NATIONAL BANKSHARES INC
Form 10-Q
August 06, 2015
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________

Commission File Number 0-15204

NATIONAL BANKSHARES, INC.

(Exact name of registrant as specified in its charter)

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

101 Hubbard Street

P. O. Box 90002

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

(540) 951-6300

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ] Smaller reporting company [ ]

(Do not check if a smaller reporting company)

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

[ ] Yes [x] No

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

Class	Outstanding at August 3, 2015
Common Stock, $1.25 Par Value	6,954,474

(This report contains 53 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

Form 10-Q

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Part I

Item 1. Financial Statements Financial Information
National Bankshares, Inc. and Subsidiaries

Consolidated Balance Sheets

$ in thousands, except per share data	**(Unaudited)** **June 30, 2015**	**December 31, 2014**
Assets		
Cash and due from banks	**$ 11,353**	$ 12,894
Interest-bearing deposits	**83,818**	102,548
Securities available for sale, at fair value	**218,524**	222,844
Securities held to maturity (fair value approximates $158,925 at June 30, 2015 and $167,703 at December 31, 2014)	**155,704**	161,452
Restricted stock, at cost	**1,129**	1,089
Loans held for sale	**853**	291
Loans:		
Loans, net of unearned income and deferred fees	**626,941**	605,466
Less allowance for loan losses	**(8,131)**	(8,263)
Loans, net	**618,810**	597,203
Premises and equipment, net	**8,878**	9,131
Accrued interest receivable	**5,857**	5,748
Other real estate owned, net	**4,441**	4,744
Intangible assets and goodwill	**6,685**	7,223
Bank-owned life insurance	**22,097**	21,797
Other assets	**10,122**	7,767
Total assets	**$ 1,148,271**	$ 1,154,731
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	**$ 157,983**	$ 150,744
Interest-bearing demand deposits	**526,749**	533,641
Savings deposits	**86,354**	81,297
Time deposits	**203,070**	216,746
Total deposits	**974,156**	982,428
Accrued interest payable	**61**	68
Other liabilities	**6,484**	5,932
Total liabilities	**980,701**	988,428
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	**---**	---
Common stock of $1.25 par value. Authorized 10,000,000 shares; issued and outstanding 6,954,474 shares at June 30, 2015 and 6,950,474 at December 31, 2014	**8,693**	8,688
Retained earnings	**167,764**	163,287

Accumulated other comprehensive loss, net	**(8,887)**	(5,672)
Total stockholders' equity	**167,570**	166,303
Total liabilities and stockholders' equity	**$ 1,148,271**	$ 1,154,731

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended June 30, 2015 and 2014

(Unaudited)

$ in thousands, except per share data	**June 30, 2015**	**June 30, 2014**
Interest Income		
Interest and fees on loans	**$7,673**	$7,819
Interest on interest-bearing deposits	**55**	64
Interest on securities – taxable	**1,712**	1,697
Interest on securities – nontaxable	**1,357**	1,474
Total interest income	**10,797**	11,054
Interest Expense		
Interest on time deposits	**120**	145
Interest on other deposits	**931**	1,150
Total interest expense	**1,051**	1,295
Net interest income	**9,746**	9,759
Provision for loan losses	**355**	701
Net interest income after provision for loan losses	**9,391**	9,058
Noninterest Income		
Service charges on deposit accounts	**570**	607
Other service charges and fees	**48**	38
Credit card fees	**976**	961
Trust income	**299**	332
BOLI income	**172**	177
Other income	**349**	229
Realized securities gains, net	**5**	---
Total noninterest income	**2,419**	2,344
Noninterest Expense		
Salaries and employee benefits	**3,254**	3,007
Occupancy and furniture and fixtures	**417**	417
Data processing and ATM	**409**	394
FDIC assessment	**135**	117
Credit card processing	**675**	665
Intangible assets amortization	**269**	269
Net costs of other real estate owned	**46**	84
Franchise taxes	**322**	287
Other operating expenses	**863**	820
Total noninterest expense	**6,390**	6,060
Income before income taxes	**5,420**	5,342
Income tax expense	**1,310**	1,233

Net Income	**$4,110**	$4,109
Basic net income per common share	**$0.59**	$0.59
Fully diluted net income per common share	**$0.59**	$0.59
Weighted average number of common shares outstanding – basic	**6,952,540**	6,947,974
Weighted average number of common shares outstanding – diluted	**6,956,039**	6,960,683
Dividends declared per common share	**$0.53**	$0.55

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

Three Months Ended June 30, 2015 and 2014

(Unaudited)

$ in thousands	**June 30, 2015**	**June 30, 2014**
Net Income	**$4,110**	**$4,109**
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gains (losses) on available for sale securities net of tax of ($3,048) and $1,664 for the periods ended June 30, 2015 and 2014, respectively	**(5,665)**	**3,091**
Reclassification adjustment for gains included in net income, net of tax of ($2) for the period ended June 30, 2015	**(3)**	**---**
Other comprehensive income (loss), net of tax of ($3,050) and $1,664 for the periods ended June 30, 2015 and 2014, respectively	**(5,668)**	**3,091**
Total Comprehensive Income (Loss)	**$(1,558)**	**$7,200**

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Six Months Ended June 30, 2015 and 2015

(Unaudited)

$ in thousands, except per share data	**June 30, 2015**	**June 30, 2014**
Interest Income		
Interest and fees on loans	**$15,322**	$15,754
Interest on interest-bearing deposits	**119**	129
Interest on securities – taxable	**3,446**	3,350
Interest on securities – nontaxable	**2,743**	2,974
Total interest income	**21,630**	22,207
Interest Expense		
Interest on time deposits	**248**	298
Interest on other deposits	**1,890**	2,312
Total interest expense	**2,138**	2,610
Net interest income	**19,492**	19,597
Provision for loan losses	**556**	804
Net interest income after provision for loan losses	**18,936**	18,793
Noninterest Income		
Service charges on deposit accounts	**1,105**	1,199
Other service charges and fees	**119**	103
Credit card fees	**1,871**	1,758
Trust income	**588**	625
BOLI income	**342**	352
Other income	**631**	506
Realized securities gains, net	**3**	1
Total noninterest income	**4,659**	4,544
Noninterest Expense		
Salaries and employee benefits	**6,326**	6,006
Occupancy and furniture and fixtures	**869**	857
Data processing and ATM	**843**	757
FDIC assessment	**270**	264
Credit card processing	**1,285**	1,214
Intangible assets amortization	**538**	538
Net costs of other real estate owned	**517**	161
Franchise taxes	**630**	566
Other operating expenses	**1,820**	1,879
Total noninterest expense	**13,098**	12,242

