SUMMIT FINANCIAL GROUP INC
Form 10-Q
August 04, 2016
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, 2016
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ___________ to __________.

Commission File Number 0-16587

Summit Financial Group, Inc.
(Exact name of registrant as specified in its charter)

West Virginia	55-0672148
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

300 North Main Street

Moorefield, West Virginia	26836
(Address of principal executive offices)	(Zip Code)

(304) 530-1000
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

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

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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ
Non-accelerated filer o	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock as of the latest practicable date.

Common Stock, $2.50 par value
10,692,320 shares outstanding as of July 31, 2016

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Consolidated Balance Sheets (unaudited)

Dollars in thousands	June 30, 2016 (unaudited)	December 31, 2015 (*)	June 30, 2015 (unaudited)
ASSETS			
Cash and due from banks	$4,161	$3,625	$3,988
Interest bearing deposits with other banks	8,897	5,862	9,274
Cash and cash equivalents	13,058	9,487	13,262
Securities available for sale	261,633	280,792	276,661
Other investments	12,233	8,949	8,583
Loans held for sale, net	245	779	—
Loans, net	1,166,723	1,079,331	1,064,472
Property held for sale	23,425	25,567	31,500
Premises and equipment, net	21,405	21,572	20,490
Accrued interest receivable	5,352	5,544	5,473
Intangible assets	7,398	7,498	7,598
Cash surrender value of life insurance policies	38,246	37,732	37,222
Other assets	15,463	15,178	14,708
Total assets	$1,565,181	$1,492,429	$1,479,969
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$120,845	$119,010	$113,256
Interest bearing	975,700	947,699	940,054
Total deposits	1,096,545	1,066,709	1,053,310
Short-term borrowings	205,553	171,394	174,599
Long-term borrowings	74,625	75,581	76,536
Subordinated debentures	—	—	2,500
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	18,200	15,412	13,363
Total liabilities	1,414,512	1,348,685	1,339,897
Commitments and Contingencies			
Shareholders' Equity			
Preferred stock, $1.00 par value, authorized 250,000 shares	—	—	—
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares; issued: 10,856,356 shares 2016, 10,853,566 shares December 2015 and 10,843,676 shares June 2015; outstanding: 10,692,320 shares 2016, 10,671,744 shares December 2015 and 10,843,676 shares June 2015	45,967	45,741	45,563
Unallocated common stock held by Employee Stock Ownership Plan - 2016 - 164,036 shares, December 2015 - 181,822 shares	(1,772)	(1,964)	—
Retained earnings	106,594	100,423	94,318
Accumulated other comprehensive income	(120)	(456)	191
Total shareholders' equity	150,669	143,744	140,072

Total liabilities and shareholders' equity	$ 1,565,181	$ 1,492,429	$ 1,479,969

(*) - December 31, 2015 financial information has been extracted from audited consolidated financial statements

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Consolidated Statements of Income (unaudited)

Dollars in thousands, except per share amounts	For the Three Months Ended June 30, 2016	2015	For the Six Months Ended June 30, 2016	2015
Interest income				
Interest and fees on loans				
Taxable	$13,488	$12,854	$26,779	$25,588
Tax-exempt	134	118	280	233
Interest and dividends on securities				
Taxable	1,063	1,092	2,146	2,368
Tax-exempt	594	593	1,236	1,211
Interest on interest bearing deposits with other banks	4	1	7	2
Total interest income	15,283	14,658	30,448	29,402
Interest expense				
Interest on deposits	2,154	2,074	4,324	4,145
Interest on short-term borrowings	419	126	659	238
Interest on long-term borrowings and subordinated debentures	976	1,000	1,952	2,041
Total interest expense	3,549	3,200	6,935	6,424
Net interest income	11,734	11,458	23,513	22,978
Provision for loan losses	250	500	500	750
Net interest income after provision for loan losses	11,484	10,958	23,013	22,228
Other income				
Insurance commissions	1,090	1,080	2,014	2,208
Service fees related to deposit accounts	1,059	1,072	2,038	2,048
Realized securities gains	383	170	775	650
Bank owned life insurance income	258	261	514	522
Other	255	277	511	571
Total other income	3,045	2,860	5,852	5,999
Other expense				
Salaries, commissions, and employee benefits	4,764	4,442	9,446	8,629
Net occupancy expense	512	489	1,051	988
Equipment expense	686	560	1,342	1,095
Professional fees	429	372	901	707
Amortization of intangibles	50	50	100	100
FDIC premiums	300	320	600	650
Merger expense	153	—	265	—
Foreclosed properties expense	93	158	217	366
(Gain) loss on sale of foreclosed properties	(276)	103	(282)	253
Write-down of foreclosed properties	259	160	369	732
Other	1,467	1,407	2,982	2,746
Total other expense	8,437	8,061	16,991	16,266
Income before income taxes	6,092	5,757	11,874	11,961
Income tax expense	1,849	1,747	3,569	3,667
Net Income	$4,243	$4,010	$8,305	$8,294
Basic earnings per common share	$0.40	$0.38	$0.78	$0.85
Diluted earnings per common share	$0.40	$0.38	$0.78	$0.78

