EMCLAIRE FINANCIAL CORP
Form 10-Q
November 12, 2013

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

**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, 2013**

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____________ to _____________

Commission File Number: **001-34527**

**EMCLAIRE FINANCIAL CORP**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Pennsylvania** | **25-1606091** |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| **612 Main Street, Emlenton, Pennsylvania** | **16373** |
| (Address of principal executive offices) | (Zip Code) |

**(724) 867-2311**
(Registrant's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

The number of shares outstanding of the Registrant's common stock was 1,763,158 at November 12, 2013.

**EMCLAIRE FINANCIAL CORP**

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**PART I FINANCIAL INFORMATION**



**PART II OTHER INFORMATION**

**PART I - FINANCIAL INFORMATION**

**Item 1. Interim Financial Statements**

# Emclaire Financial Corp

Consolidated Balance Sheets
As of September 30, 2013 (Unaudited) and December 31, 2012
(Dollar amounts in thousands, except per share data)

| | September 30, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| Assets | | | | |
| Cash and due from banks | $ | 2,184 | $ | 2,468 |
| Interest earning deposits with banks | | 12,452 | | 17,956 |
| Cash and cash equivalents | | 14,636 | | 20,424 |
| Securities available for sale | | 125,325 | | 120,206 |
| Loans receivable, net of allowance for loan losses of $4,787 and $5,350 | | 347,729 | | 333,801 |
| Federal bank stocks, at cost | | 3,707 | | 2,885 |
| Bank-owned life insurance | | 10,319 | | 10,072 |
| Accrued interest receivable | | 1,607 | | 1,533 |
| Premises and equipment, net | | 11,369 | | 9,180 |
| Goodwill | | 3,664 | | 3,664 |
| Core deposit intangible, net | | 1,022 | | 1,235 |
| Prepaid expenses and other assets | | 6,822 | | 6,014 |
| Total Assets | $ | 526,200 | $ | 509,014 |
| Liabilities and Stockholders' Equity | | | | |
| Liabilities: | | | | |
| Deposits: | | | | |
| Non-interest bearing | $ | 100,389 | $ | 98,559 |
| Interest bearing | | 329,053 | | 333,900 |
| Total deposits | | 429,442 | | 432,459 |
| Short-term borrowed funds | | 26,650 | | - |
| Long-term borrowed funds | | 20,000 | | 20,000 |
| Accrued interest payable | | 305 | | 442 |
| Accrued expenses and other liabilities | | 5,140 | | 4,388 |
| Total Liabilities | | 481,537 | | 457,289 |
| Commitments and Contingent Liabilities | | - | | - |
| Stockholders' Equity: | | | | |
| Preferred stock, $1.00 par value, 3,000,000 shares authorized; | | | | |

| | | | | |
|---|---|---|---|---|
| Series B, non-cumulative preferred stock, $5,000 and $10,000 liquidation value, 5,000 and 10,000 shares issued and outstanding, respectively | | 5,000 | | 10,000 |
| Common stock, $1.25 par value, 12,000,000 shares authorized; 1,865,175 and 1,861,425 shares issued; 1,763,158 and 1,759,408 shares outstanding | | 2,331 | | 2,327 |
| Additional paid-in capital | | 19,418 | | 19,270 |
| Treasury stock, at cost; 102,017 shares | | (2,114) | | (2,114) |
| Retained earnings | | 23,129 | | 21,672 |
| Accumulated other comprehensive income (loss) | | (3,101) | | 570 |
| Total Stockholders' Equity | | 44,663 | | 51,725 |
| Total Liabilities and Stockholders' Equity | $ | 526,200 | $ | 509,014 |

See accompanying notes to consolidated financial statements.

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# Emclaire Financial Corp

Consolidated Statements of Net Income (Unaudited)
For the three and nine months ended September 30, 2013 and 2012
(Dollar amounts in thousands, except per share data)