Income before income taxes	**10,497**	11,095
Income tax expense	**2,421**	2,582
Net Income	**$8,076**	$8,513
Basic net income per common share	**$1.16**	$1.23
Fully diluted net income per common share	**$1.16**	$1.22
Weighted average number of common shares outstanding – basic	**6,951,513**	6,947,974
Weighted average number of common shares outstanding – diluted	**6,955,093**	6,962,274
Dividends declared per common share	**$0.53**	$0.55

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

Six Months Ended June 30, 2015 and 2014

(Unaudited)

$ in thousands	**June 30, 2015**	**June 30, 2014**
Net Income	**$8,076**	$8,513
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gains (losses) on available for sale securities net of tax of ($1,728) and $3,345 for the periods ended June 30, 2015 and 2014, respectively	**(3,213)**	6,213
Reclassification adjustment for gains included in net income, net of tax of ($1) for the period ended June 30, 2015 and $0 for the period ended June 30, 2014	**(2)**	(1)
Other comprehensive income (loss), net of tax of ($1,729) and $3,345 for the periods ended June 30, 2015 and 2014, respectively	**(3,215)**	6,212
Total Comprehensive Income	**$4,861**	$14,725

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Six Months June 30, 2015 and 2014

(Unaudited)

$ in thousands	**Common Stock**	**Retained Earnings**	**Accumulated Other Comprehensive Loss**	**Total**
Balances at December 31, 2013	$ 8,685	$ 154,171	$ (16,964)	$ 145,892
Net income	---	8,513	---	8,513
Dividends $0.55 per share	---	(3,821)	---	(3,821)
Other comprehensive income, net of tax of $3,345	---	---	6,212	6,212
Balances at June 30, 2014	$ 8,685	$ 158,863	$ (10,752)	$ 156,796
Balances at December 31, 2014	$ 8,688	$ 163,287	$ (5,672)	$ 166,303
Net income	---	8,076	---	8,076
Dividends $0.53 per share	---	(3,686)	---	(3,686)
Exercise of stock options	5	87		92
Other comprehensive (loss), net of tax of ($1,729)	---	---	(3,215)	(3,215)
Balances at June 30, 2015	**$ 8,693**	**$ 167,764**	**$ (8,887)**	**$ 167,570**

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Six Months Ended June 30, 2015 and 2014

(Unaudited)

$ in thousands	**June 30, 2015**	**June 30, 2014**
Cash Flows from Operating Activities		
Net income	**$8,076**	$8,513
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**556**	804
Depreciation of bank premises and equipment	**376**	355
Amortization of intangibles	**538**	538
Amortization of premiums and accretion of discounts, net	**60**	74
Losses on disposal of premises and equipment	**6**	94
Gains on sales and calls of securities available for sale, net	**(3)**	---
Gains on calls of securities held to maturity, net	**---**	(1)
Losses and write-downs on other real estate owned, net	**392**	23
Increase in cash value of bank-owned life insurance	**(300)**	(310)
Net change in:		
Loans held for sale	**(562)**	893
Accrued interest receivable	**(109)**	151
Other assets	**(626)**	(1,366)
Accrued interest payable	**(7)**	(21)
Other liabilities	**552**	(461)
Net cash provided by operating activities	**8,949**	9,286
Cash Flows from Investing Activities		
Net change interest-bearing deposits	**18,730**	(8,046)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	**32,342**	3,828
Proceeds from calls, principal payments and maturities of securities held to maturity	**5,682**	6,342
Purchases of securities available for sale	**(32,957)**	(7,974)
Purchases of securities held to maturity	**---**	(5,381)
Net change in restricted stock	**(40)**	325
Purchases of loan participations	**---**	---
Collections of loan participations	**1,943**	1,373
Loan originations and principal collections, net	**(24,814)**	(1,165)
Proceeds from sale of other real estate owned	**531**	234
Recoveries on loans charged off	**88**	184
Proceeds from sale and purchases of premises and equipment, net	**(129)**	22
Net cash provided by (used in) investing activities	**1,376**	(10,258)
Cash Flows from Financing Activities		
Net change in time deposits	**(13,676)**	(10,532)
Net change in other deposits	**5,404**	17,959

Cash dividends paid	**(3,686)**	(3,821)
Stock options exercised	**92**	---
Net cash provided by (used in) financing activities	**(11,866)**	3,606
Net change in cash and due from banks	**(1,541)**	2,634
Cash and due from banks at beginning of period	**12,894**	13,283
Cash and due from banks at end of period	**$11,353**	$15,917
Supplemental Disclosures of Cash Flow Information		
Interest paid on deposits and borrowed funds	**$2,145**	$2,631
Income taxes paid	**2,560**	2,922
Supplemental Disclosure of Noncash Activities		
Loans charged against the allowance for loan losses	**$776**	$1,244
Loans transferred to other real estate owned	**620**	838
Unrealized net gains (losses) on securities available for sale	**(4,944)**	9,557

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2015

(Unaudited)

$ in thousands, except per share data

Note 1: General

The consolidated financial statements of National Bankshares, Inc. ("NBI") and its wholly-owned subsidiaries, The National Bank of Blacksburg ("NBB") and National Bankshares Financial Services, Inc. ("NBFS") (collectively, the "Company"), conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the three and six month periods ended June 30, 2015 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to consolidated financial statements included in the Company's 2014 Form 10-K. The Company posts all reports required to be filed under the Securities and Exchange Act of 1934 on its web site at www.nationalbankshares.com.

