OLD SECOND BANCORP INC
Form 10-Q
August 07, 2017
Table of Contents

I

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

OR

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

For transition period from to

Commission File Number 0 -10537

(Exact name of Registrant as specified in its charter)

Delaware	36-3143493
(State or other jurisdiction	(I.R.S. Employer Identification Number)

of incorporation or organization)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(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.

Yes No

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company Emerging growth company

(Do not check if a smaller reporting company)

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

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

Yes No

As of August 4, 2017, the Registrant had 29,627,086 shares of common stock outstanding at $1.00 par value per share.

Table of Contents

OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

Table of Contents

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share data)

	(unaudited) June 30, 2017	December 31, 2016
Assets		
Cash and due from banks	$ 32,614	$ 33,805
Interest bearing deposits with financial institutions	18,483	13,529
Cash and cash equivalents	51,097	47,334
Securities available-for-sale, at fair value	568,227	531,838
Federal Home Loan Bank Chicago ("FHLBC") and Federal Reserve Bank Chicago ("FRBC") stock	8,593	7,918
Loans held-for-sale	5,440	4,918
Loans	1,539,647	1,478,809
Less: allowance for loan losses	15,836	16,158
Net loans	1,523,811	1,462,651
Premises and equipment, net	38,061	38,977
Other real estate owned	11,724	11,916
Mortgage servicing rights, net	6,528	6,489
Goodwill and core deposit intangible	8,968	9,018
Bank-owned life insurance ("BOLI")	61,041	60,332
Deferred tax assets, net	45,356	53,464
Other assets	14,595	16,333
Total assets	$ 2,343,441	$ 2,251,188
Liabilities		
Deposits:		
Noninterest bearing demand	$ 546,463	$ 513,688
Interest bearing:		
Savings, NOW, and money market	971,715	950,849
Time	391,967	402,248
Total deposits	1,910,145	1,866,785
Securities sold under repurchase agreements	36,361	25,715
Other short-term borrowings	75,000	70,000
Junior subordinated debentures	57,615	57,591
Senior notes	44,008	43,998
Other liabilities	29,182	11,889
Total liabilities	2,152,311	2,075,978

Stockholders’ Equity		
Common stock	34,626	34,534
Additional paid-in capital	117,186	116,653
Retained earnings	138,442	129,005
Accumulated other comprehensive loss	(2,668)	(8,762)
Treasury stock	(96,456)	(96,220)
Total stockholders’ equity	191,130	175,210
Total liabilities and stockholders’ equity	$ 2,343,441	$ 2,251,188

	June 30, 2017 Common Stock	December 31, 2016 Common Stock
Par value	$ 1.00	$ 1.00
Shares authorized	60,000,000	60,000,000
Shares issued	34,625,734	34,534,234
Shares outstanding	29,627,086	29,556,216
Treasury shares	4,998,648	4,978,018

See accompanying notes to consolidated financial statements.

Table of Contents

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Income

(In thousands, except per share data)

	(unaudited) Quarters Ended June 30,		(unaudited) Six Months Ended June 30,	
	2017	2016	2017	2016
Interest and dividend income				
Loans, including fees	$ 17,385	$ 13,039	$ 33,994	$ 26,097
Loans held-for-sale	37	39	61	67
Securities:				
Taxable	2,607	4,382	5,570	8,593
Tax exempt	1,975	220	3,040	399
Dividends from FHLBC and FRBC stock	92	84	177	168
Interest bearing deposits with financial institutions	31	15	54	34
Total interest and dividend income	22,127	17,779	42,896	35,358
Interest expense				
Savings, NOW, and money market deposits	233	193	456	384
Time deposits	1,025	869	2,004	1,691
Other short-term borrowings	150	26	258	46
Junior subordinated debentures	1,059	1,083	2,143	2,167
Senior notes	672	-	1,345	-
Subordinated debt	-	243	-	482
Notes payable and other borrowings	-	2	-	4
Total interest expense	3,139	2,416	6,206	4,774
Net interest and dividend income	18,988	15,363	36,690	30,584
Provision for loan losses	750	-	750	-
Net interest and dividend income after provision for loan losses	18,238	15,363	35,940	30,584
Noninterest income				
Trust income	1,638	1,502	3,096	2,871
Service charges on deposits	1,615	1,646	3,233	3,205
Secondary mortgage fees	223	280	399	473
Mortgage servicing rights mark to market loss	(429)	(733)	(562)	(1,774)
Mortgage servicing income	444	422	879	843
Net gain on sales of mortgage loans	1,473	1,642	2,620	2,854
Securities loss, net	(131)	-	(267)	(61)
Increase in cash surrender value of BOLI	350	319	709	604
Debit card interchange income	1,081	1,049	2,056	1,996
Gain (loss) on disposal and transfer of fixed assets, net	12	-	10	(1)
Other income	1,041	1,150	2,172	2,542
Total noninterest income	7,317	7,277	14,345	13,552
Noninterest expense				