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Interest and dividend income: | | | | |
| Loans receivable, including fees | $ 4,114 | $ 4,389 | $ 12,411 | $ 12,989 |
| Securities: | | | | |
| Taxable | 440 | 617 | 1,328 | 1,763 |
| Exempt from federal income tax | 314 | 287 | 875 | 873 |
| Federal bank stocks | 18 | 15 | 52 | 46 |
| Interest earning deposits with banks | 12 | 17 | 44 | 68 |
| Total interest and dividend income | 4,898 | 5,325 | 14,710 | 15,739 |
| Interest expense: | | | | |
| Deposits | 662 | 1,008 | 2,305 | 3,105 |
| Borrowed funds | 198 | 238 | 590 | 707 |
| Total interest expense | 860 | 1,246 | 2,895 | 3,812 |
| Net interest income | 4,038 | 4,079 | 11,815 | 11,927 |
| Provision for loan losses | 143 | 1,359 | 438 | 1,587 |
| Net interest income after provision for loan losses | 3,895 | 2,720 | 11,377 | 10,340 |
| Noninterest income: | | | | |
| Fees and service charges | 428 | 428 | 1,254 | 1,159 |
| Commissions on financial services | 48 | 158 | 187 | 383 |
| Title premiums | 6 | 13 | 55 | 46 |
| Net gain on sales of available for sale securities | 107 | 390 | 291 | 1,352 |
| Net gain on sales of loans | 9 | - | 9 | - |
| Earnings on bank-owned life insurance | 97 | 81 | 290 | 205 |
| Other | 307 | 303 | 877 | 868 |
| Total noninterest income | 1,002 | 1,373 | 2,963 | 4,013 |
| Noninterest expense: | | | | |
| Compensation and employee benefits | 1,847 | 1,678 | 5,684 | 5,488 |
| Premises and equipment | 516 | 509 | 1,586 | 1,527 |
| Intangible asset amortization | 67 | 86 | 213 | 272 |
| Professional fees | 158 | 135 | 513 | 510 |
| Federal deposit insurance | 99 | 92 | 307 | 282 |
| Other | 856 | 857 | 2,447 | 2,476 |
| Total noninterest expense | 3,543 | 3,357 | 10,750 | 10,555 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Income before provision for income taxes | | 1,354 | | 736 | | 3,590 | | 3,798 |
| Provision for income taxes | | 272 | | 67 | | 711 | | 835 |
| Net income | | 1,082 | | 669 | | 2,879 | | 2,963 |
| Preferred stock dividends | | 115 | | 118 | | 365 | | 368 |
| Net income available to common stockholders | $ | 967 | $ | 551 | $ | 2,514 | $ | 2,595 |
| Basic earnings per common share | $ | 0.55 | $ | 0.31 | $ | 1.43 | $ | 1.48 |
| Diluted earnings per common share | | 0.54 | | 0.31 | | 1.42 | | 1.48 |
| Average common shares outstanding | | 1,762,810 | | 1,751,908 | | 1,761,972 | | 1,751,908 |

See accompanying notes to consolidated financial statements.

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**Emclaire Financial Corp**

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
For the three and nine months ended September 30, 2013 and 2012
(Dollar amounts in thousands)

| | For the three months ended September 30, 2013 | 2012 | For the nine months ended September 30, 2013 | 2012 |
|---|---|---|---|---|
| Net income | $ 1,082 | $ 669 | $ 2,879 | $ 2,963 |
| Other comprehensive income (loss) | | | | |
| Unrealized gains (losses) on securities: | | | | |
| Unrealized holding gain (loss) arising during the period | (800) | 444 | (5,271) | 887 |
| Reclassification adjustment for gains included in net income | (107) | (390) | (291) | (1,352) |
| | (907) | 54 | (5,562) | (465) |
| Tax effect | 308 | (18) | 1,891 | 158 |
| Net of tax | (599) | 36 | (3,671) | (307) |
| Comprehensive income (loss) | $ 483 | $ 705 | $ (792) | $ 2,656 |

See accompanying notes to consolidated financial statements.

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**Emclaire Financial Corp**
Condensed Consolidated Statements of Cash Flows (Unaudited)
For the nine months ended September 30, 2013 and 2012
(Dollar amounts in thousands)

| | For the nine months ended September 30, 2013 | 2012 |
|---|---|---|
| Cash flows from operating activities | | |
| Net income | $ 2,879 | $ 2,963 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 503 | 505 |
| Provision for loan losses | 438 | 1,587 |
| Amortization of premiums, net | 152 | 92 |
| Amortization of intangible assets and mortgage servicing rights | 213 | 277 |
| Realized gains on sales of available for sale securities, net | (291) | (1,352) |
| Net gains on sales of loans | (9) | - |
| Net losses on foreclosed real estate | 5 | 21 |
| Originations of loans sold | (202) | - |
| Proceeds from the sale of loans | 211 | - |
| Restricted stock and stock option compensation | 133 | 92 |
| Increase in bank-owned life insurance, net | (247) | (180) |
| Increase in accrued interest receivable | (74) | (106) |
| (Increase) decrease in prepaid expenses and other assets | 1,159 | (643) |
| Decrease in accrued interest payable | (137) | (25) |
| Increase (decrease) in accrued expenses and other liabilities | 644 | (13) |
| Net cash provided by operating activities | 5,377 | 3,218 |
| | | |
| Cash flows from investing activities | | |
| Loan originations and principal collections, net | (14,733) | (20,975) |
| Available for sale securities: | | |
| Sales | 21,015 | 11,639 |
| Maturities, repayments and calls | 28,767 | 78,146 |
| Purchases | (60,116) | (109,243) |
| (Purchase) redemption of federal bank stocks | (822) | 493 |
| Proceeds from the sale of foreclosed real estate | 167 | 271 |
| Write-down of foreclosed real estate | 19 | - |
| Purchases of premises and equipment | (2,692) | (431) |
| Purchase of bank-owned life insurance | - | (4,000) |
| Net cash used in investing activities | (28,395) | (44,100) |
| | | |
| Cash flows from financing activities | | |
| Net increase (decrease) in deposits | (3,017) | 37,029 |
| Net change in short-term borrowings | 26,650 | - |
| Proceeds from exercise of stock options, inlcuding tax benefit | 20 | - |
| Dividends paid | (1,423) | (1,313) |
| Redemption of preferred stock (Series B) | (5,000) | - |
| Net cash provided by financing activities | 17,230 | 35,716 |