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Consolidated Statement of Comprehensive Income (unaudited)

	For the Three Months Ended June 30,	
Dollars in thousands	2016	2015
Net income	$4,243	$4,010
Other comprehensive income (loss):		
Net unrealized gain (loss) on cashflow hedge of: 2016 - ($759), net of deferred taxes of ($281); 2015 - $379, net of deferred taxes of $140	(478)	239
Net unrealized gain (loss) on available for sale debt securities of: 2016 - $2,570, net of deferred taxes of $951 and reclassification adjustment for net realized gains included in net income of $383; 2015 - ($2,683), net of deferred taxes of ($993) and reclassification adjustment for net realized gains included in net income of $170	1,619	(1,690)
Total comprehensive income	$5,384	$2,559

	For the Six Months Ended June 30,	
Dollars in thousands	2016	2015
Net income	$8,305	$8,294
Other comprehensive income (loss):		
Net unrealized loss on cashflow hedge of: 2016 - ($3,079), net of deferred taxes of ($1,139); 2015 - ($1,030), net of deferred taxes of ($381)	(1,940)	(649)
Net unrealized gain (loss) on available for sale debt securities of: 2016 - $3,613, net of deferred taxes of $1,337 and reclassification adjustment for net realized gains included in net income of $775; 2015 - ($1,956), net of deferred taxes of ($724) and reclassification adjustment for net realized gains included in net income of $650	2,276	(1,232)
Total comprehensive income	$8,641	$6,413

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Consolidated Statements of Shareholders' Equity (unaudited)

Dollars in thousands, except per share amounts	Series 2009 Preferred Stock and Related Surplus	Series 2011 Preferred Stock and Related Surplus	Common Stock and Related Surplus	Unallocated Common Stock Held by ESOP	Retained Earnings	Accumulated Other Compre-hensive Income	Total Share-holders' Equity
Balance, December 31, 2015	$—	$—	$45,741	$ (1,964)	$100,423	$ (456)	$143,744
Six Months Ended June 30, 2016							
Comprehensive income:							
Net income	—	—	—	—	8,305	—	8,305
Other comprehensive income	—	—	—	—	—	336	336
Total comprehensive income							8,641
Stock compensation expense	—	—	100	—	—	—	100
Unallocated ESOP shares committed to be released - 17,786 shares	—	—	79	192	—	—	271
Common stock issuances from reinvested dividends	—	—	47	—	(47)	—	—
Common stock cash dividends declared ($0.20 per share)	—	—	—	—	(2,087)	—	(2,087)
Balance, June 30, 2016	$—	$—	$45,967	$ (1,772)	$106,594	$ (120)	$150,669
Balance, December 31, 2014	$3,419	$5,764	$32,670	$—	$87,719	$ 2,072	$131,644
Six Months Ended June 30, 2015							
Comprehensive income:							
Net income	—	—	—	—	8,294	—	8,294
Other comprehensive loss	—	—	—	—	—	(1,881)	(1,881)
Total comprehensive income							6,413
Stock compensation expense	—	—	50	—	—	—	50
Conversion of Series 2009 Preferred Stock to common stock	(3,419)	—	3,405	—	—	—	(14)
Conversion of Series 2011 Preferred Stock to common stock	—	(5,764)	5,749	—	—	—	(15)
Issuance of 496,335 shares of common stock	—	—	4,769	—	—	—	4,769
Repurchase and retirement of 100,000 shares of common stock	—	—	(1,080)	—	—	—	(1,080)
Common stock cash dividends declared ($0.16 per share)	—	—	—	—	(1,695)	—	(1,695)
Balance, June 30, 2015	$—	$—	$45,563	$—	$94,318	$ 191	$140,072

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Consolidated Statements of Cash Flows (unaudited)