Salaries and employee benefits	10,545	8,814	21,118	17,840
Occupancy, furniture and equipment	1,462	1,346	3,028	2,927
Computer and data processing	1,112	1,063	2,202	1,988
FDIC insurance	165	362	313	565
General bank insurance	264	272	534	570
Amortization of core deposit intangible	25	-	50	-
Advertising expense	452	435	838	782
Debit card interchange expense	399	620	748	823
Legal fees	184	191	288	352
Other real estate expense, net	539	879	1,248	1,617
Other expense	2,839	2,718	5,673	5,500
Total noninterest expense	17,986	16,700	36,040	32,964
Income before income taxes	7,569	5,940	14,245	11,172
Provision for income taxes	2,112	2,095	4,216	4,005
Net income	$ 5,457	$ 3,845	$ 10,029	$ 7,167
Basic earnings per share	$ 0.19	$ 0.13	$ 0.34	$ 0.24
Diluted earnings per share	0.18	0.13	0.33	0.24

See accompanying notes to consolidated financial statements.

4

Table of Contents

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(In thousands)

	(unaudited)		(unaudited)	
	Quarters Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net Income	$ 5,457	$ 3,845	$ 10,029	$ 7,167
Unrealized holding gains on available-for-sale securities arising during the period	6,269	8,076	10,347	5,767
Related tax expense	(2,520)	(3,233)	(4,134)	(2,308)
Holding gains after tax on available-for-sale securities	3,749	4,843	6,213	3,459
Less: Reclassification adjustment for the net (losses) gains realized during the period				
Net realized losses	(131)	-	(267)	(61)
Income tax benefit on net realized losses	52	-	106	25
Net realized losses after tax	(79)	-	(161)	(36)
Other comprehensive income on available-for-sale securities	3,828	4,843	6,374	3,495
Accretion and reversal of net unrealized holding gains on held-to-maturity securities	-	5,715	-	5,939
Related tax expense	-	(2,354)	-	(2,446)
Other comprehensive income on held-to-maturity securities	-	3,361	-	3,493
Changes in fair value of derivatives used for cashflow hedges	(613)	(1,597)	(464)	(4,024)
Related tax benefit	245	640	184	1,612
Other comprehensive loss on cashflow hedges	(368)	(957)	(280)	(2,412)
Total other comprehensive income	3,460	7,247	6,094	4,576
Total comprehensive income	$ 8,917	$ 11,092	$ 16,123	$ 11,743

See accompanying notes to consolidated financial statements.

Table of Contents

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	(unaudited) Six Months Ended June 30, 2017	2016
Cash flows from operating activities		
Net income	$ 10,029	$ 7,167
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation of fixed assets and amortization of leasehold improvements	1,193	1,097
Change in fair value of mortgage servicing rights	562	1,774
Loan loss reserve	750	-
Provision for deferred tax expense	4,052	3,717
Originations of loans held-for-sale	(75,079)	(83,698)
Proceeds from sales of loans held-for-sale	76,649	83,324
Net gain on sales of mortgage loans	(2,620)	(2,854)
Net discount accretion of purchase accounting adjustment on loans	(850)	-
Change in current income taxes (payable) receivable	(66)	259
Increase in cash surrender value of BOLI	(709)	(604)
Change in accrued interest receivable and other assets	1,665	(3,152)
Change in accrued interest payable and other liabilities	16,895	(185)
Net premium amortization/discount (accretion) on securities	293	(385)
Securities losses, net	267	61
Amortization of core deposit	50	-
Amortization of junior subordinated debentures issuance costs	24	24
Amortization of senior notes issuance costs	52	-
Stock based compensation	625	325
Net gain on sale of other real estate owned	(178)	(67)
Provision for other real estate owned losses	710	940
Net (gain) loss on disposal of fixed assets	(11)	1
Loss on transfer of premises to other real estate owned	1	-
Net cash provided by operating activities	34,304	7,744
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	78,564	25,687
Proceeds from sales of securities available-for-sale	100,856	44,993
Purchases of securities available-for-sale	(205,755)	(122,700)
Proceeds from maturities and calls including pay down of securities held-to-maturity	-	3,372
Net proceeds from (purchases) sales of FHLBC stock	(675)	600
Net change in loans	(64,585)	(28,805)
Improvements in other real estate owned	-	(12)