| | | | | |
|---|---|---|---|---|
| Decrease in cash and cash equivalents | | (5,788) | | (5,166) |
| Cash and cash equivalents at beginning of period | | 20,424 | | 28,193 |
| Cash and cash equivalents at end of period | $ | 14,636 | $ | 23,027 |
| | | | | |
| Supplemental information: | | | | |
| Interest paid | $ | 3,032 | $ | 3,837 |
| Income taxes paid | | 140 | | 1,465 |
| | | | | |
| Supplemental noncash disclosure: | | | | |
| Transfers from loans to foreclosed real estate | | 159 | | 288 |

See accompanying notes to consolidated financial statements.

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# Emclaire Financial Corp

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)
For the three and nine months ended September 30, 2013 and 2012
(Dollar amounts in thousands, except per share data)

| | For the three months ended September 30, 2013 | 2012 | For the nine months ended September 30, 2013 | 2012 |
|---|---|---|---|---|
| Balance at beginning of period | $ 49,613 | $ 51,862 | $ 51,725 | $ 50,730 |
| Net income | 1,082 | 669 | 2,879 | 2,963 |
| Other comprehensive income (loss) | (599) | 36 | (3,671) | (307) |
| Stock compensation expense | 34 | 31 | 133 | 92 |
| Dividends declared on preferred stock | (115) | (118) | (365) | (368) |
| Dividends declared on common stock | (352) | (315) | (1,058) | (945) |
| Exercise of stock options, including tax benefit | - | - | 20 | - |
| Redemption of preferred stock (5,000 shares, Series B) | (5,000) | - | (5,000) | - |
| Balance at end of period | $ 44,663 | $ 52,165 | $ 44,663 | $ 52,165 |
| Common cash dividend per share | $ 0.20 | $ 0.18 | $ 0.60 | $ 0.54 |

See accompanying notes to consolidated financial statements.

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**Emclaire Financial Corp**
Notes to Consolidated Financial Statements (Unaudited)

## 1. Nature of Operations and Basis of Presentation

Emclaire Financial Corp (the Corporation) is a Pennsylvania corporation and the holding company of The Farmers National Bank of Emlenton (the Bank) and Emclaire Settlement Services, LLC (the Title Company). The Corporation provides a variety of financial services to individuals and businesses through its offices in Western Pennsylvania. Its primary deposit products are checking, savings and term certificate accounts and its primary lending products are residential and commercial mortgages, commercial business loans and consumer loans.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries, the Bank and the Title Company. All significant intercompany transactions and balances have been eliminated in preparing the consolidated financial statements.

The accompanying unaudited consolidated financial statements for the interim periods include all adjustments, consisting of normal recurring accruals, which are necessary, in the opinion of management, to fairly reflect the Corporation's consolidated financial position and results of operations. Additionally, these consolidated financial statements for the interim periods have been prepared in accordance with instructions for the Securities and Exchange Commission's (SEC's) Form 10-Q and Article 10 of Regulation S-X and therefore do not include all information or footnotes necessary for a complete presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (GAAP). For further information, refer to the audited consolidated financial statements and footnotes thereto for the year ended December 31, 2012, as contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC.

The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements.

The preparation of financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, goodwill, real estate owned, the valuation of deferred tax assets and other-than-temporary impairment charges on securities. The results of operations for interim quarterly or year-to-date periods are not necessarily indicative of the results that may be expected for the entire year or any other period. Certain amounts previously reported may have been reclassified to conform to the current year's financial statement presentation.