Dollars in thousands	Six Months Ended June 30, 2016	June 30, 2015
Cash Flows from Operating Activities		
Net income	$8,305	$8,294
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	587	523
Provision for loan losses	500	750
Stock compensation expense	100	50
Deferred income tax expense (benefit)	(159)	360
Loans originated for sale	(3,727)	(1,417)
Proceeds from loans sold	4,260	1,944
Securities gains	(775)	(650)
(Gain) loss on disposal of assets	(312)	255
Write down of foreclosed properties	369	732
Amortization of securities premiums (accretion of discounts), net	2,210	2,603
Amortization of intangibles, net	106	106
Decrease in accrued interest receivable	193	365
Increase in cash surrender value of bank owned life insurance	(514)	(522)
Increase in other assets	(1,076)	(847)
Decrease in other liabilities	(1,274)	(296)
Net cash provided by operating activities	8,793	12,250
Cash Flows from Investing Activities		
Proceeds from maturities and calls of securities available for sale	55	615
Proceeds from sales of securities available for sale	52,052	40,593
Principal payments received on securities available for sale	17,946	20,380
Purchases of securities available for sale	(48,716)	(59,324)
Purchases of other investments	(9,531)	(6,072)
Proceeds from sales & redemptions of other investments	6,247	3,672
Net loans made to customers	(86,808)	(46,372)
Purchases of premises and equipment	(433)	(954)
Proceeds from disposal of premises and equipment	43	—
Proceeds from sales of other repossessed assets & property held for sale	2,973	6,482
Net cash (used in) investing activities	(66,172)	(40,980)
Cash Flows from Financing Activities		
Net increase (decrease) in demand deposit, NOW and savings accounts	31,169	(9,902)
Net increase (decrease) in time deposits	(1,333)	1,869
Net increase in short-term borrowings	34,158	50,966
Repayment of long-term borrowings	(956)	(954)
Repayment of subordinated debt	—	(14,300)
Net proceeds from issuance of common stock	—	4,741
Retirement of common stock	—	(1,080)
Dividends paid on common stock	(2,088)	(1,667)
Dividends paid on preferred stock	—	(191)
Net cash provided by financing activities	60,950	29,482
Increase in cash and cash equivalents	3,571	752
Cash and cash equivalents:		

Beginning	9,487	12,510
Ending	$13,058	$13,262

(Continued)

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Consolidated Statements of Cash Flows (unaudited) - continued

Dollars in thousands	Six Months Ended June 30, 2016	June 30, 2015
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$6,999	$ 6,456
Income taxes	$3,814	$ 3,632
Supplemental Schedule of Noncash Investing and Financing Activities		
Real property and other assets acquired in settlement of loans	$172	$ 713

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NOTE 1. BASIS OF PRESENTATION

We, Summit Financial Group, Inc. and subsidiaries, prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for annual year end financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature.

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates.

The results of operations for the quarter and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2015 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2015 and June 30, 2015, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 was effective for us January 1, 2016, and did not have a significant impact on our financial statements.

ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs specifies that debt issuance costs related to a recognized liability are to be reported 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. ASU 2015-03 was effective for us January 1, 2016 and did not have a material impact on our financial statements.

The guidance of ASU No. 2015-03 did not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance for debt issuance costs related to line-of-credit arrangements within the update, in ASU 2015-15, Interest—Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting), issued in August 2015, the SEC staff stated that they would not object to any entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.

ASU 2015-16, Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments requires that adjustments to provisional amounts that are identified during the measurement period of a business combination be recognized in the reporting period in which the adjustment amounts are determined. Furthermore, the income statement effects of such adjustments, if any, must be calculated as if the accounting had been completed at the acquisition date reflecting the portion of the amount recorded in current-period earnings that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. Under previous guidance, adjustments to provisional amounts identified during the measurement period are to be recognized retrospectively. ASU 2015-16 became effective for us on January 1, 2016 and did not have a significant impact on our financial statements.

ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to

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be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2016-02, Leases (Topic 842) will, among other things, require lessees to recognize a lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, Revenue from Contracts with Customers. ASU 2016-02 will be effective for us on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the potential impact of ASU 2016-02 on our financial statements.

ASU 2016-05, Derivatives and Hedging (Topic 815) Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships, clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under ASC Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU 2016-05 will be effective for us on January 1, 2017 and is not expected to have a significant impact on our financial statements.

ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, requires that all excess tax benefits and tax deficiencies related to share-based payment awards be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective on January 1, 2017 and is not expected to have a significant impact on our financial statements.

ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective on January 1, 2020. We are currently evaluating the potential impact of ASU 2016-13 on our financial statements.

NOTE 3. FAIR VALUE MEASUREMENTS

ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Accordingly, securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record other assets at fair value on a nonrecurring basis, such as loans held for sale, and impaired loans held for investment. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

Derivative Financial Instruments: Derivative financial instruments are recorded at fair value on a recurring basis. Fair value measurement is based on pricing models run by a third-party, utilizing observable market-based inputs. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. As a result, we classify interest rate swaps as Level 2.

Loans Held for Sale: Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, we classify loans subject to nonrecurring fair value adjustments as Level 2.

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the original contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Accounting by Creditors for Impairment of a Loan. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the discounted cash flows or collateral value exceeds the recorded investments in such loans. These loans are carried at recorded loan investment, and therefore are not included in the following tables of loans measured at fair value. Impaired loans internally graded as substandard, doubtful, or loss are evaluated using the fair value of collateral method. All other impaired loans are measured for impairment using the discounted cash flows method. In accordance with ASC Topic 310, impaired loans where an allowance is established based on the fair value of collateral requires classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

When impaired loans are deemed required to be included in the fair value hierarchy, management immediately begins the process of evaluating the estimated fair value of the underlying collateral to determine if a related specific allowance for loan losses or charge-off is necessary. Current appraisals are ordered once a loan is deemed impaired if the existing appraisal is more than twelve months old, or more frequently if there is known deterioration in value. For recently identified impaired loans, a current appraisal may not be available at the financial statement date. Until the current appraisal is obtained, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the loan's underlying collateral since the date of the original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar collateral within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends. When a new appraisal is received (which generally are received within 3 months of a loan being identified as impaired), management then re-evaluates the fair value of the collateral and adjusts any specific allocated allowance for loan losses, as appropriate. In addition, management also assigns a discount of 7–10% for the estimated costs to sell the collateral.