Note 2: Stock-Based Compensation

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

Options	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2015	20,500	$ 23.00		

Exercised	(4,000)	23.00		
Forfeited or expired	---	---		
Outstanding June 30, 2015	16,500	$ 23.00	0.359	$ 103
Exercisable at June 30, 2015	16,500	$ 23.00	0.359	$ 103

Options	**Shares**	**Weighted Average Exercise Price Per Share**	**Weighted Average Remaining Contractual Term**	**Aggregate Intrinsic Value**
Outstanding at January 1, 2014	46,000	$ 23.96		
Exercised	(2,500)	23.00		
Forfeited or expired	(23,000)	24.93		
Outstanding December 31, 2014	20,500	$ 23.00	0.85	$ 151
Exercisable at December 31, 2014	20,500	$ 23.00	0.85	$ 151

There were 4,000 shares with an intrinsic value of $23 exercised during the six months ended June 30, 2015. There were 2,500 shares with an intrinsic value of $15 exercised in 2014.

Note 3: Loan Portfolio

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

	June 30, 2015	December 31, 2014
Real estate construction	**$42,246**	$45,562
Consumer real estate	**146,210**	147,039
Commercial real estate	**323,334**	310,762
Commercial non real estate	**32,973**	33,413
Public sector and IDA	**53,383**	41,361
Consumer non real estate	**29,639**	28,182
Gross loans	**627,785**	606,319
Less unearned income and deferred fees	**(844)**	(853)
Loans, net of unearned income and deferred fees	**$626,941**	$605,466

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

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

Impaired loans are those loans that have been modified in a troubled debt restructure ("TDR" or "restructure") and larger, non-homogeneous loans that are in nonaccrual or exhibit payment history or financial status that indicate the probability that collection will not occur when due according to the loan's original terms. Generally, impaired loans are given risk ratings that indicate higher risk, such as "classified" or "other assets especially mentioned." Impaired loans are individually evaluated to determine appropriate reserves and are measured at the lower of the invested amount or the fair market value. Impaired loans that are not troubled debt restructures and for which fair value measurement indicates an impairment loss are designated nonaccrual. A restructured loan that maintains current status for at least six months may be in accrual status. Please refer to Note 1 of the Company's 2014 Form 10-K, "Summary of Significant Accounting Policies" for additional information on evaluation of impaired loans and associated specific reserves, and policies regarding nonaccruals, past due status and charge-offs.

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

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

Portfolio Segments and Classes

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

Real Estate Construction

Construction, residential

Construction, other

Consumer Real Estate

Equity lines

Residential closed-end first liens

Residential closed-end junior liens

Investor-owned residential real estate

Commercial Real Estate

Multifamily real estate

Commercial real estate, owner-occupied

Commercial real estate, other

Commercial Non Real Estate

Commercial and Industrial

Public Sector and IDA

Public sector and IDA

Consumer Non Real Estate

Credit cards

Automobile

Other consumer loans

Historical Loss Rates

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

Risk Factors

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

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

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

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

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

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

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

Factor allocations applied to each class are increased for loans rated special mention and classified. The Company allocates additional reserves for "high risk" loans. High risk loans include junior liens, interest only and high loan to value loans.

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

Activity in the Allowance for Loan Losses for the Six Months Ended June 30, 2015

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2014	**$612**	**$ 1,662**	**$ 3,537**	**$ 1,475**	**$ 327**	**$ 602**	**$ 48**	**$8,263**
Charge-offs	**---**	**(201)**	**(116)**	**(330)**	**---**	**(129)**	**---**	**(776)**
Recoveries	**---**	**1**	**24**	**---**	**---**	**63**	**---**	**88**
Provision for loan losses	**(136)**	**375**	**373**	**(204)**	**159**	**(22)**	**11**	**556**
Balance, June 30, 2015	**$476**	**$ 1,837**	**$ 3,818**	**$ 941**	**$ 486**	**$ 514**	**$ 59**	**$8,131**

Activity in the Allowance for Loan Losses for the Six Months Ended June 30, 2014

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2013	$863	$ 1,697	$ 3,685	$ 989	$ 132	$ 576	$ 285	$8,227
Charge-offs	(2)	(70)	(943)	(79)	---	(150)	---	(1,244)
Recoveries	---	---	25	131	---	28	---	184
Provision for loan losses	(198)	(73)	1,023	15	146	98	(207)	804
Balance, June 30, 2014	$663	$ 1,554	$ 3,790	$ 1,056	$ 278	$ 552	$ 78	$7,971

Activity in the Allowance for Loan Losses for the Year Ended December 31, 2014

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2013	$863	$ 1,697	$ 3,685	$ 989	$ 132	$ 576	$ 285	$8,227
Charge-offs	(2)	(222)	(1,201)	(89)	---	(346)	---	(1,860)
Recoveries	---	---	50	132	---	73	---	255
Provision for loan losses	(249)	187	1,003	443	195	299	(237)	1,641
Balance, December 31, 2014	$612	$ 1,662	$ 3,537	$ 1,475	$ 327	$ 602	$ 48	$8,263

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Allowance for Loan Losses as of June 30, 2015

	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Unallocated**	**Total**
Individually evaluated for impairment	**$---**	**$ 13**	**$ 138**	**$ ---**	**$ ---**	**$ ---**	**$ ---**	**$151**
Collectively evaluated for impairment	**476**	**1,824**	**3,680**	**941**	**486**	**514**	**59**	**7,980**
Total	**$476**	**$ 1,837**	**$ 3,818**	**$ 941**	**$ 486**	**$ 514**	**$ 59**	**$8,131**

Allowance for Loan Losses as of December 31, 2014

	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Unallocated**	**Total**
Individually evaluated for impairment	$---	$ 14	$ 258	$ 10	$ ---	$ ---	$ ---	$282
Collectively evaluated for impairment	612	1,648	3,279	1,465	327	602	48	7,981
Total	$612	$ 1,662	$ 3,537	$ 1,475	$ 327	$ 602	$ 48	$8,263

Loans as of June 30, 2015

	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Unallocated**	**Total**
Individually evaluated for impairment	**$---**	**$798**	**$ 13,375**	**$ 512**	**$---**	**$ ---**	**$ ---**	**$14,685**
Collectively evaluated for impairment	**42,246**	**145,412**	**309,959**	**32,461**	**53,383**	**29,639**	**---**	**613,100**
Total loans	**$42,246**	**$146,210**	**$ 323,334**	**$ 32,973**	**$53,383**	**$ 29,639**	**$ ---**	**$627,785**

Loans as of December 31, 2014

Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and**	**Consumer Non Real Estate**	**Unallocated**	**Total**

					IDA			
Individually evaluated for impairment	$---	$ 819	$ 13,624	$ 678	$---	$ ---	$ ---	$ 15,121
Collectively evaluated for impairment	45,562	146,220	297,138	32,735	41,361	28,182	---	591,198
Total	$45,562	$ 147,039	$ 310,762	$ 33,413	$41,361	$ 28,182	$ ---	$606,319

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

	As of the Six Months Ended June 30, 2015	As of the Six Months Ended June 30, 2014	For the Year Ended December 31, 2014
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	**1.30 %**	1.34 %	1.36 %
Ratio of net charge-offs to average loans, net of unearned income and deferred fees[1]	**0.22 %**	0.36 %	0.27 %

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

A summary of nonperforming assets follows.