## 2. Participation in the Small Business Lending Fund (SBLF) of the U.S. Treasury Department (U.S. Treasury)

On August 18, 2011, the Corporation entered into a Securities Purchase Agreement (the Agreement) with the U.S. Treasury Department, pursuant to which the Corporation issued and sold to the U.S. Treasury 10,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), having a liquidation preference of $1,000 per share, for aggregate proceeds of $10.0 million, pursuant to the U.S. Treasury's SBLF program. On September 17, 2013, with the approval of the Corporation's primary federal banking regulator, the Corporation redeemed 5,000 shares, or 50%, of its Series B Preferred Stock held by the U.S. Treasury at an aggregate redemption price of $5.0 million, plus accrued but unpaid dividends. Following this redemption, the Treasury holds 5.000 shares of the Series B preferred Stock, representing a remaining liquidation value of $5.0 million.

The Series B Preferred Stock is entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate liquidation amount, was initially set at 5% per annum based upon the current level of Qualified Small Business Lending (QSBL) by the Bank. The dividend rate in subsequent periods is based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the time the Agreement was entered into. Such dividend rate varies from 1% to 5% per annum for the first two and one-half years through the quarter ending December 31, 2013. For the two year period beginning with the quarter ending March 31, 2014, the dividend rate will be fixed at a rate of 1% to 7% per annum. If the Series B Preferred Stock remains outstanding for more than four-and-one-half years, beginning with the quarter ending March 31, 2016, the dividend rate will be fixed at 9%. The dividend rate was 5.0% and 4.72%, respectively, for the quarters ended September 30, 2013 and 2012. For the two-year period beginning with the quarter ended March 31, 2014, the dividend rate will be fixed at 2.0%. Such dividends are not cumulative, but the Corporation may only declare and pay dividends on its common stock (or any other equity securities junior to the Series B Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series B Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities.

As more completely described in the Certificate of Designation, holders of the Series B Preferred Stock have the right to vote as a separate class on certain matters relating to the rights of holders of Series B Preferred Stock and on certain corporate transactions. Except with respect to such matters, the Series B Preferred Stock does not have voting rights.

The Corporation may redeem the shares of Series B Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the liquidation amount and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Corporation's primary federal banking regulator. If paid in part, payments are required to be at least 25% of the original proceeds.

## 3. Earnings per Common Share

Basic earnings per common share (EPS) excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS includes the dilutive effect of additional potential common shares for assumed issuance of restricted stock and shares issued under stock options.

**3. Earnings per Common Share (continued)**

The factors used in the Corporation's earnings per common share computation follow:

| (Dollar amounts in thousands, except for per share amounts) | For the three months ended September 30, 2013 | 2012 | For the nine months ended September 30, 2013 | 2012 |
|---|---|---|---|---|
| Earnings per common share - basic | | | | |
| Net income | $ 1,082 | $ 669 | $ 2,879 | $ 2,963 |
| Less: Preferred stock dividends | 115 | 118 | 365 | 368 |
| Net income available to common stockholders | $ 967 | $ 551 | $ 2,514 | $ 2,595 |
| Average common shares outstanding | 1,762,810 | 1,751,908 | 1,761,972 | 1,751,908 |
| Basic earnings per common share | $ 0.55 | $ 0.31 | $ 1.43 | $ 1.48 |
| Earnings per common share - diluted | | | | |
| Net income available to common stockholders | $ 967 | $ 551 | $ 2,514 | $ 2,595 |
| Average common shares outstanding | 1,762,810 | 1,751,908 | 1,761,972 | 1,751,908 |
| Add: Dilutive effects of assumed exercises of restricted stock and stock options | 13,616 | - | 12,777 | - |
| Average shares and dilutive potential common shares | 1,776,426 | 1,751,908 | 1,774,749 | 1,751,908 |
| Diluted earnings per common share | $ 0.54 | $ 0.31 | $ 1.42 | $ 1.48 |
| Stock options and restricted stock awards not considered in computing diluted earnings per share because they were antidilutive | 67,000 | 84,000 | 67,000 | 84,000 |