Foreclosed properties: Foreclosed properties consists of real estate acquired in foreclosure or other settlement of loans. Such assets are carried on the balance sheet at the lower of the investment in the real estate or its fair value less estimated selling costs. The fair value of foreclosed properties is determined on a nonrecurring basis generally utilizing current appraisals performed by an independent, licensed appraiser applying an income or market value approach using observable market data (Level 2). Updated appraisals of foreclosed properties are generally obtained if the existing appraisal is more than 18 months old or more frequently if there is a known deterioration in value. However, if a current appraisal is not available, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the real estate since the date of its original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar property within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends (Level 3). Upon foreclosure, any fair value adjustment is charged against the allowance for loan losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest expense in the consolidated statements of income.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

Dollars in thousands	Balance at June 30, 2016	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$17,885	$—	$17,885	$—
Mortgage backed securities:				
Government sponsored agencies	139,365	—	139,365	—
Nongovernment sponsored entities	6,285	—	6,285	—
State and political subdivisions	250	—	250	—
Corporate debt securities	19,528	—	8,276	11,252
Other equity securities	77	—	77	—
Tax-exempt state and political subdivisions	78,243	—	78,243	—
Total available for sale securities	$261,633	$—	$250,381	$11,252
Derivative financial liabilities				
Interest rate swaps	$9,408	$—	$9,408	$—

Dollars in thousands	Balance at December 31, 2015	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$ 21,475	$—	$21,475	$—
Mortgage backed securities:				
Government sponsored agencies	146,734	—	146,734	—
Nongovernment sponsored entities	7,885	—	7,885	—
State and political subdivisions	1,953	—	1,953	—
Corporate debt securities	14,226	—	8,367	5,859
Other equity securities	77	—	77	—
Tax-exempt state and political subdivisions	88,442	—	88,442	—
Total available for sale securities	$ 280,792	$—	$274,933	$5,859

Derivative financial liabilities				
Interest rate swaps	$ 5,072	$—	$5,072	$—

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

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Dollars in thousands	Balance at June 30, 2016	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$245	$—	$245	$—
Collateral-dependent impaired loans				
Commercial	$—	$—	$—	$—
Commercial real estate	400	—	400	—
Construction and development	1,013	—	1,013	—
Residential real estate	121	—	121	—
Total collateral-dependent impaired loans	$1,534	$—	$1,534	$—
Foreclosed properties				
Commercial real estate	$976	$—	$552	$424
Construction and development	20,267	—	19,546	721
Residential real estate	340	—	340	—
Total foreclosed properties	$21,583	$—	$20,438	$1,145

Dollars in thousands	Balance at December 31, 2015	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ 779	$—	$779	$—
Collateral-dependent impaired loans				
Commercial	$ —	—	$—	$—
Commercial real estate	627	—	—	627
Construction and development	1,054	—	—	1,054
Residential real estate	279	—	279	—
Total collateral-dependent impaired loans	$ 1,960	$—	$279	$1,681
Foreclosed properties				
Commercial real estate	$ 1,103	$—	$1,103	$—
Construction and development	18,477	—	18,419	58
Residential real estate	314	—	314	—
Total foreclosed properties	$ 19,894	$—	$19,836	$58

ASC Topic 825, Financial Instruments, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The following summarizes the methods and significant assumptions we used in estimating our fair value disclosures for financial instruments.

Cash and cash equivalents: The carrying values of cash and cash equivalents approximate their estimated fair value.

Interest bearing deposits with other banks: The carrying values of interest bearing deposits with other banks approximate their estimated fair values.

Federal funds sold: The carrying values of Federal funds sold approximate their estimated fair values.

Securities: Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

Loans held for sale: The carrying values of loans held for sale approximate their estimated fair values.

Loans: The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

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Accrued interest receivable and payable: The carrying values of accrued interest receivable and payable approximate their estimated fair values.

Deposits: The estimated fair values of demand deposits (i.e. non-interest bearing checking, NOW, money market and savings accounts) and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

Short-term borrowings: The carrying values of short-term borrowings approximate their estimated fair values.

Long-term borrowings: The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.

Subordinated debentures: The carrying values of subordinated debentures approximate their estimated fair values.

Subordinated debentures owed to unconsolidated subsidiary trusts: The carrying values of subordinated debentures owed to unconsolidated subsidiary trusts approximate their estimated fair values.