Proceeds from sales of other real estate owned	3,280	2,996
Proceeds from disposition of premises and equipment	13	-
Net purchases of premises and equipment	(375)	(439)
Net cash used in investing activities	(88,677)	(74,308)
Cash flows from financing activities		
Net change in deposits	43,360	23,039
Net change in securities sold under repurchase agreements	10,646	9,068
Net change in other short-term borrowings	5,000	35,000
Payment of senior note issuance costs	(42)	-
Dividends paid on common stock	(592)	(296)
Purchase of treasury stock	(236)	(254)
Net cash provided by financing activities	58,136	66,557
Net change in cash and cash equivalents	3,763	(7)
Cash and cash equivalents at beginning of period	47,334	40,338
Cash and cash equivalents at end of period	$ 51,097	$ 40,331

Table of Contents

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows - Continued

(In thousands)

	(unaudited) Six Months Ended June 30,	
Supplemental cash flow information	2017	2016
Income taxes paid, net	$ 230	$ 100
Interest paid for deposits	2,448	2,053
Interest paid for borrowings	3,787	2,665
Non-cash transfer of loans to other real estate owned	3,525	968
Non-cash transfer of premises to other real estate owned	95	-
Non-cash transfer of securities held-to-maturity to securities available-for-sale	-	244,823

See accompanying notes to consolidated financial statements.

Table of Contents

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in

Stockholders' Equity

(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2015	$ 34,427	$ 115,918	$ 114,209	$ (12,659)	$ (95,966)	$ 155,929
Net income			7,167			7,167
Other comprehensive gain, net of tax				4,576		4,576
Dividends declared and paid			(296)			(296)
Vesting of restricted stock	106	(106)				-
Tax effect from vesting of restricted stock		174				174
Stock based compensation		325				325
Purchase of treasury stock					(254)	(254)
Balance, June 30, 2016	$ 34,533	$ 116,311	$ 121,080	$ (8,083)	$ (96,220)	$ 167,621
Balance, December 31, 2016	$ 34,534	$ 116,653	$ 129,005	$ (8,762)	$ (96,220)	$ 175,210
Net income			10,029			10,029
Other comprehensive gain, net of tax				6,094		6,094
Dividends declared and paid			(592)			(592)
Vesting of restricted stock	92	(92)				-
Stock based compensation		625				625
Purchase of treasury stock					(236)	(236)
Balance, June 30, 2017	$ 34,626	$ 117,186	$ 138,442	$ (2,668)	$ (96,456)	$ 191,130

See accompanying notes to consolidated financial statements.

8

Table of Contents

Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data, unaudited)

Note 1 – Summary of Significant Accounting Policies

The accounting policies followed in the preparation of the interim consolidated financial statements are consistent with those used in the preparation of the annual financial information. The interim consolidated financial statements reflect all normal and recurring adjustments that are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended June 30, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These interim consolidated financial statements are unaudited and should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the "Company") annual report on Form 10-K for the year ended December 31, 2016. Unless otherwise indicated, amounts in the tables contained in the notes to the consolidated financial statements are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with United States generally accepted accounting principles ("GAAP") and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the consolidated financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. In August 2015, the FASB issued ASU 2015-14 “Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date.” This accounting standards update defers the effective date of ASU 2014-09 for an additional year. ASU 2015-14 will be effective for annual reporting periods beginning after December 15, 2017. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. Early application is not permitted. In March 2016, the FASB issued ASU 2016-08 “Revenue from Contracts with Customers (TOPIC 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” and in April 2016, the FASB issued ASU 2016-10 “Revenue from Contracts with Customers (TOPIC 606): Identifying Performance Obligations and Licensing.” ASU 2016-08 requires the entity to determine if it is acting as a principal with control over the goods or services it is contractually obligated to provide, or an agent with no control over specified goods or services provided by another party to a customer. ASU 2016-10 was issued to further clarify ASU 2014-09 implementation regarding identifying performance obligation materiality, identification of key contract components, and scope. The Company is assessing the impact of ASU 2014-09 and other related ASUs as noted above on its accounting and disclosures within noninterest income, as any interest income impact was not included in the scope of this final ASU pronouncement. Adoption of this ASU is expected to affect the methodology used to record certain recurring revenue streams within trust and asset management fees, but this impact is not anticipated to be significant to the Company’s financial statements. The Company will adopt ASU 2015-14 and related issuances on January 1, 2018, with a cumulative effect adjustment to opening retained earnings, if an adjustment is deemed to be material.

In February 2016, the FASB issued ASU No. 2016-02- “Leases (Topic 842).” This ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. One key revision from prior guidance was to include operating leases within assets and liabilities recorded; another revision was included which created a new model to follow for sale-leaseback transactions. The impact of this pronouncement will affect lessees primarily, as virtually all of their assets will be recognized on the balance sheet, by recording a right of use asset and lease liability. This pronouncement is effective for fiscal years beginning after December 15, 2018. The Company is assessing the impact of ASU 2016-02 on its accounting and disclosures.