	June 30, 2015	June 30, 2014	December 31, 2014
Nonperforming assets:			
Nonaccrual loans	**$2,870**	$2,335	$ 3,999
Restructured loans in nonaccrual	**6,035**	2,674	5,288
Total nonperforming loans	**8,905**	5,009	9,287
Other real estate owned, net	**4,441**	5,293	4,744
Total nonperforming assets	**$13,346**	$10,302	$ 14,031
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	**2.11 %**	1.72 %	2.30 %
Ratio of allowance for loan losses to nonperforming loans[1]	**91.31 %**	159.13 %	88.97 %

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

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

	June 30, 2015	June 30, 2014	December 31, 2014
Loans past due 90 days or more and still accruing	**$80**	$266	$ 207
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	**0.01 %**	0.04 %	0.03 %
Accruing restructured loans	**$5,943**	$6,240	$ 6,040
Impaired loans:			
Impaired loans with no valuation allowance	**$12,182**	$8,155	$ 7,615
Impaired loans with a valuation allowance	**2,503**	2,989	7,506
Total impaired loans	**$14,685**	$11,144	$ 15,121
Valuation allowance	**(151)**	(291)	(282)
Impaired loans, net of allowance	**$14,534**	$10,853	$ 14,839
Average recorded investment in impaired loans[1]	**$15,543**	$11,898	$ 16,311
Interest income recognized on impaired loans, after designation as impaired	**$172**	$191	$ 473
Amount of income recognized on a cash basis	**$---**	$---	$ ---

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

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Nonaccrual loans that meet the Company's balance threshold of $250 and all TDRs are designated as impaired. No interest income was recognized on nonaccrual loans for the six months ended June 30, 2015 or June 30, 2014 or for the year ended December 31, 2014.

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

Impaired Loans as of June 30, 2015

	Principal Balance	(A) Total Recorded Investment[1]	Recorded Investment[1] in (A) for Which There is No Related Allowance	Recorded Investment[1] in (A) for Which There is a Related Allowance	Related Allowance
Consumer Real Estate[2]					
Residential closed-end first liens	$520	$ 493	$ 308	$ 185	$ 2
Residential closed-end junior liens	229	229	---	229	7
Investor-owned residential real estate	76	76	---	76	4
Commercial Real Estate[2]					
Multifamily real estate	2,902	2,672	868	1,804	123
Commercial real estate, owner-occupied	4,815	4,755	4,564	191	15
Commercial real estate, other	6,035	5,948	5,948	---	---
Commercial Non Real Estate[2]					
Commercial and Industrial	512	512	494	18	---
Total	**$15,089**	**$ 14,685**	**$ 12,182**	**$ 2,503**	**$ 151**

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

(2) Only classes with impaired loans are shown.

Impaired Loans as of December 31, 2014

Principal Balance	(A) Total Recorded Investment[1]	Recorded Investment[1] in (A) for Which There is No Related Allowance	Recorded Investment[1] in (A) for Which There is a Related Allowance	Related Allowance

Consumer Real Estate[2]					
Residential closed-end first liens	$530	$ 503	$ 311	$ 192	$ 2
Residential closed-end junior liens	239	239	---	239	8
Investor-owned residential real estate	77	77	---	77	4
Commercial Real Estate[2]					
Multifamily real estate	2,911	2,735	868	1,866	170
Commercial real estate, owner occupied	4,919	4,821	3,314	1,508	74
Commercial real estate, other	6,080	6,068	3,072	2,996	14
Commercial Non Real Estate[2]					
Commercial and Industrial	678	678	50	628	10
Total	$15,434	$ 15,121	$ 7,615	$ 7,506	$ 282

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.
(2) Only classes with impaired loans are shown.

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

	For the Six Months Ended June 30, 2015	
	Average Recorded Investment[1]	Interest Income Recognized
Consumer Real Estate[2]		
Residential closed-end first liens	**$499**	**$ 15**
Residential closed-end junior liens	**233**	**8**
Investor-owned residential real estate	**76**	**2**
Commercial Real Estate[2]		
Multifamily real estate	**2,678**	**---**
Commercial real estate, owner occupied	**5,565**	**57**
Commercial real estate, other	**5,974**	**86**
Commercial Non Real Estate[2]		
Commercial and Industrial	**518**	**4**
Total	**$15,543**	**$ 172**

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

(2) Only classes with impaired loans are shown.

	For the Six Months Ended June 30, 2014	
	Average Recorded Investment[1]	Interest Income Recognized
Consumer Real Estate[2]		
Residential closed-end first liens	452	13
Residential closed-end junior liens	254	8
Investor-owned residential real estate	81	2
Commercial Real Estate[2]		
Multifamily real estate	2,821	---
Commercial real estate, owner occupied	5,032	77
Commercial real estate, other	3,140	89
Commercial Non Real Estate[2]		
Commercial and Industrial	95	2
Consumer Non Real Estate[2]		

Automobile	23	---
Total	$11,898	$ 191

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

(2) Only classes with impaired loans are shown.

	Average Investment and Interest Income for Impaired Loans For the Year Ended December 31, 2014	
	Average Recorded Investment[1]	Interest Income Recognized
Consumer Real Estate[2]		
Residential closed-end first liens	555	31
Residential closed-end junior liens	249	16
Investor-owned residential real estate	77	5
Commercial Real Estate[2]		
Multifamily real estate	2,773	---
Commercial real estate, owner occupied	5,836	203
Commercial real estate, other	6,114	175
Commercial Non Real Estate[2]		
Commercial and Industrial	707	43
Total	$16,311	$ 473

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

(2) Only classes with impaired loans are shown.