**4. Securities**

The following table summarizes the Corporation's securities as of September 30, 2013 and December 31, 2012:

| (Dollar amounts in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale: | | | | |
| September 30, 2013: | | | | |
| U.S. Treasury and federal agency | $ 4,465 | $ - | $ (217) | $ 4,248 |
| U.S. government sponsored entities and agencies | 23,636 | - | (592) | 23,044 |
| Mortgage-backed securities: residential | 12,373 | 486 | - | 12,859 |
| Collateralized mortgage obligations: residential | 44,403 | - | (1,851) | 42,552 |
| State and political subdivisions | 39,820 | 962 | (847) | 39,935 |
| Corporate debt securities | 250 | - | (10) | 240 |
| Equity securities | 2,356 | 103 | (12) | 2,447 |
| | $ 127,303 | $ 1,551 | $ (3,529) | $ 125,325 |
| December 31, 2012: | | | | |
| U.S. Treasury and federal agency | $ 3,959 | $ 8 | $ - | $ 3,967 |
| U.S. government sponsored entities and agencies | 28,030 | 132 | - | 28,162 |
| Mortgage-backed securities: residential | 21,137 | 1,587 | - | 22,724 |
| Collateralized mortgage obligations: residential | 22,508 | 47 | (80) | 22,475 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| State and political subdivisions | | 34,904 | | 1,862 | | (1) | | 36,765 |
| Corporate debt securities | | 3,728 | | 34 | | (1) | | 3,761 |
| Equity securities | | 2,356 | | 4 | | (8) | | 2,352 |
| | $ | 116,622 | $ | 3,674 | $ | (90) | $ | 120,206 |

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**4. Securities (continued)**

The following table summarizes scheduled maturities of the Corporation's debt securities as of September 30, 2013. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations are not due at a single maturity and are shown separately.

| (Dollar amounts in thousands) | Available for sale Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 1,001 | $ 1,014 |
| Due after one year through five years | 19,688 | 19,609 |
| Due after five through ten years | 42,394 | 42,056 |
| Due after ten years | 5,088 | 4,788 |
| Mortgage-backed securities: residential | 12,373 | 12,859 |
| Collateralized mortgage obligations: residential | 44,403 | 42,552 |
| | $ 124,947 | $ 122,878 |

Information pertaining to securities with gross unrealized losses at September 30, 2013 and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous loss position are included in the table below:

| (Dollar amounts in thousands) | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| Description of Securities | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| September 30, 2013: | | | | | | |
| U.S. Treasury and federal agency | $ 4,248 | $ (217) | $ - | $ - | $ 4,248 | $ (217) |
| U.S. government sponsored entities and agencies | 23,044 | (592) | - | - | 23,044 | (592) |
| Collateralized mortgage obligations: residential | 42,552 | (1,851) | - | - | 42,552 | (1,851) |
| State and political subdivisions | 15,286 | (847) | - | - | 15,286 | (847) |
| Corporate debt securities | 241 | (10) | - | - | 241 | (10) |
| Equity securities | 954 | (12) | - | - | 954 | (12) |
| | $ 86,325 | $ (3,529) | $ - | $ - | $ 86,325 | $ (3,529) |
| December 31, 2012: | | | | | | |
| Collateralized mortgage obligations: residential | $ 10,698 | $ (80) | $ - | $ - | $ 10,698 | $ (80) |
| State and political subdivisions | 521 | (1) | - | - | 521 | (1) |
| Corporate debt securities | 500 | (1) | - | - | 500 | (1) |
| Equity securities | 493 | (8) | - | - | 493 | (8) |
| | $ 12,212 | $ (90) | $ - | $ - | $ 12,212 | $ (90) |

Gains on sales of available for sale securities for the three and nine months ended September 30 were as follows:

| (Dollar amounts in thousands) | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |

| | | | | |
|---|---|---|---|---|
| Proceeds | $ 17,701 | $ 6,043 | $ 21,015 | $ 11,639 |
| Gains | 107 | 390 | 291 | 1,352 |
| Tax provision related to gains | 36 | 133 | 99 | 460 |

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**4. Securities (continued)**

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other conditions warrant such evaluation. Consideration is given to: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before recovery of its amortized cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will be required to sell the security before its anticipated recovery, the Corporation records an other-than-temporary loss in an amount equal to the entire difference between fair value and amortized cost. Otherwise, only the credit portion of the estimated loss on debt securities is recognized in earnings, with the other portion of the loss recognized in other comprehensive income. For equity securities determined to be other-than-temporarily impaired, the entire amount of impairment is recognized through earnings.

There were two equity securities in an unrealized loss position as of September 30, 2013. These securities have been in an unrealized loss position for less than 12 months and were valued at 94% and 99% of their cost basis, respectively. Equity securities owned by the Corporation consist of common stock of various financial service providers. The investment securities are in an unrealized loss position as a result of recent market volatility. The Corporation does not invest in these securities with the intent to sell them for a profit in the near term. For investments in equity securities, in addition to the general factors mentioned above for determining whether the decline in market value is other-than-temporary, the analysis of whether an equity security is other-than-temporarily impaired includes a review of the profitability and capital adequacy and other relevant information available to determine the financial position and near term prospects of each issuer. The results of analyzing the aforementioned metrics and financial fundamentals suggest recovery of amortized cost as the sector improves. Based on that evaluation, and given that the Corporation's current intention is not to sell any impaired security and it is more likely than not it will not be required to sell these securities before the recovery of their amortized cost basis, the Corporation does not consider the equity securities with an unrealized loss as of September 30, 2013 to be other-than-temporarily impaired.