In March 2016, the FASB issued ASU No. 2016-09 “Stock Compensation - Improvements to Employee Share-Based Payment Accounting (Topic 718).” FASB issued this ASU as part of the Simplification Initiative. This ASU involves several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or

Table of Contents

liability, and classification on the statement of cash flows. ASU 2016-09 is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. This standard was adopted by the Company effective January 2017; the adoption of this standard did not have a material effect on the Company's operating results or financial condition.

In June 2016, the FASB issued ASU No. 2016-13 "Measurement of Credit Losses on Financial Instruments (Topic 326)." ASU 2016-13 was issued to provide financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date to enhance the decision making process. The new methodology to be used should reflect expected credit losses based on relevant vintage historical information, supported by reasonable forecasts of projected loss given defaults, which will affect the collectability of the reported amounts. This new methodology will also require available-for-sale debt securities to have a credit loss recorded through an allowance rather than write-downs. ASU 2016-13 is effective for financial statements issued for fiscal years beginning after December 15, 2019. The Company is assessing the impact of ASU 2016-13 on its accounting and disclosures, and is in the process of accumulating data and evaluating model options to support future risk assessments.

In March 2017, the FASB issued ASU No. 2017-08 "Receivables-Nonrefundable Fees and Other Costs – Premium Amortization on Purchased Callable Debt Securities (Subtopic 310-20)." This ASU was issued to shorten the amortization period for the premium to the earliest call date on debt securities. This premium will now be recorded as a reduction to net interest margin during the shorter yield to call period, as compared to prior practice of amortizing the premium as a reduction to net interest margin over the contractual life of the instrument. This ASU does not change the current method of amortizing any discount over the contractual life of the debt security, and this pronouncement is effective for fiscal years beginning after December 15, 2018, with earlier adoption permitted. The Company is assessing the impact of ASU 2017-08 on its accounting and disclosures, as this pronouncement will reduce net interest income over the period until the security's call date, as compared to a net interest income reduction for all remaining premium as of the date of call if earlier than the date of maturity. As the Company has a significant unamortized premium on tax exempt debt securities, management has determined that early adoption will be implemented under a modified retrospective basis. Adoption of ASU 2017-08 is expected to reduce the net interest margin by approximately 10 basis points a quarter going forward as the premium amortization recorded will increase over current levels.

Subsequent Events

On July 18, 2017, the Company's Board of Directors declared a cash dividend of $0.01 per share payable on August 7, 2017, to stockholders of record as of July 28, 2017; dividends of $296,000 were paid to stockholders on August 7, 2017.

Note 2 – Acquisitions

On October 28, 2016, the Bank acquired the Chicago branch of Talmer Bank and Trust, the banking subsidiary of Talmer Bancorp, Inc. (“Talmer”). As a result of this transaction, the Bank recorded assets with a fair value of approximately $230.9 million, including approximately $221.0 million of loans, and assumed deposits with a fair value of approximately $48.9 million. Goodwill of $8.4 million was included within the total assets recorded upon acquisition; net cash of $181.5 million was paid for the purchase.

Note 3 – Securities

Investment Portfolio Management

Our investment portfolio serves the liquidity needs and income objectives of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio also serve as income producing assets. The size and composition of the portfolio reflects liquidity needs, loan demand and interest income objectives. Portfolio size and composition will be adjusted from time to time. While a significant portion of the portfolio consists of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. Securities available-for-sale are carried at fair value. Unrealized gains and losses, net of tax, on securities available-for-sale are reported as a separate component of equity. This balance sheet component changes as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

FHLBC and FRBC stock are considered nonmarketable equity investments. FHLBC stock was recorded at $3.8 million at June 30, 2017, and $3.1 million at December 31, 2016, and is necessary to maintain access to FHLBC advances, which are utilized as a component to meet the Bank’s daily funding needs. FRBC stock was recorded at $4.8 million at June 30, 2017, and December 31, 2016.

Table of Contents

The following table summarizes the amortized cost and fair value of the securities portfolio at June 30, 2017, and December 31, 2016, and the corresponding amounts of gross unrealized gains and losses:

June 30, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale				
U.S. government agencies mortgage-backed	$ 21,039	$ 6	$ (199)	$ 20,846
States and political subdivisions	222,098	4,472	(1,052)	225,518
Corporate bonds	12,807	58	(249)	12,616
Collateralized mortgage obligations	102,717	159	(1,963)	100,913
Asset-backed securities	144,812	557	(4,984)	140,385
Collateralized loan obligations	67,735	305	(91)	67,949
Total securities available-for-sale	$ 571,208	$ 5,557	$ (8,538)	$ 568,227

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale				
U.S. government agencies mortgage-backed	$ 42,511	$ -	$ (977)	$ 41,534
States and political subdivisions	68,718	258	(273)	68,703
Corporate bonds	10,957	9	(336)	10,630
Collateralized mortgage obligations	174,352	374	(3,799)	170,927
Asset-backed securities	146,391	341	(8,325)	138,407
Collateralized loan obligations	102,504	29	(896)	101,637
Total securities available-for-sale	$ 545,433	$ 1,011	$ (14,606)	$ 531,838

The fair value, amortized cost and weighted average yield of debt securities at June 30, 2017, by contractual maturity, were as follows in the table below. Securities not due at a single maturity date are shown separately.