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

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

An analysis of past due and nonaccrual loans follows.

June 30, 2015

	30 – 89 Days Past Due	90 or More Days Past Due	90 or More Days Past Due and Still Accruing	Nonaccruals (Including Impaired Nonaccruals)
Real Estate Construction[1]				
Construction, other	$---	$---	$ ---	$ ---
Consumer Real Estate[1]				
Equity lines	67	---	---	---
Residential closed-end first liens	972	67	67	4
Residential closed-end junior liens	66	---	---	---
Investor-owned residential real estate	71	---	---	13
Commercial Real Estate[1]				
Multifamily real estate	837	868	---	2,672
Commercial real estate, owner-occupied	637	1,569	---	2,805
Commercial real estate, other	807	---	---	2,921
Commercial Non Real Estate[1]				
Commercial and Industrial	---	442	---	490
Consumer Non Real Estate[1]				
Credit cards	4	8	8	---
Automobile	147	3	3	---
Other consumer loans	52	2	2	---
Total	$3,660	$2,959	$ 80	$ 8,905

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

An analysis of past due and nonaccrual loans follows.

December 31, 2014

	30 – 89 Days Past Due	90 or More Days Past Due	90 or More Days Past Due and Still Accruing	Nonaccruals (Including Impaired Nonaccruals)
Real Estate Construction[1]				
Construction, other	28	---	---	---
Consumer Real Estate[1]				
Equity Lines	25	---	---	---
Residential closed-end first liens	719	185	80	105
Residential closed-end junior liens	74	1	1	---
Investor-owned residential real estate	336	45	---	59
Commercial Real Estate[1]				
Multifamily real estate	850	868	---	2,735
Commercial real estate, owner occupied	---	1,066	102	2,573
Commercial real estate, other	---	70	---	3,066
Commercial Non Real Estate[1]				
Commercial and Industrial	153	43	---	749
Consumer Non Real Estate[1]				
Credit cards	3	4	4	---
Automobile	205	20	20	---
Other consumer loans	54	---	---	---
Total	$2,447	$2,302	$ 207	$ 9,287

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

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

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

Determination of risk grades was completed for the portfolio as of June 30, 2015 and December 31, 2014.

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

June 30, 2015

	Pass	Special Mention	Classified (Excluding Impaired)
Real Estate Construction			
Construction, 1-4 family residential	$11,564	$3,860	$ 1,196
Construction, other	25,626	---	---
Consumer Real Estate			
Equity lines	16,287	---	116
Closed-end first liens	78,556	1,173	970
Closed-end junior liens	4,431	55	66
Investor-owned residential real estate	41,986	887	885
Commercial Real Estate			
Multifamily residential real estate	77,752	1,363	1,830
Commercial real estate owner-occupied	127,913	1,707	1,894
Commercial real estate, other	95,540	1,960	---
Commercial Non Real Estate			
Commercial and Industrial	30,393	479	1,589
Public Sector and IDA			
States and political subdivisions	53,383	---	---
Consumer Non Real Estate			
Credit cards	5,675	---	---
Automobile	11,666	114	48
Other consumer	12,109	23	4
Total	$592,881	$11,621	$ 8,598

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

December 31, 2014

	Pass	Special Mention (Excluding Impaired)	Classified (Excluding Impaired)
Real Estate Construction			
Construction, 1-4 family residential	$14,222	$ ---	$ 2,265
Construction, other	29,047	---	28
Consumer Real Estate			
Equity lines	15,861	59	60
Closed-end first liens	78,806	1,566	1,412
Closed-end junior liens	4,258	21	95
Investor-owned residential real estate	42,781	688	614
Commercial Real Estate			
Multifamily residential real estate	73,611	1,397	850
Commercial real estate owner-occupied	125,643	202	2,855
Commercial real estate, other	90,821	1,177	582
Commercial Non Real Estate			
Commercial and Industrial	31,247	97	1,390
Public Sector and IDA			
States and political subdivisions	41,361	---	---
Consumer Non Real Estate			
Credit cards	5,705	---	---
Automobile	11,505	93	128
Other consumer	10,745	---	6
Total	$575,613	$ 5,300	$ 10,285

Sales, Purchases and Reclassification of Loans

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

Troubled Debt Restructurings

The Company modifies loans in troubled debt restructurings. Total troubled debt restructurings amounted to $11,978 at June 30, 2015, $11,328 at December 31, 2014, and $8,914 at June 30, 2014. The following tables present restructurings by class that occurred during the six month period ended June 30, 2015, and the three and six month periods ended June 30, 2014. The Company did not modify any loans in troubled debt restructures during the three-month period ended June 30, 2015.

Note: Only classes with restructured loans are presented.

	Restructurings That Occurred During the Six Months Ended June 30, 2015		
	Number of Contracts	**Pre-Modification Outstanding Principal Balance**	**Post-Modification Outstanding Principal Balance**
Commercial Real Estate			
Commercial real estate, owner occupied	**1**	**1,007**	**907**
Total	**1**	**$ 1,007**	**$ 907**

During the six-month period ended June 30, 2015, the Company restructured one loan to provide payment relief. The restructuring provided payment relief by capitalizing interest and re-amortizing payments. The fair value measurements of the restructured loans as of June 30, 2015 resulted in no specific allocations to the allowance for loan losses.

	Restructurings That Occurred During the Three Months Ended June 30, 2014		
	Number of Contracts	**Pre-Modification Outstanding Principal Balance**	**Post-Modification Outstanding Principal Balance**
Commercial Real Estate			
Multifamily real estate	1	2,484	2,484
Total	1	$ 2,484	$ 2,484

	Restructurings That Occurred During the Six Months Ended June 30, 2014		
	Number of Contracts	**Pre-Modification Outstanding Principal Balance**	**Post-Modification Outstanding Principal Balance**
Commercial Real Estate			
Commercial real estate, owner occupied	1	$ 184	$ 209
Multifamily real estate	1	2,484	2,484
Total	2	$ 2,668	$ 2,693

During the six-month period ended June 30, 2014, the Company restructured two loans. One commercial real estate, owner occupied loan was restructured pursuant to bankruptcy court orders. The restructuring provided payment relief by capitalizing interest, reducing the interest rate and re-amortizing payments. The fair value measurement of the restructured loan as of June 30, 2014 resulted in a specific allocation to the allowance for loan losses of $27. One multifamily real estate loan was restructured to provide payment relief. The Company reduced the loan's interest rate and re-amortized payments. The fair value measurement of the restructured loan as of June 30, 2014 resulted in a specific allocation to the allowance for loan losses of $248.