There were 119 debt securities in an unrealized loss position as of September 30, 2013, all of which were in an unrealized loss position for less than 12 months. Of these securities, eight were U.S. Treasury securities, 17 were U.S. agency securities, 29 were government-backed collateralized mortgage obligations, 64 were state and political subdivision securities and one was a corporate debt security. The unrealized losses associated with these securities were not due to the deterioration in the credit quality of the issuer that would likely result in the failure to collect contractual principal and interest, but rather have been caused by a rise in interest rates from the time the securities were purchased. Based on that evaluation and other general considerations, and given that the Corporation's current intention is not to sell any impaired securities and it is more likely than not it will not be required to sell these securities before the recovery of its amortized cost basis, the Corporation does not consider the debt securities with unrealized losses as of September 30, 2013 to be other-than-temporarily impaired.

**5. Loans Receivable and Related Allowance for Loan Losses**

The Corporation’s loans receivable as of the respective dates are summarized as follows:

| (Dollar amounts in thousands) | September 30, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| Mortgage loans on real estate: | | | | |
| Residential first mortgages | $ | 99,412 | $ | 97,246 |
| Home equity loans and lines of credit | | 87,763 | | 85,615 |
| Commercial real estate | | 103,079 | | 98,823 |
| | | 290,254 | | 281,684 |
| Other loans: | | | | |
| Commercial business | | 52,309 | | 45,581 |
| Consumer | | 9,953 | | 11,886 |
| | | 62,262 | | 57,467 |
| Total loans, gross | | 352,516 | | 339,151 |
| Less allowance for loan losses | | 4,787 | | 5,350 |
| Total loans, net | $ | 347,729 | $ | 333,801 |

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**5. Loans Receivable and Related Allowance for Loan Losses (continued)**

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of September 30, 2013:

*(Dollar amounts in thousands)*

| | Impaired Loans with Specific Allowance | | | | | |
|---|---|---|---|---|---|---|
| | As of September 30, 2013 | | | For the three months ended September 30, 2013 | | |
| | Unpaid Principal Balance | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized in Period | Cash Basis Interest Recognized in Period |
| Residential first mortgages | $ 82 | $ 82 | $ 21 | $ 81 | $ 2 | $ 2 |
| Home equity and lines of credit | - | - | - | - | - | - |
| Commercial real estate | 3,633 | 2,692 | 209 | 2,708 | 2 | 2 |
| Commercial business | - | - | - | - | - | - |
| Consumer | - | - | - | - | - | - |
| Total | $ 3,715 | $ 2,774 | $ 230 | $ 2,789 | $ 4 | $ 4 |

| | For the nine months ended September 30, 2013 | | |
|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized in Period | Cash Basis Interest Recognized in Period |
| Residential first mortgages | $ 41 | $ 4 | $ 4 |
| Home equity and lines of credit | - | - | - |
| Commercial real estate | 3,372 | 11 | 11 |
| Commercial business | - | - | - |
| Consumer | - | - | - |
| Total | $ 3,413 | $ 15 | $ 15 |

| | Impaired Loans with No Specific Allowance | | | | |
|---|---|---|---|---|---|
| | As of September 30, 2013 | | For the three months ended September 30, 2013 | | |
| | Unpaid Principal Balance | Recorded Investment | Average Recorded Investment | Interest Income Recognized in Period | Cash Basis Interest Recognized in Period |
| Residential first mortgages | $ - | $ - | $ - | $ - | $ - |
| Home equity and lines of credit | - | - | - | - | - |
| Commercial real estate | 1,012 | 613 | 637 | 2 | 2 |
| Commercial business | 346 | 346 | 351 | - | - |
| Consumer | 1,348 | 1,348 | 1,348 | - | - |
| Total | $ 2,706 | $ 2,307 | $ 2,336 | $ 2 | $ 2 |

For the nine months ended September 30, 2013

| | Average Recorded Investment | Interest Income Recognized in Period | Cash Basis Interest Recognized in Period |
|---|---|---|---|
| Residential first mortgages | $ - | $ - | $ - |
| Home equity and lines of credit | - | - | - |
| Commercial real estate | 561 | 4 | 4 |
| Commercial business | 359 | - | - |
| Consumer | 1,484 | - | - |
| Total | $ 2,404 | $ 4 | $ 4 |