Securities available-for-sale	Amortized Cost	Weighted Average Yield		Fair Value
Due in one year or less	$ 11,600	2.60	%	$ 11,636
Due after one year through five years	1,847	4.65		1,844
Due after five years through ten years	18,178	2.88		18,202

Due after ten years	203,280	3.01		206,452
	234,905	2.99		238,134
Mortgage-backed and collateralized mortgage obligations	123,756	2.54		121,759
Asset-backed securities	144,812	2.21		140,385
Collateralized loan obligations	67,735	4.01		67,949
Total securities available-for-sale	$ 571,208	2.82	%	$ 568,227

At June 30, 2017, the Company's investments include $119.3 million of asset-backed securities that are backed by student loans originated under the Federal Family Education Loan program ("FFEL"). Under the FFEL, private lenders made federally guaranteed student loans to parents and students and packaged and sold them as asset-backed securities. While the program was modified several times before elimination in 2010, not less than 97% of the outstanding principal amount of the loans made under FFEL are guaranteed by the U.S. Department of Education. In addition to the U.S. Department of Education guarantee, total added credit enhancement in the form of overcollateralization and/or subordination amounted to $13.4 million, or 10.43%, of outstanding principal.

The Company has invested in securities issued from one originator that individually amounts to over 10% of the Company's stockholders equity. As of June 30, 2017, GCO Education Loan Funding Corp's amortized cost was $27.5 million and fair value was $26.0 million within the Company's portfolio.

Table of Contents

Securities with unrealized losses at June 30, 2017, and December 31, 2016, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (in thousands except for number of securities):

e 30, 2017	Less than 12 months in an unrealized loss position			12 months or more in an unrealized loss position			Total		
curities ilable-for-sale	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value
S. government encies rtgage-backed	8	$ 178	$ 17,764	1	$ 21	$ 805	9	$ 199	$ 18,56
tes and itical odivisions	4	1,052	16,372	-	-	-	4	1,052	16,37
rporate bonds	1	108	4,892	2	141	5,205	3	249	10,09
llateralized rtgage igations	10	1,776	64,987	4	187	10,898	14	1,963	75,88
set-backed urities	1	274	4,281	12	4,710	106,755	13	4,984	111,0
llateralized n obligations	1	91	7,905	-	-	-	1	91	7,905
tal securities ilable-for-sale	25	$ 3,479	$ 116,201	19	$ 5,059	$ 123,663	44	$ 8,538	$ 239,8

mber 31, 2016	Less than 12 months in an unrealized loss position			12 months or more in an unrealized loss position			Total		
rities able-for-sale	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Valu
government cies gage-backed	11	$ 957	$ 40,636	1	$ 20	$ 898	12	$ 977	$ 41,5
s and political ivisions	12	273	35,241	-	-	-	12	273	35,2
orate bonds	1	183	4,817	2	153	5,328	3	336	10,1
teralized gage ations	16	3,402	117,752	7	397	18,109	23	3,799	135
t-backed rities	4	328	17,604	12	7,997	107,112	16	8,325	124

ateralized loan ations	-	-	-	12	896	81,613	12	896	81,6
securities able-for-sale	44	$ 5,143	$ 216,050	34	$ 9,463	$ 213,060	78	$ 14,606	$ 429

Recognition of other-than-temporary impairment was not necessary in the three and six months ended June 30, 2017, June 30, 2016, or the year ended December 31, 2016. The changes in fair value related primarily to interest rate fluctuations. Our review of other-than-temporary impairment determined that there was no credit quality deterioration.

Note 4 – Loans

Major classifications of loans were as follows:

	June 30, 2017	December 31, 2016
Commercial	$ 256,760	$ 228,113
Real estate - commercial	706,103	736,247
Real estate - construction	93,661	64,720
Real estate - residential	398,170	377,851
Consumer	2,878	3,237
Overdraft	316	436
Lease financing receivables	70,138	55,451
Other	10,943	11,537
	1,538,969	1,477,592
Net deferred loan costs	678	1,217
Total loans	$ 1,539,647	$ 1,478,809

It is the policy of the Company to review each prospective credit prior to making a loan in order to determine if an adequate level of security or collateral has been obtained. The type of collateral, when required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to lending laws, the Company's lending standards and credit monitoring procedures. With selected exceptions, the Bank makes loans solely within its market area. There are no significant concentrations of loans where the customers' ability to honor loan terms is dependent upon a single economic sector, although the real estate related categories listed above represent 77.8% and 79.7% of the portfolio at June 30, 2017, and December 31, 2016, respectively.