Derivative financial instruments: The fair value of the interest rate swaps is valued using independent pricing models.

Off-balance sheet instruments: The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counter parties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below.

The carrying values and estimated fair values of our financial instruments are summarized below:

	June 30, 2016		December 31, 2015	
Dollars in thousands	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$13,058	$13,058	$9,487	$9,487
Securities available for sale	261,633	261,633	280,792	280,792
Other investments	12,233	12,233	8,949	8,949
Loans held for sale, net	245	245	779	779
Loans, net	1,166,723	1,177,526	1,079,331	1,084,955
Accrued interest receivable	5,352	5,352	5,544	5,544
	$1,459,244	$1,470,047	$1,384,882	$1,390,506
Financial liabilities				
Deposits	$1,096,545	$1,108,899	$1,066,709	$1,077,510
Short-term borrowings	205,553	205,553	171,394	171,394
Long-term borrowings	74,625	78,896	75,581	80,506
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	762	762	826	826
Derivative financial liabilities	9,408	9,408	5,072	5,072
	$1,406,482	$1,423,107	$1,339,171	$1,354,897

NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

	For the Three Months Ended June 30,					
	2016			2015		
Dollars in thousands, except per share amounts	Income (Numerator)	Common Shares (Denominator)	Per Share	Income (Numerator)	Common Shares (Denominator)	Per Share
Net income	$4,243			$4,010		
Basic EPS	$4,243	10,681,995	$0.40	$4,010	10,667,892	$0.38
Effect of dilutive securities:						
Stock options		9,008			8,582	
Stock appreciation rights		10,014			—	
Diluted EPS	$4,243	10,701,017	$0.40	$4,010	10,676,474	$0.38

	For the Six Months Ended June 30,					
	2016			2015		
Dollars in thousands, except per share amounts	Income (Numerator)	Common Shares (Denominator)	Per Share	Income (Numerator)	Common Shares (Denominator)	Per Share
Net income	$8,305			$8,294		
Basic EPS	$8,305	10,676,925	$0.78	$8,294	9,747,042	$0.85
Effect of dilutive securities:						
Stock options		8,365			8,574	
Stock appreciation rights		—			—	
Series 2011 convertible preferred stock	—	—		—	575,953	
Series 2009 convertible preferred stock	—	—		—	253,842	
Diluted EPS	$8,305	10,685,290	$0.78	$8,294	10,585,411	$0.78

Stock option and stock appreciation right (SAR) grants and the convertible preferred shares are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options at June 30, 2016 and 2015 totaled 57,000 shares and 136,900 shares, respectively, and our anti-dilutive SARs for the six months ended June 30, 2016 and both the three and six months ended June 30, 2015 were 166,717.

NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at June 30, 2016, December 31, 2015, and June 30, 2015 are summarized as follows:

	June 30, 2016			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	$16,815	$1,123	$ 53	$17,885
Residential mortgage-backed securities:				
Government-sponsored agencies	136,821	2,862	318	139,365
Nongovernment-sponsored entities	6,265	61	41	6,285
State and political subdivisions				
Water and sewer revenues	250	—	—	250
Corporate debt securities	19,928	60	460	19,528
Total taxable debt securities	180,079	4,106	872	183,313
Tax-exempt debt securities				
State and political subdivisions				
General obligations	41,282	2,788	4	44,066
Water and sewer revenues	7,535	360	—	7,895
Lease revenues	6,267	458	—	6,725
Sales tax revenues	2,889	182	—	3,071
Other revenues	15,542	944	—	16,486
Total tax-exempt debt securities	73,515	4,732	4	78,243
Equity securities	77	—	—	77
Total available for sale securities	$253,671	$8,838	$ 876	$261,633

	December 31, 2015			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	$20,461	$1,063	$49	$21,475
Residential mortgage-backed securities:				
Government-sponsored agencies	145,586	1,943	795	146,734
Nongovernment-sponsored entities	7,836	82	33	7,885
State and political subdivisions				
Water and sewer revenues	250	—	—	250
Other revenues	1,729	—	26	1,703
Corporate debt securities	14,494	—	268	14,226
Total taxable debt securities	190,356	3,088	1,171	192,273
Tax-exempt debt securities				
State and political subdivisions				
General obligations	52,490	1,767	41	54,216
Water and sewer revenues	7,614	172	—	7,786
Lease revenues	8,671	187	1	8,857
Special tax revenues	4,532	72	—	4,604
Other revenues	12,703	290	14	12,979

Total tax-exempt debt securities	86,010	2,488	56	88,442
Equity securities	77	—	—	77
Total available for sale securities	$276,443	$5,576	$1,227	$280,792