The Company analyzed its TDR portfolio for loans that defaulted during the three and six month periods ended June 30, 2015 and June 30, 2014, and that were modified within 12 months prior to default. The Company defines default as one or more payments that occur more than 90 days past the due date, charge-offs, or foreclosure after the date of restructuring. There were no restructured loans that defaulted and were modified within 12 months prior to default for the three or six month periods ended June 30, 2015 and 2014.

Note 5: Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities available for sale by major security type are as follows.

	June 30, 2015			
	Amortized Costs	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Values**
Available for Sale:				
U.S. Government agencies and corporations	**$200,713**	**$ 464**	**$ 8,231**	**$192,946**
States and political subdivisions	**16,481**	**649**	**---**	**17,130**
Mortgage-backed securities	**1,530**	**160**	**---**	**1,690**
Corporate debt securities	**6,991**	**18**	**386**	**6,623**
Other securities	**188**	**---**	**53**	**135**
Total securities available for sale	**$225,903**	**$ 1,291**	**$ 8,670**	**$218,524**

	December 31, 2014			
	Amortized Costs	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Values**
Available for Sale:				
U.S. Government agencies and corporations	$197,740	$ 973	$ 4,494	$194,219
States and political subdivisions	18,529	851	---	19,380
Mortgage-backed securities	1,830	184	---	2,014
Corporate debt securities	6,991	140	27	7,104
Other securities	189	---	62	127
Total securities available for sale	$225,279	$ 2,148	$ 4,583	$222,844

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type are as follows.

	June 30, 2015			
	Amortized Costs	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Values**
Held to Maturity:				
U.S. Government agencies and corporations	**$15,914**	**$ 302**	**$ 428**	**$15,788**
States and political subdivisions	**138,001**	**5,133**	**1,838**	**141,296**
Mortgage-backed securities	**373**	**47**	**---**	**420**

Corporate debt securities	**1,416**	**6**	**1**	**1,421**
Total securities held to maturity	**$155,704**	**$ 5,488**	**$ 2,267**	**$158,925**

	December 31, 2014			
	Amortized Costs	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Values**
Held to Maturity:				
U.S. Government agencies and corporations	$18,922	$ 350	$ 245	$19,027
States and political subdivisions	140,702	6,823	727	146,798
Mortgage-backed securities	415	51	---	466
Corporate debt securities	1,413	1	2	1,412
Total securities held to maturity	$161,452	$ 7,225	$ 974	$167,703

Information pertaining to securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows.

	June 30, 2015			
	Less Than 12 Months		**12 Months or More**	
	Fair Value	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Temporarily Impaired Securities:				
U.S. Government agencies and corporations	**$81,425**	**$ 2,993**	**$88,618**	**$ 5,666**
States and political subdivisions	**27,353**	**965**	**9,509**	**873**
Corporate debt securities	**4,882**	**386**	**200**	**1**
Other securities	**---**	**---**	**189**	**53**
Total	**$113,660**	**$ 4,344**	**$98,516**	**$ 6,593**

	December 31, 2014			
	Less Than 12 Months		**12 Months or More**	
	Fair Value	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Temporarily Impaired Securities:				
U.S. Government agencies and corporations	$6,964	$ 30	$156,149	$ 4,709
States and political subdivisions	1,222	35	19,818	692
Corporate debt securities	450	2	1,948	27
Other securities	---	---	127	62
Total	$8,636	$ 67	$178,042	$ 5,490

The Company had 245 securities with a fair value of $212,176 that were temporarily impaired at June 30, 2015. The total unrealized loss on these securities was $10,937. Of the temporarily impaired total, 111 securities with a fair value of $98,516 and an unrealized loss of $6,593 have been in a continuous loss position for twelve months or more. The Company has determined that these securities are temporarily impaired at June 30, 2015 for the reasons set out below.

U.S. Government agencies. The unrealized losses in this category of investments were caused by interest rate and market fluctuations. The contractual terms of the investments do not permit the issuer to settle the securities at a price less than the cost basis of each investment. The Company is monitoring bond market trends and developing strategies to address unrealized losses. Because the Company does not intend to sell any of the investments and it is not likely that the Company will be required to sell any of the investments before recovery of its amortized cost basis, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired.

States and political subdivisions. This category's unrealized losses are primarily the result of interest rate and market fluctuations. The contractual terms of the investments do not permit the issuer to settle the securities at a price less than the cost basis of each investment. Because the Company does not intend to sell any of the investments and it is not likely that the Company will be required to sell any of the investments before recovery of its amortized cost basis, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired.

Corporate. The Company's unrealized losses in corporate debt securities are related to interest rate and market fluctuations. The contractual terms of the investments do not permit the issuer to settle the securities at a price less than the cost basis of each investment. Because the Company does not intend to sell any of the investments before recovery of its amortized cost basis, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired.

Other securities. The Company holds a small investment in community bank stock. The value of this investment has been negatively affected by market conditions. Because the Company does not intend to sell this investment before recovery of its amortized cost basis, the Company does not consider this investment to be other-than-temporarily impaired.

Restricted stock. Restricted stock is reported separately from available-for-sale securities and held-to-maturity securities. As a member of the Federal Reserve and the Federal Home Loan Bank ("FHLB") of Atlanta, NBB is required to maintain certain minimum investments in the common stock of those entities. Required levels of investment are based upon NBB's capital and a percentage of qualifying assets. In addition, NBB is eligible to borrow from the FHLB with borrowings collateralized by qualifying assets, primarily residential mortgage loans and NBB's capital stock investment in the FHLB. Redemption of FHLB stock is subject to certain limitations and conditions. At its discretion, the FHLB may declare dividends on the stock. Management reviews for impairment based upon the ultimate recoverability of the cost basis of the FHLB stock, and at June 30, 2015, management did not determine any impairment.