Table of Contents

Aged analysis of past due loans by class of loans was as follows:

June 30, 2017	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Past Due and Accruing
Commercial	$ 21	$ -	$ -	$ 21	$ 256,523	$ 216	$ 256,760	$ -
Leases	898	-	-	898	68,780	460	70,138	
Real estate - commercial								
Owner occupied general purpose	629	-	-	629	139,964	460	141,053	-
Owner occupied special purpose	-	-	-	-	170,186	366	170,552	-
Non-owner occupied general purpose	835	-	-	835	215,423	1,085	217,343	-
Non-owner occupied special purpose	-	-	-	-	116,218	-	116,218	-
Retail properties	-	-	-	-	44,781	1,144	45,925	-
Farm	1,305	-	-	1,305	13,707	-	15,012	-
Real estate - construction								
Homebuilder	-	-	-	-	1,947	-	1,947	-
Land	-	-	-	-	2,870	-	2,870	-
Commercial speculative	-	-	-	-	31,268	68	31,336	-
All other	-	-	-	-	57,356	152	57,508	-
Real estate - residential								
Investor	3	95	-	98	59,113	686	59,897	-
Multifamily	1,390	-	-	1,390	92,896	4,824	99,110	-
Owner occupied	-	279	-	279	119,355	4,187	123,821	-
Revolving and junior liens	557	74	-	631	113,685	1,026	115,342	-

Consumer	2	-	-	2	2,867	9	2,878	-
Other1	-	-	-	-	11,937	-	11,937	-
Total	$ 5,640	$ 448	$ -	$ 6,088	$ 1,518,876	$ 14,683	$ 1,539,647	$ -

December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 days or Greater Pas Due and Accruing
Commercial	$ 57	$ 74	$ -	$ 131	$ 227,742	$ 240	$ 228,113	$ -
Leases	-	286		286	54,799	366	55,451	
Real estate - commercial								
Owner occupied general purpose	758	-	-	758	135,599	879	137,236	-
Owner occupied special purpose	-	-	-	-	177,755	385	178,140	-
Non-owner occupied general purpose	667	379	-	1,046	229,315	1,930	232,291	-
Non-owner occupied special purpose	-	-	-	-	118,052	1,013	119,065	-
Retail properties	-	-	-	-	53,474	1,179	54,653	-
Farm	1,353	-	-	1,353	13,509	-	14,862	-
Real estate - construction								
Homebuilder	-	-	-	-	3,883	-	3,883	-
Land	-	-	-	-	3,029	-	3,029	-
Commercial speculative	-	-	-	-	22,654	74	22,728	-
All other	364	-	-	364	34,509	207	35,080	-
Real estate - residential								
Investor	237	-	-	237	54,924	936	56,097	-
Multifamily	-	-		-	96,502	-	96,502	
Owner occupied	274	-	-	274	116,900	6,452	123,626	-
Revolving and junior liens	225	405	-	630	99,374	1,622	101,626	-
Consumer	10	36	-	46	3,191	-	3,237	-
Other1	14	-	-	14	13,176	-	13,190	-
Total	$ 3,959	$ 1,180	$ -	$ 5,139	$ 1,458,387	$ 15,283	$ 1,478,809	$ -

1 The “Other” class includes overdrafts and net deferred costs.

Credit Quality Indicators

The Company categorizes loans into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, historical payment experience, and current economic trends. This analysis includes loans with outstanding balances or commitments greater than $50,000 and excludes homogeneous loans such as home equity lines of credit and residential mortgages. Loans with a classified risk rating are reviewed quarterly regardless of size or loan type. The Company uses the following definitions for classified risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

Table of Contents

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Credits that are not covered by the definitions above are pass credits, which are not considered to be adversely rated.

Credit Quality Indicators by class of loans were as follows:

June 30, 2017	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	$ 238,814	$ 17,691	$ 255	$ -	$ 256,760
Leases	68,780	898	460	-	70,138
Real estate - commercial					
Owner occupied general purpose	136,655	3,174	1,224	-	141,053
Owner occupied special purpose	165,945	4,241	366	-	170,552
Non-owner occupied general purpose	215,604	654	1,085	-	217,343
Non-owner occupied special purpose	112,543	-	3,675	-	116,218
Retail Properties	43,535	1,246	1,144	-	45,925
Farm	12,494	1,213	1,305	-	15,012
Real estate - construction					
Homebuilder	1,947	-	-	-	1,947
Land	2,870	-	-	-	2,870
Commercial speculative	31,267	-	69	-	31,336
All other	56,286	894	328	-	57,508
Real estate - residential					
Investor	59,054	-	843	-	59,897
Multifamily	94,286	-	4,824	-	99,110
Owner occupied	118,320	566	4,935	-	123,821
Revolving and junior liens	113,379	-	1,963	-	115,342
Consumer	2,869	-	9	-	2,878
Other	11,937	-	-	-	11,937
Total	$ 1,486,585	$ 30,577	$ 22,485	$ -	$ 1,539,647