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Dollars in thousands	June 30, 2015 Amortized Cost	Unrealized Gains	Losses	Estimated Fair Value
Available for Sale				
Taxable debt securities:				
U.S. Government and agencies and corporations	$24,336	$1,093	$40	$25,389
Residential mortgage-backed securities:				
Government-sponsored agencies	150,675	3,005	737	152,943
Nongovernment-sponsored agencies	9,880	116	34	9,962
State and political subdivisions:				
Water and sewer revenues	500	3	—	503
Lottery/casino revenues	1,218	—	37	1,181
Corporate debt securities	11,896	—	90	11,806
Total taxable debt securities	198,505	4,217	938	201,784
Tax-exempt debt securities:				
State and political subdivisions:				
General obligations	49,067	1,463	586	49,944
Water and sewer revenues	7,982	52	33	8,001
Special tax revenues	4,548	30	72	4,506
Lottery/casino revenues	3,576	58	74	3,560
Other revenues	8,729	162	32	8,859
Total tax-exempt debt securities	73,902	1,765	797	74,870
Equity securities	7	—	—	7
Total available for sale securities	$272,414	$5,982	$1,735	$276,661

The below information is relative to the five states where issuers with the highest volume of state and political subdivision securities held in our portfolio are located. We own no such securities of any single issuer which we deem to be a concentration.

Dollars in thousands	June 30, 2016 Amortized Cost	Unrealized Gains	Losses	Estimated Fair Value
Illinois	$12,925	$ 781	$ 4	$ 13,702
Michigan	11,216	609	—	11,825
West Virginia	8,732	213	—	8,945
Texas	6,132	461	—	6,593
Indiana	4,724	361	—	5,085

Management performs pre-purchase and ongoing analysis to confirm that all investment securities meet applicable credit quality standards. Prior to July 1, 2013, we principally used credit ratings from Nationally Recognized Statistical Rating Organizations (“NRSROs”) to support analyses of our portfolio of securities issued by state and political subdivisions, as we generally do not purchase securities that are rated below the six highest NRSRO rating categories. Beginning July 1, 2013, in addition to considering a security’s NRSRO rating, we now also assess or confirm through an internal review of an issuer’s financial information and other applicable information that: 1) the issuer’s risk of default is low; 2) the characteristics of the issuer’s demographics and economic environment are satisfactory; and 3) the issuer’s budgetary position and stability of tax or other revenue sources are sound.

The maturities, amortized cost and estimated fair values of securities at June 30, 2016, are summarized as follows:

Dollars in thousands	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 56,757	$ 57,762
Due from one to five years	91,359	93,272
Due from five to ten years	16,653	17,304
Due after ten years	88,825	93,218
Equity securities	77	77
	$ 253,671	$ 261,633

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The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the six months ended June 30, 2016 are as follows:

	Proceeds from			Gross realized	
Dollars in thousands	Sales	Calls and Maturities	Principal Payments	Gains	Losses
Securities available for sale	$52,052	$ 55	$ 17,946	$950	$ 175

We held 38 available for sale securities having an unrealized loss at June 30, 2016. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no other-than-temporary impairment charge to earnings is warranted at this time.

Provided below is a summary of securities available for sale which were in an unrealized loss position at June 30, 2016 and December 31, 2015.

	June 30, 2016					
	Less than 12 months		12 months or more		Total	
Dollars in thousands	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U.S. Government agencies and corporations	$878	$ (5)	$2,911	$ (48)	$3,789	$ (53)
Residential mortgage-backed securities:						
Government-sponsored agencies	17,694	(206)	11,424	(112)	29,118	(318)
Nongovernment-sponsored entities	—	—	3,723	(41)	3,723	(41)
Corporate debt securities	4,082	(184)	3,134	(276)	7,216	(460)
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	1,128	(4)	—	—	1,128	(4)
Total temporarily impaired securities	23,782	(399)	21,192	(477)	44,974	(876)
Total other-than-temporarily impaired securities	—	—	—	—	—	—
Total	$23,782	$ (399)	$21,192	$ (477)	$44,974	$ (876)

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Dollars in thousands	December 31, 2015 Less than 12 months Estimated Fair Value	Unrealized Loss	12 months or more Estimated Fair Value	Unrealized Loss	Total Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U.S. Government agencies and corporations	$2,104	$ (2)	$3,151	$ (47)	$5,255	$ (49)
Residential mortgage-backed securities:						
Government-sponsored agencies	52,970	(569)	8,672	(226)	61,642	(795)
Nongovernment-sponsored entities	2,298	—	2,819	(33)	5,117	(33)
State and political subdivisions:						
Other revenues	1,702	(26)	—	—	1,702	(26)
Corporate debt securities	8,367	(268)	—	—	8,367	(268)
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	5,977	(41)	—	—	5,977	(41)
Lease revenues	576	(1)	—	—	576	(1)
Other revenues	1,218	(14)	—	—	1,218	(14)
Total temporarily impaired securities	75,212	(921)	14,642	(306)	89,854	(1,227)
Total other-than-temporarily impaired securities	—	—	—	—	—	—
Total	$75,212	$ (921)	$14,642	$ (306)	$89,854	$ (1,227)

NOTE 6. LOANS

Loans are generally stated at the amount of unpaid principal, reduced by unearned discount and allowance for loan losses. Interest on loans is accrued daily on the outstanding balances. Loan origination fees and certain direct loan origination costs are deferred and amortized as adjustments of the related loan yield over its contractual life. We categorize residential real estate loans in excess of $600,000 as jumbo loans.