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**5. Loans Receivable and Related Allowance for Loan Losses (continued)**

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2012:

*(Dollar amounts in thousands)*

| | Impaired Loans with Specific Allowance | | | | | |
|---|---|---|---|---|---|---|
| | As of December 31, 2012 | | | For the year ended December 31, 2012 | | |
| | Unpaid Principal Balance | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized in Period | Cash Basis Interest Recognized in Period |
| Residential first mortgages | $ - | $ - | $ - | $ - | $ - | $ - |
| Home equity and lines of credit | - | - | - | - | - | - |
| Commercial real estate | 4,242 | 4,068 | 1,448 | 2,075 | 186 | 16 |
| Commercial business | - | - | - | - | - | - |
| Consumer | - | - | - | - | - | - |
| Total | $ 4,242 | $ 4,068 | $ 1,448 | $ 2,075 | $ 186 | $ 16 |

| | Impaired Loans with No Specific Allowance | | | | |
|---|---|---|---|---|---|
| | As of December 31, 2012 | | For the year ended December 31, 2012 | | |
| | Unpaid Principal Balance | Recorded Investment | Average Recorded Investment | Interest Income Recognized in Period | Cash Basis Interest Recognized in Period |
| Residential first mortgages | $ - | $ - | $ - | $ - | $ - |
| Home equity and lines of credit | - | - | - | - | - |
| Commercial real estate | 730 | 505 | 690 | 12 | 12 |
| Commercial business | 394 | 369 | 368 | 5 | 5 |
| Consumer | 1,650 | 1,650 | 1,774 | - | - |
| Total | $ 2,774 | $ 2,524 | $ 2,832 | $ 17 | $ 17 |

Unpaid principal balance includes any loans that have been partially charged off but not forgiven. Accrued interest is not included in the recorded investment in loans based on the amounts not being material.

***Troubled debt restructurings (TDR).*** The Corporation has certain loans that have been modified in order to maximize collection of loan balances. If, for economic or legal reasons related to the customer's financial difficulties, management grants a concession compared to the original terms and conditions of the loan that it would not have otherwise considered, the modified loan is classified as a TDR. Concessions related to TDRs generally do not include forgiveness of principal balances. The Corporation generally does not extend additional credit to borrowers with loans classified as TDRs.

At September 30, 2013 and December 31, 2012, the Corporation had $2.1 million and $2.3 million, respectively, of loans classified as TDRs, which are included in impaired loans above. At September 30, 2013 and December 31, 2012, the Corporation had $56,000 and $36,000, respectively, of the allowance for loan losses allocated to these specific loans. At September 30, 2012, the Corporation had $791,000 of loans classified as TDRs with $36,000 of the allowance for loan losses allocated to these specific loans.

During the nine month period ended September 30, 2013, the Corporation modified a residential mortgage loan with a pre- and post-modification recorded investment of $83,000 as a TDR due to financial difficulties experienced by the borrower. The modification included a reduction in the interest rate from 6.75% to 4.00% and a 65 month extension of the original term. At September 30, 2013, the Corporation had $21,000 of the allowance for loan losses allocated to this specific loan. During the nine month period ended September 30, 2012, the Corporation did not modify any additional loans as TDRs.

**5. Loans Receivable and Related Allowance for Loan Losses (continued)**

During the nine month periods ended September 30, 2013 and 2012, the Corporation did not have any loans which were modified as TDRs for which there was a payment default within twelve months following the modification.

***Credit Quality Indicators.*** Management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors.

Commercial real estate and commercial business loans not identified as impaired are evaluated as risk rated pools of loans utilizing a risk rating practice that is supported by a quarterly special asset review. In this review process, strengths and weaknesses are identified, evaluated and documented for each criticized and classified loan and borrower, strategic action plans are developed, risk ratings are confirmed and the loan's performance status is reviewed.

Management has determined certain portions of the loan portfolio to be homogeneous in nature and assigns like reserve factors for the following loan pool types: residential real estate, home equity loans and lines of credit, and consumer installment and personal lines of credit.

The reserve allocation for risk rated loan pools is developed by applying the following factors:

Historic: Management utilizes a computer model to develop the historical net charge-off experience which is used to formulate the assumptions employed in the migration analysis applied to estimate future losses in the portfolio. Outstanding balance and charge-off information are input into the model and historical loss migration rate assumptions are developed to apply to pass, special mention, substandard and doubtful risk rated loans. A twelve-quarter rolling weighted-average is utilized to anticipate probable incurred losses in the portfolios.