Management regularly monitors the credit quality of the investment portfolio. Changes in ratings are noted and follow-up research on the issuer is undertaken when warranted. Management intends to carefully monitor any changes in bond quality.

Note 6: Recent Accounting Pronouncements

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation – Stock Compensation (Topic 718)," should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." This update is intended to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management is required under the new guidance to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued when preparing financial statements for each interim and annual reporting period. If conditions or events are identified, the ASU specifies the process that must be followed by management and also clarifies the timing and content of going concern footnote disclosures in order to reduce diversity in practice. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on its consolidated financial statements.

In November 2014, the FASB issued ASU No. 2014-16, “Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity.” The amendments in ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. The Company does not expect the adoption of ASU 2014-16 to have a material impact on its consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, "Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items." The amendments in this ASU eliminate from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of ASU 2015-01 to have a material impact on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification™ and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Company does not expect the adoption of ASU 2015-02 to have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of ASU 2015-03 to have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." The amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer's accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. The amendments in this ASU are effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Company is currently assessing the impact that ASU 2015-05 will have on its consolidated financial statements.

In May 2015, the FASB issued ASU No. 2015-08, "Business Combinations (Topic 805): Pushdown Accounting – Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115." The amendments in ASU 2015-08 amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115, Topic 5: Miscellaneous Accounting, regarding various pushdown accounting issues, and did not have a material impact on the Company's consolidated financial statements.

Note 7: Defined Benefit Plan

Components of Net Periodic Benefit Cost

	Pension Benefits Six Months Ended June 30,	
	2015	**2014**
Service cost	**$310**	$262
Interest cost	**334**	332
Expected return on plan assets	**(584)**	(556)
Amortization of prior service cost	**(54)**	(54)
Recognized net actuarial loss	**208**	130
Net periodic benefit cost	**$214**	$114

2015 Plan Year Employer Contribution

For the six months ended June 30, 2015, the Company is not required to make a minimum contribution and has elected not to make a contribution to the Plan.

Note 8: Fair Value Measurements

The Company records fair value adjustments to certain assets and liabilities and determines fair value disclosures utilizing a definition of fair value of assets and liabilities that states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Additional considerations come into play in determining the fair value of assets in markets that are not active.

The Company uses a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company’s market assumptions. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 –	Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.
Level 3 –	Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain assets and liabilities recorded at fair value on a recurring basis in the financial statements.

Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). The carrying value of restricted Federal Reserve Bank and Federal Home Loan Bank stock approximates fair value based upon the redemption provisions of each entity and is therefore excluded from the following table.

		Fair Value Measurements at June 30, 2015 Using		
Description	**Balance as of June 30, 2015**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U.S. Government agencies and corporations	**$192,946**	**$---**	**$ 192,946**	**$ ---**
States and political subdivisions	**17,130**	**---**	**17,130**	**---**
Mortgage-backed securities	**1,690**	**---**	**1,690**	**---**
Corporate debt securities	**6,623**	**---**	**6,623**	**---**
Other securities	**135**	**---**	**135**	**---**
Total securities available for sale	**$218,524**	**$---**	**$ 218,524**	**$ ---**

		Fair Value Measurements at December 31, 2014 Using		
Description	**Balance as of December 31, 2014**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U.S. Government agencies and corporations	$ 194,219	$---	$ 194,219	$ ---

States and political subdivisions	19,380	---	19,380	---
Mortgage-backed securities	2,014	---	2,014	---
Corporate debt securities	7,104	---	7,104	---
Other securities	127	---	127	---
Total securities available for sale	$ 222,844	$---	$ 222,844	$ ---

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or market value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets offer at the report date for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale at June 30, 2015 or December 31, 2014.

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due will not be collected when due according to the contractual terms of the loan agreement. Troubled debt restructurings are impaired loans. Impaired loans are measured at fair value on a nonrecurring basis. If an individually-evaluated impaired loan's balance exceeds fair value, the amount is allocated to the allowance for loan losses. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

The fair value of an impaired loan and measurement of associated loss is based on one of three methods: the observable market price of the loan, the present value of projected cash flows, or the fair value of the collateral. The observable market price of a loan is categorized as a Level 1 input. The present value of projected cash flows method results in a Level 3 categorization because the calculation relies on the Company's judgment to determine projected cash flows, which are then discounted at the current rate of the loan, or the rate prior to modification if the loan is a troubled debt restructure.

Loans measured using the fair value of collateral method may be categorized in Level 2 or Level 3. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. Most collateral is real estate. The Company bases collateral method fair valuation upon the “as-is” value of independent appraisals or evaluations. Valuations for impaired loans with outstanding principal balances of $250 or more are based on a current appraisal. Appraisals are also used to value impaired loans with principal balances of $100 or greater and secured by one piece of collateral. Collateral-method impaired loans with principal balances below $100, or if secured by multiple pieces of collateral, below $250, are valued using an internal evaluation.

The value of real estate collateral is determined by a current (less than 12 months of age) appraisal or internal evaluation utilizing an income or market valuation approach. Appraisals conducted by an independent, licensed appraiser outside of the Company using observable market data are categorized as Level 2. If a current appraisal cannot be obtained prior to a reporting date and an existing appraisal is discounted to obtain an estimated value, or if declines in value are identified after the date of the appraisal, or if an appraisal is discounted for estimated selling costs, the valuation of real estate collateral is categorized as Level 3. Valuations derived from internal evaluations are categorized as Level 3. The value of business equipment is based upon an outside appraisal (Level 2) if deemed significant, or the net book value on the applicable business' financial statements (Level 3) if not considered significant. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3).

Impaired loans are measured quarterly for impairment. The Company employs the most applicable valuation method for each loan based on current information at the time of valuation. Valuations of loans using the collateral method may include a discount for selling costs if collection of the loan is expected to come from sale of the collateral. Fair value measurement using the collateral method for a loan that is dependent on the operation, but not the sale, of collateral for collection is not discounted for selling costs.

The following table summarizes the Company's impaired loans that were measured at fair value on a nonrecurring basis at June 30, 2015 and at December 31, 2014.