Generally, loans are placed on nonaccrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms. Interest is accrued daily on impaired loans unless the loan is placed on nonaccrual status. Impaired loans are placed on nonaccrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on nonaccrual loans is recognized primarily using the cost-recovery method. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan or, if applicable, the terms of the restructured loans.

Commercial-related loans or portions thereof (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination is made on a case by case basis considering many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower’s equity. We deem a loss confirmed when a loan or a portion of a loan is classified “loss” in accordance with bank regulatory classification guidelines, which state, “Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted”.

Consumer-related loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), which ever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Loans are summarized as follows:

Dollars in thousands	June 30, 2016	December 31, 2015	June 30, 2015
Commercial	$101,521	$ 97,201	$97,284
Commercial real estate			
Owner-occupied	190,534	203,555	191,743
Non-owner occupied	348,099	337,294	331,056
Construction and development			
Land and land development	65,702	65,500	64,435
Construction	8,506	9,970	18,214
Residential real estate			
Non-jumbo	225,919	221,750	220,199
Jumbo	52,105	50,313	49,203
Home equity	75,904	74,300	72,504
Mortgage warehouse lines	80,282	—	—
Consumer	19,520	19,251	18,683
Other	10,008	11,669	12,423
Total loans, net of unearned fees	1,178,100	1,090,803	1,075,744
Less allowance for loan losses	11,377	11,472	11,272
Loans, net	$1,166,723	$ 1,079,331	$1,064,472

The following table presents the contractual aging of the recorded investment in past due loans by class as of June 30, 2016 and 2015 and December 31, 2015.

	At June 30, 2016					
	Past Due					> 90 days
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	and Accruing
Commercial	$318	$107	$211	$636	$100,885	$ —
Commercial real estate						
Owner-occupied	157	—	1,278	1,435	189,099	—
Non-owner occupied	180	14	—	194	347,905	—
Construction and development						
Land and land development	45	475	4,748	5,268	60,434	—
Construction	—	—	—	—	8,506	—
Residential mortgage						
Non-jumbo	3,978	950	2,466	7,394	218,525	—
Jumbo	—	—	—	—	52,105	—
Home equity	—	77	447	524	75,380	—
Mortgage warehouse lines	—	—	—	—	80,282	—
Consumer	145	52	84	281	19,239	—
Other	—	—	—	—	10,008	—
Total	$4,823	$1,675	$9,234	$15,732	$1,162,368	$ —

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	At December 31, 2015					
	Past Due					> 90 days
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	and Accruing
Commercial	$345	$26	$632	$1,003	$96,198	$ —
Commercial real estate						
Owner-occupied	158	386	437	981	202,574	—
Non-owner occupied	1	—	856	857	336,437	—
Construction and development						
Land and land development	1,182	194	4,547	5,923	59,577	—
Construction	—	—	—	—	9,970	—
Residential mortgage						
Non-jumbo	2,276	2,647	1,591	6,514	215,236	—
Jumbo	—	—	—	—	50,313	—
Home equity	374	172	100	646	73,654	—
Consumer	155	41	92	288	18,963	9
Other	—	—	—	—	11,669	—
Total	$4,491	$3,466	$8,255	$16,212	$1,074,591	$ 9

	At June 30, 2015					
	Past Due					> 90 days
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	and Accruing
Commercial	$344	$—	$661	$1,005	$96,279	$ —
Commercial real estate						
Owner-occupied	118	—	630	748	190,995	—
Non-owner occupied	320	5,629	309	6,258	324,798	—
Construction and development						
Land and land development	—	21	5,228	5,249	59,186	—
Construction	—	—	—	—	18,214	—
Residential mortgage						
Non-jumbo	2,263	1,335	2,137	5,735	214,464	—
Jumbo	—	1,111	724	1,835	47,368	—
Home equity	171	195	37	403	72,101	—
Consumer	204	27	42	273	18,410	8
Other	—	—	—	—	12,423	—
Total	$3,420	$8,318	$9,768	$21,506	$1,054,238	$ 8

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at June 30, 2016, December 31, 2015 and June 30, 2015.