Qualitative: Qualitative adjustment factors for pass, special mention, substandard and doubtful ratings are developed and applied to risk rated loans to allow for: quality of lending policies and procedures; national and local economic and business conditions; changes in the nature and volume of the portfolio; experiences, ability and depth of lending management; changes in trends, volume and severity of past due, nonaccrual and classified loans and loss and recovery trends; quality of loan review systems; concentrations of credit and other external factors.

Management uses the following definitions for risk ratings:

Pass: Loans classified as pass typically exhibit good payment performance and have underlying borrowers with acceptable financial trends where repayment capacity is evident. These borrowers typically would have a sufficient cash flow that would allow them to weather an economic downturn and the value of any underlying collateral could withstand a moderate degree of depreciation due to economic conditions.

Special Mention: Loans classified as special mention are characterized by potential weaknesses that could jeopardize repayment as contractually agreed. These loans may exhibit adverse trends such as increasing leverage, shrinking profit margins and/or deteriorating cash flows. These borrowers would inherently be more vulnerable to the application of economic pressures.

Substandard: Loans classified as substandard exhibit weaknesses that are well-defined to the point that repayment is jeopardized. Typically, the Corporation is no longer adequately protected by both the apparent net worth and repayment capacity of the borrower.

Doubtful: Loans classified as doubtful have advanced to the point that collection or liquidation in full, on the basis of currently ascertainable facts, conditions and value, is highly questionable or improbable.

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**5. Loans Receivable and Related Allowance for Loan Losses (continued)**

The following table presents the classes of the loan portfolio summarized by the aggregate pass and the criticized categories of special mention, substandard and doubtful within the Corporation's internal risk rating system as of September 30, 2013 and December 31, 2012:

*(Dollar amounts in thousands)*

| | Not Rated | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|---|
| September 30, 2013: | | | | | | |
| Residential first mortgages | $ 98,906 | $ - | $ - | $ 506 | $ - | $ 99,412 |
| Home equity and lines of credit | 87,613 | - | - | 150 | - | 87,763 |
| Commercial real estate | - | 95,378 | 266 | 7,435 | - | 103,079 |
| Commercial business | - | 49,097 | 682 | 2,530 | - | 52,309 |
| Consumer | 8,605 | - | - | 1,348 | - | 9,953 |
| Total | $ 195,124 | $ 144,475 | $ 948 | $ 11,969 | $ - | $ 352,516 |
| | | | | | | |
| December 31, 2012: | | | | | | |
| Residential first mortgages | $ 96,713 | $ - | $ - | $ 533 | $ - | $ 97,246 |
| Home equity and lines of credit | 85,443 | - | - | 172 | - | 85,615 |
| Commercial real estate | - | 88,944 | 1,658 | 6,870 | 1,351 | 98,823 |
| Commercial business | - | 42,417 | 2,157 | 1,007 | - | 45,581 |
| Consumer | 10,236 | - | - | 1,650 | - | 11,886 |
| Total | $ 192,392 | $ 131,361 | $ 3,815 | $ 10,232 | $ 1,351 | $ 339,151 |

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonperforming loans as of September 30, 2013 and December 31, 2012:

*(Dollar amounts in thousands)*

| | Performing Accruing Loans Not Past Due | Accruing 30-59 Days Past Due | Accruing 60-89 Days Past Due | Nonperforming Accruing 90 Days + Past Due | Nonaccrual | Total Loans |
|---|---|---|---|---|---|---|
| September 30, 2013: | | | | | | |
| Residential first mortgages | $ 96,594 | $ 1,886 | $ 426 | $ 100 | $ 406 | $ 99,412 |
| Home equity and lines of credit | 87,075 | 525 | 13 | - | 150 | 87,763 |
| Commercial real estate | 99,915 | 185 | 19 | - | 2,960 | 103,079 |
| Commercial business | 51,909 | 54 | - | - | 346 | 52,309 |
| Consumer | 8,581 | 22 | 2 | - | 1,348 | 9,953 |
| Total loans | $ 344,074 | $ 2,672 | $ 460 | $ 100 | $ 5,210 | $ 352,516 |
| | | | | | | |
| December 31, 2012: | | | | | | |
| Residential first mortgages | $ 95,001 | $ 1,272 | $ 440 | $ - | $ 533 | $ 97,246 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Home equity and lines of credit | 84,592 | 669 | 157 | - | 197 | 85,615 |
| Commercial real estate | 94,485 | 50 | 49 | 21 | 4,218 | 98,823 |
| Commercial business | 44,915 | 297 | - | - | 369 | 45,581 |
| Consumer | 10,172 | 41 | 23 | - | | |