the identification of specific problem loans through our credit review process and also estimate losses inherent in other loans on an aggregate basis by loan type. The credit review process includes the independent evaluation of the loan officer assigned risk ratings by the Chief Credit Officer and a third party loan review company. Such risk ratings are assigned loss component factors that reflect our loss estimate for each group of loans. It is management's and the Board of Directors' responsibility to oversee the lending process to ensure that all credit risks are properly identified, monitored, and controlled, and that loan pricing, terms and other safeguards against non-performance and default are commensurate with the level of risk undertaken and is rated as such based on a risk-rating system. Factors considered in assigning risk ratings and loss component factors include: borrower specific information related to expected future cash flows and operating results, collateral values, financial condition, payment status and other information; levels of and trends in portfolio charge-offs and recoveries; levels in portfolio delinquencies; effects of changes in loan concentrations and observed trends in the economy and other qualitative measurements.

Our risk-rating system is consistent with the classification system used by regulatory agencies and with industry practices. Loan classifications of Substandard, Doubtful or Loss are consistent with the regulatory definitions of classified assets. The classification system is as follows:

- Pass: This category represents loans performing to contractual terms and conditions and the primary source of repayment is adequate to meet the obligation. We have five categories within the Pass classification depending on strength of repayment sources, collateral values and financial condition of the borrower.

- Special Mention: This category represents loans performing to contractual terms and conditions; however the primary source of repayment or the borrower is exhibiting some deterioration or weaknesses in financial condition that could potentially threaten the borrowers' future ability to repay our loan principal and interest or fees due.

- Substandard: This category represents loans that the primary source of repayment has significantly deteriorated or weakened which has or could threaten the borrowers' ability to make scheduled payments. The weaknesses require close supervision by management and there is a distinct possibility that we could sustain some loss if the deficiencies are not corrected. Such weaknesses could jeopardize the timely and ultimate collection of our loan principal and interest or fees due. Loss may not be expected or evident, however, loan repayment is inadequately supported by current financial information or pledged collateral.

- Doubtful: Loans so classified have all the inherent weaknesses of a substandard loan with the added provision that collection or liquidation in full is highly questionable and not reasonably assured. The probability of at least partial loss is high, but extraneous factors might strengthen the asset to prevent loss. The validity of the extraneous factors must be continuously monitored. Once these factors are questionable the loan should be considered for full or partial charge-off.

- Loss: Loans so classified are considered uncollectible, and of such little value that their continuance as active assets is not warranted. Such loans are fully charged off.

The following tables illustrate our corporate credit risk profile by creditworthiness category as of September 30, 2014 and December 31, 2013:

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
September 30, 2014					
Commercial and industrial	$ 18,183	$ 16	$ 60	$ -	$ 18,259
Construction	10,058	-	-	-	10,058
Commercial real estate	290,785	6,953	8,062	-	305,800
Residential real estate	104,150	471	2,577	-	107,198
Consumer and other	1,716	138	1	-	1,855
	$ 424,892	$ 7,578	$ 10,700	$ -	$ 443,170
December 31, 2013					
Commercial and industrial	$ 15,192	$ 13	$ -	$ -	$ 15,205
Construction	7,307	-	-	-	7,307
Commercial real estate	240,204	7,378	12,917	165	260,664
Residential real estate	104,383	871	2,738	-	107,992
Consumer and other	1,477	140	-	-	1,617
	$ 368,563	$ 8,402	$ 15,655	$ 165	$ 392,785

The following table reflects information about our impaired loans by class as of September 30, 2014 and December 31, 2013:

	September 30, 2014			December 31, 2013		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial real estate	$ 3,882	$ 4,520	$ -	$ 7,394	$ 7,967	$ -
Residential real estate	1,949	1,981	-	1,849	1,874	-
With an allowance recorded:						
Commercial and industrial	60	60	17	-	-	-
Commercial real estate	3,338	3,881	170	3,500	4,595	322

Residential real estate	428	432	82	777	871	163
Consumer and other	1	1	1	-	-	-
Total:						
Commercial and industrial	60	60	17	-	-	-
Commercial real estate	7,220	8,401	170	10,894	12,562	322
Residential real estate	2,377	2,413	82	2,626	2,745	163
Consumer and other	1	1	1	-	-	-
	$ 9,658	$ 10,875	$ 270	$ 13,520	$ 15,307	$ 485

13

The following table presents the average recorded investment and income recognized for the three and nine months ended September 30, 2014 and 2013:

(Dollars in thousands)	For the Three Months Ended September 30, 2014 Average Recorded Investment	For the Three Months Ended September 30, 2014 Interest Income Recognized	For the Three Months Ended September 30, 2013 Average Recorded Investment	For the Three Months Ended September 30, 2013 Interest Income Recognized
With no related allowance recorded:				
Commercial real estate	$ 4,080	$ 4	$ 8,386	$ 11
Residential real estate	1,818	5	2,261	22
Total impaired loans without a related allowance	5,898	9	10,647	33
With an allowance recorded:				
Commercial and industrial	30	1	-	-
Construction	-	-	328	-
Commercial real estate	4,309	29	2,764	-
Residential real estate	485	-	887	-
Consumer and other	1	-	-	-
Total impaired loans with an allowance	4,825	30	3,979	-
Total impaired loans	$ 10,723	$ 39	$ 14,626	$ 33

(Dollars in thousands)	For the Nine Months Ended September 30, 2014 Average Recorded Investment	For the Nine Months Ended September 30, 2014 Interest Income Recognized	For the Nine Months Ended September 30, 2013 Average Recorded Investment	For the Nine Months Ended September 30, 2013 Interest Income Recognized
With no related allowance recorded:				
Construction	$ -	$ -	$ 329	$ -
Commercial real estate	4,999	22	8,334	51
Residential real estate	1,831	34	2,288	24
Total impaired loans without a related allowance	6,830	56	10,951	75

With an allowance recorded:						
Commercial and industrial	15		1	-		-
Construction	-		-	374		-
Commercial real estate	4,339		30	2,927		-
Residential real estate	667		7	946		3
Consumer and other	1		-	-		-
Total impaired loans with an allowance	5,022		38	4,247		3
Total impaired loans	$ 11,852	$	94	$ 15,198	$	78

We recognize income on impaired loans by recording all payments as a reduction of principal on such loans.

Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, postponement or forgiveness of principal, forbearance or other actions intended to maximize collection. The concessions rarely result in the forgiveness of principal or accrued interest. In addition, we attempt to obtain additional collateral or guarantor support when modifying such loans. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

The following table presents the recorded investment in troubled debt restructured loans, based on payment performance status:

(Dollars in thousands)	Commercial Real Estate	Residential Real Estate	Total
September 30, 2014			
Performing	$ 1,177	$ 424	$ 1,601
Non-performing	2,828	224	3,052
Total	$ 4,005	$ 648	$ 4,653
December 31, 2013			
Performing	$ 1,195	$ 433	$ 1,628
Non-performing	3,000	496	3,496
Total	$ 4,195	$ 929	$ 5,124

Troubled debt restructured loans are considered impaired and are included in the previous impaired loans disclosures in this footnote. As of September 30, 2014, we have not committed to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

There were no troubled debt restructurings that occurred during the three and nine months ended September 30, 2014. The following table summarizes troubled debt restructurings that occurred during the three and nine months ended September 30, 2013:

(Dollars in thousands)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Three Months Ended:			
September 30, 2013			
Commercial real estate	1	$ 1,201	$ 1,201
Nine Months Ended:			
September 30, 2013			
Commercial real estate	3	$ 3,100	$ 3,100
Residential real estate	1	302	302

The troubled debt restructurings presented in the table above resulted in an allocation of the allowance for credit losses of $49 thousand and $112 thousand for the three and nine months ended September 30, 2013. These specific reserves are included in the allowance for credit losses for loans individually evaluated for impairment. There were $200 thousand in charge-offs on the troubled debt restructurings presented in the table above during the three and nine months ended September 30, 2013.

There were no troubled debt restructurings that occurred during the three and nine months ended September 30, 2014, therefore, no allocation for the allowance for credit losses or charge-offs were required on loans modified as troubled debt restructurings during the three and nine months ended September 30, 2014.

There were no troubled debt restructurings for which there was a payment default within twelve months following the date of the restructuring for the three and nine months ended September 30, 2014 and 2013.

NOTE 5 – EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares (non-vested restricted stock grants and stock options) had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by us. Potential common shares related to stock options are determined using the treasury stock method.

(In thousands, except share and per share data)	Three Months Ended September 30, 2014 Income (Numerator)	Shares (Denominator)	Per Share Amount	Three Months Ended September 30, 2013 Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share:						
Net earnings applicable to common shareholders	$ 592	4,548,293	$ 0.13	$ 575	4,031,022	$ 0.14
Effect of dilutive securities:						
Nonvested stock awards	-	40,492		-	35,887	
Diluted earnings per share:						
Net income applicable to common shareholders and assumed conversions	$ 592	4,588,785	$ 0.13	$ 575	4,066,909	$ 0.14

(In thousands, except share and per share data)	Nine Months Ended September 30, 2014 Income (Numerator)	Shares (Denominator)	Per Share Amount	Nine Months Ended September 30, 2013 Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share:						
Net income applicable to common shareholders	$					