14

Table of Contents

December 31, 2016	Pass	Special Mention	Substandard 1	Doubtful	Total
Commercial	$ 214,028	$ 11,558	$ 2,527	$ -	$ 228,113
Leases	53,366	976	1,109		55,451
Real estate - commercial					
Owner occupied general purpose	135,503	53	1,680	-	137,236
Owner occupied special purpose	172,353	5,402	385	-	178,140
Non-owner occupied general purpose	229,448	913	1,930	-	232,291
Non-owner occupied special purpose	114,293	-	4,772	-	119,065
Retail Properties	52,207	1,267	1,179	-	54,653
Farm	11,840	1,240	1,782	-	14,862
Real estate - construction					
Homebuilder	3,883	-	-	-	3,883
Land	3,029	-	-	-	3,029
Commercial speculative	22,654	-	74	-	22,728
All other	34,696	-	384	-	35,080
Real estate - residential					
Investor	55,001	-	1,096	-	56,097
Multifamily	96,502	-	-	-	96,502
Owner occupied	115,831	570	7,225	-	123,626
Revolving and junior liens	99,286	-	2,340	-	101,626
Consumer	3,236	-	1	-	3,237
Other	13,165	25	-	-	13,190
Total	$ 1,430,321	$ 22,004	$ 26,484	$ -	$ 1,478,809

1 The substandard credit quality indicator includes both potential problem loans that are currently performing and nonperforming loans.

The Company had $991,000 and $1.8 million residential assets in the process of foreclosure as of June 30, 2017, and December 31, 2016, respectively. The Company also had $986,000 and $225,000 in residential real estate included in OREO as of June 30, 2017, and December 31, 2016, respectively.

Table of Contents

Impaired loans, which include nonaccrual loans and troubled debt restructurings, by class of loans for the June 30, 2017 periods listed were as follows:

	As of June 30, 2017			Six Months Ended June 30, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ 216	$ 368	$ -	$ 128	$ -
Leases	220	245	-	293	-
Commercial real estate					
Owner occupied general purpose	460	495	-	1,170	-
Owner occupied special purpose	366	510	-	376	-
Non-owner occupied general purpose	1,143	1,425	-	1,443	1
Non-owner occupied special purpose	-	-	-	507	-
Retail properties	1,144	1,209	-	1,161	-
Farm	-	-	-	-	-
Construction					
Homebuilder	-	-	-	-	-
Land	-	-	-	-	-
Commercial speculative	68	79	-	72	-
All other	152	156	-	180	-
Residential					
Investor	1,576	2,065	-	1,708	20
Multifamily	4,824	4,965	-	2,412	-
Owner occupied	8,209	9,543	-	9,016	65
Revolving and junior liens	1,971	2,211	-	2,227	15
Consumer	9	9	-	105	-
Total impaired loans with no recorded allowance	20,358	23,280	-	20,798	101
With an allowance recorded					
Commercial	-	-	-	-	-
Leases	240	240	98	120	-
Commercial real estate					
Owner occupied general purpose	-	-	-	-	-
Owner occupied special purpose	-	-	-	-	-
Non-owner occupied general purpose	-	-	-	123	-
Non-owner occupied special purpose	-	-	-	-	-
Retail properties	-	-	-	-	-
Farm	-	-	-	-	-
Construction					
Homebuilder	-	-	-	-	-
Land	-	-	-	-	-
Commercial speculative	-	-	-	-	-

All other	-	-	-	-	-
Residential					
Investor	-	-	-	-	-
Multifamily	-	-	-	-	-
Owner occupied	-	-	-	402	-
Revolving and junior liens	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired loans with a recorded allowance	240	240	98	645	-
Total impaired loans	$ 20,598	$ 23,520	$ 98	$ 21,443	$ 101

16

Table of Contents

Impaired loans by class of loans as of December 31, 2016, and for the six months ended June 30, 2016, were as follows:

	As of December 31, 2016			Six Months Ended June 30, 2016	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Commercial	$ 240	$ 388	$ -	$ 299	$ -
Leases	366	371	-	-	-
Commercial real estate					
Owner occupied general purpose	1,881	2,131	-	2,494	44
Owner occupied special purpose	385	518	-	650	-
Non-owner occupied general purpose	1,744	2,010	-	1,573	1
Non-owner occupied special purpose	1,013	1,649	-	-	-
Retail properties	1,179	1,235	-	1,017	-
Farm	-	-	-	636	-
Construction					
Homebuilder	-	-	-	-	-
Land	-	-	-	-	-
Commercial speculative	74	81	-	80	-
All other	207	221	-	-	-
Residential					
Investor	1,841	2,308	-	1,879	23
Multifamily	-	-	-	-	-
Owner occupied	9,824	11,391	-	10,124	79
Revolving and junior liens	2,484	3,018	-	2,673	6
Consumer	-	-	-	-	-
Total impaired loans with no recorded allowance	21,238	25,321	-	21,425	153
With an allowance recorded					
Commercial	-	-	-	1	-
Leases	-	-	-	-	-
Commercial real estate					
Owner occupied general purpose	-	-	-	-	-
Owner occupied special purpose	-	-	-	-	-
Non-owner occupied general purpose	246	595	246	306	-
Non-owner occupied special purpose	-	-	-	825	-
Retail properties	-	-	-	-	-
Farm	-	-	-	-	-
Construction					
Homebuilder	-	-	-	-	-
Land	-	-	-	-	-
Commercial speculative	-	-	-	-	-

All other	-	-	-	-	-
Residential					
Investor	-	-	-	-	-
Multifamily	-	-	-	-	-
Owner occupied	803	853	803	222	-
Revolving and junior liens	-	-	-	23	-
Consumer	-	-	-	-	-
Total impaired loans with a recorded allowance	1,049	1,448	1,049	1,377	-
Total impaired loans	$ 22,287	$ 26,769	$ 1,049	$ 22,802	$ 153

Troubled debt restructurings ("TDRs") are loans for which the contractual terms have been modified and both of these conditions exist: (1) there is a concession to the borrower and (2) the borrower is experiencing financial difficulties. Loans are restructured on a case-by-case basis during the loan collection process with modifications generally initiated at the request of the borrower. These modifications may include reduction in interest rates, extension of term, deferrals of principal, and other modifications. The Bank participates in the U.S. Department of the Treasury's (the "Treasury") Home Affordable Modification Program ("HAMP") which gives qualifying homeowners an opportunity to refinance into more affordable monthly payments.

Table of Contents

The specific allocation of the allowance for loan losses for all loans, including TDRs, is determined by either discounting the modified cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance (i.e., specific reserve) as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. The allowance for loan losses also includes an allowance based on a loss migration analysis for each loan category on loans that are not individually evaluated for specific impairment. All loans charged-off, including TDRs charged-off, are factored into this calculation by portfolio segment.

TDRs that were modified during the period are as follows:

	TDR Modifications Quarter Ended June 30, 2017			TDR Modifications Six Months Ended June 30, 2017		
	# of contracts	Pre-modification recorded investment	Post-modification recorded investment	# of contracts	Pre-modification recorded investment	Post-modification recorded investment
Troubled debt restructurings						
Real estate - residential						
Revolving and junior liens						
Other1	2	$ 155	$ 147	6	$ 399	$ 388
Total	2	$ 155	$ 147	6	$ 399	$ 388

	TDR Modifications Quarter Ended June 30, 2016			TDR Modifications Six Months Ended June 30, 2016		
	# of contracts	Pre-modification recorded investment	Post-modification recorded investment	# of contracts	Pre-modification recorded investment	Post-modification recorded investment
Troubled debt restructurings						
Real estate - commercial						
Other1	-	$ -	$ -	2	$ 312	$ 220
Real estate - residential						
Owner occupied HAMP2	-	-	-	1	239	237

Revolving and junior liens						
HAMP2	1	39	39	4	469	438
Total	1	$ 39	$ 39	7	$ 1,020	$ 895

1 Other: Change of terms from bankruptcy court

2 HAMP: Home Affordable Modification Program

TDRs are classified as being in default on a case-by-case basis when they fail to be in compliance with the modified terms. There was no TDR default activity for the six months ended June 30, 2017, and June 30, 2016, for loans that were restructured within the 12 month period prior to default.

Table of Contents

Note 5 – Allowance for Loan Losses

Changes in the allowance for loan losses by segment of loans based on method of impairment for three and six months ended June 30, 2017, were as follows:

Allowance for loan losses:	Commercial	Leases	Real Estate Commercial	Real Estate Construction	Real Estate Residential	Consumer	Other	Total
Three months ended June 30, 2017								
Beginning balance	$ 1,672	$ 603	$ 7,831	$ 978	$ 3,056	$ 764	$ 837	$ 15,741
Charge-offs	6	-	4	-	976	80	-	1,066
Recoveries	5	-	46	60	249	46	5	411
Provision (Release)	479	188	234	(181)	247	118	(335)	750
Ending balance	$ 2,150	$ 791	$ 8,107	$ 857	$ 2,576	$ 848	$ 507	$ 15,836
Six months ended June 30, 2017								
Beginning balance	$ 1,629	$ 633	$ 9,547					