			Carrying Value		
Date	**Description**	**Balance**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	Assets:				
June 30, 2015	Impaired loans net of valuation allowance	**$ 2,352**	**$---**	**$ ---**	**$ 2,352**
December 31, 2014	Impaired loans net of valuation allowance	7,224	---	---	7,224

The following tables present information about Level 3 Fair Value Measurements for June 30, 2015 and December 31, 2014.

June 30, 2015	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average)**

Impaired loans	Present value of cash flows	Market rate for borrower (discount rate)	5.88% - 9.50% (6.22%)

December 31, 2014	Valuation Technique	Unobservable Input	Range (Weighted Average)
Impaired loans	Present value of cash flows	Discount rate	5.88% - 9.50% (6.15%)
Impaired loans	Discounted appraised value	Selling cost[(1)]	10%[(2)]

(1) Impaired loans that are collateral-dependent are valued using the fair value of collateral. The valuation is discounted for selling costs if repayment of the loan is dependent on the sale of the collateral. If repayment will come from rental income of the property, the valuation is not discounted for selling costs.
(2) Only one loan was valued using the collateral method as of December 31, 2014.

<u>Other Real Estate Owned</u>

Other real estate owned are real estate assets acquired in full or partial satisfaction of a loan. At acquisition, other real estate owned assets are measured at fair value. If the assets are marketed for sale by an outside party, the acquisition-date fair value is discounted by selling costs; if the assets are marketed for sale by the Company, no reduction to fair value for selling costs is made. Subsequent to acquisition, the assets are measured at the lower of initial measurement or current fair value, discounted for selling costs as appropriate.

The fair value of an other real estate owned asset is determined by an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). If the appraisal is discounted either for age or because management considers the real estate market to be experiencing volatility, then the fair value is considered Level 3. Discounts for selling costs also result in measurement based on Level 3 inputs. Fair value adjustments are measured on a nonrecurring basis and are recorded in the period incurred as valuation allowances to other real estate owned, and expensed through noninterest expense.

The following table summarizes the Company's other real estate owned that was measured at fair value on a nonrecurring basis.

			Carrying Value		
Date	**Description**	**Balance**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	Assets:				
June 30, 2015	Other real estate owned net of valuation allowance	**$ 4,441**	**$---**	**$ ---**	**$ 4,441**
December 31, 2014	Other real estate owned net of valuation allowance	4,744	---	---	4,744

The following tables present information about Level 3 Fair Value Measurements for June 30, 2015 and December 31, 2014.

June 30, 2015	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average)**
Other real estate owned	Discounted appraised value	Selling cost	0%[(1)] - 10% (5.82%)
Other real estate owned	Discounted appraised value	Discount for lack of marketability and age of appraisal	0% - 55.91% (17.33%)

December 31, 2014	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average)**
Other real estate owned	Discounted appraised value	Selling cost	0%[(1)] - 11% (8.60%)
Other real estate owned	Discounted appraised value	Discount for lack of marketability and age of appraisal	0% - 48.77% (20.81%)

[(1)] The Company markets other real estate owned both independently and with local realtors. Properties marketed by realtors are discounted by selling costs. Properties that the Company markets independently are not discounted by selling costs.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments.

Cash and Due from Banks and Interest-Bearing Deposits

The carrying amounts approximate fair value.

Securities

The fair value of securities, excluding restricted stock, is determined by quoted market prices or dealer quotes. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments adjusted for differences between the quoted instruments and the instruments being valued. The carrying value of restricted securities approximates fair value based upon the redemption provisions of the applicable entities.

Loans Held for Sale

The fair value of loans held for sale is based on commitments on hand from investors or prevailing market prices.

Loans

Fair value for the loan portfolio is estimated on an account-level basis by discounting scheduled cash flows through the projected maturity for each loan. The calculation applies estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Company's historical experience with repayments for loan classification, modified by an estimate of the effect of economic conditions on lending.

Impaired loans are individually evaluated for fair value. Fair value for the Company's impaired loans is estimated by using either discounted cash flows or the appraised value of collateral. Any amount of principal balance that exceeds fair value is accrued in the allowance for loan losses. Assumptions regarding credit risk, cash flows and discount rates are determined within management's judgment, using available market information and specific borrower information. Discount rates for cash flow analysis are based on the loan's interest rate, and cash flows are estimated based upon the loan's historical payment performance and the borrower's current financial condition. Appraisals may be discounted for age, reasonableness, and selling costs.

Deposits

The fair value of demand and savings deposits is the amount payable on demand. The fair value of fixed maturity term deposits and certificates of deposit is estimated using the rates currently offered for deposits with similar remaining maturities.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Bank-Owned Life Insurance

Bank owned life insurance represents insurance policies on officers of the Company and certain officers who are no longer employed by the Company. The cash values of the policies are estimates using information provided by insurance carriers. These policies are carried at their cash surrender value, which approximates the fair value.

Commitments to Extend Credit and Standby Letters of Credit

The only amounts recorded for commitments to extend credit, standby letters of credit and financial guarantees written are the deferred fees arising from these unrecognized financial instruments. These deferred fees are not deemed significant at June 30, 2015 and December 31, 2014, and, as such, the related fair values have not been estimated.

The estimated fair values and related carrying amounts of the Company’s financial instruments follow.

	June 30, 2015			
	Carrying Amount	**Quoted Prices in Active Markets for Identical Assets** **Level 1**	**Significant Other Observable Inputs** **Level 2**	**Significant Unobservable Inputs** **Level 3**
Financial Assets:				
Cash and due from banks	**$11,353**	**$ 11,353**	**$ ---**	**$ ---**
Interest-bearing deposits	**83,818**	**83,818**	**---**	**---**
Securities	**374,228**	**---**	**377,449**	**---**
Restricted securities	**1,129**	**---**	**1,129**	**---**
Loans held for sale	**853**	**---**	**853**	**---**
Loans, net	**618,810**	**---**	**---**	**632,072**
Accrued interest receivable	**5,857**	**---**	**5,857**	**---**
Bank-owned life insurance	**22,097**	**---**	**22,097**	**---**
Financial Liabilities:				
Deposits	**$974,156**	**$ ---**	**$ 771,086**	**$ 208,182**
Accrued interest payable	**61**	**---**	**61**	**---**