	June 30,		December 31,
Dollars in thousands	2016	2015	2015
Commercial	$399	$1,065	$ 853
Commercial real estate			
Owner-occupied	1,278	880	437
Non-owner occupied	4,495	1,541	5,518
Construction and development			
Land & land development	5,400	5,627	5,623
Construction	—	—	—

Residential mortgage			
Non-jumbo	2,937	3,501	2,987
Jumbo	—	724	—
Home equity	594	208	258
Mortgage warehouse lines	—	—	—
Consumer	91	37	83
Total	$15,194	$13,583	$ 15,759

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Impaired loans: Impaired loans include the following:

Loans which we risk-rate (consisting of loan relationships having aggregate balances in excess of $2.5 million, or loans exceeding $500,000 and exhibiting credit weakness) through our normal loan review procedures and which, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Risk-rated loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired.

Loans that have been modified in a troubled debt restructuring.

Both commercial and consumer loans are deemed impaired upon being contractually modified in a troubled debt restructuring. Troubled debt restructurings typically result from our loss mitigation activities and occur when we grant a concession to a borrower who is experiencing financial difficulty in order to minimize our economic loss and to avoid foreclosure or repossession of collateral. Once restructured in a troubled debt restructuring, a loan is generally considered impaired until its maturity, regardless of whether the borrower performs under the modified terms. Although such a loan may be returned to accrual status if the criteria set forth in our accounting policy are met, the loan would continue to be evaluated for an asset-specific allowance for loan losses and we would continue to report the loan in the impaired loan table below.

The table below sets forth information about our impaired loans.

Method Used to Measure Impairment of Impaired Loans
Dollars in thousands

	June 30,		December 31,	Method used to measure impairment
Loan Category	2016	2015	2015	
Commercial	$655	$41	$ 41	Fair value of collateral
	162	302	201	Discounted cash flow
Commercial real estate				
Owner-occupied	1,103	5,654	783	Fair value of collateral
	7,084	9,015	7,616	Discounted cash flow
Non-owner occupied	4,691	1,607	5,728	Fair value of collateral
	7,638	6,140	7,722	Discounted cash flow
Construction and development				
Land & land development	6,373	9,002	6,597	Fair value of collateral
	2,145	2,270	2,177	Discounted cash flow
Residential mortgage				
Non-jumbo	1,735	1,791	1,753	Fair value of collateral
	4,477	4,475	4,378	Discounted cash flow
Jumbo	3,711	5,655	3,869	Fair value of collateral
	864	880	871	Discounted cash flow
Home equity	186	186	186	Fair value of collateral
	523	523	523	Discounted cash flow
Consumer	1	—	—	Fair value of collateral
	52	75	68	Discounted cash flow
Total	$41,400	$47,616	$ 42,513	

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The following tables present loans individually evaluated for impairment at June 30, 2016, December 31, 2015 and June 30, 2015.

	June 30, 2016				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$798	$798	$ —	$199	$ 9
Commercial real estate					
Owner-occupied	5,305	5,305	—	5,375	208
Non-owner occupied	10,469	10,470	—	10,912	297
Construction and development					
Land & land development	7,364	7,365	—	7,408	162
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,866	3,880	—	3,780	169
Jumbo	3,713	3,711	—	3,725	177
Home equity	709	709	—	709	21
Mortgage warehouse lines	—	—	—	—	—
Consumer	53	53	—	57	5
Total without a related allowance	$32,277	$32,291	$ —	$32,165	$ 1,048
With a related allowance					
Commercial	$19	$19	$ 19	$—	$ —
Commercial real estate					
Owner-occupied	2,882	2,882	13	2,906	112
Non-owner occupied	1,859	1,859	144	1,850	72
Construction and development					
Land & land development	1,153	1,153	141	1,152	—
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,331	2,332	179	2,335	112
Jumbo	864	864	28	866	43
Home equity	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$9,108	$9,109	$ 524	$9,109	$ 339
Total					
Commercial	$29,849	$29,851	$ 317	$29,802	$ 860
Residential real estate	11,483	11,496	207	11,415	522
Consumer	53	53	—	57	5
Total	$41,385	$41,400	$ 524	$41,274	$ 1,387

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Dollars in thousands	December 31, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$242	$242	$ —	$319	$ 17
Commercial real estate					
Owner-occupied	5,401	5,402	—	5,438	191
Non-owner occupied	10,740	10,741	—	9,982	310
Construction and development					
Land & land development	7,635	7,635	—	9,497	263
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,590	3,600	—	3,316	160
Jumbo	3,871	3,869	—	4,412	181
Home equity	709	709	—	709	32
Consumer	68	68	—	72	6
Total without a related allowance	$32,256	$32,266	$ —	$33,745	$ 1,160
With a related allowance					
Commercial	$—	$—	$ —	$—	$ —
Commercial real estate					
Owner-occupied	2,997	2,997	45	3,003	135
Non-owner occupied	2,709	2,709	386	2,728	72
Construction and development					
Land & land development	1,139	1,139	85	1,154	—
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,530	2,531	226	2,552	114
Jumbo	871	871	34	878	43
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$10,246	$10,247	$ 776	$10,315	$ 364
Total					
Commercial	$30,863	$30,865	$ 516	$32,121	$ 988
Residential real estate	11,571	11,580	260	11,867	530
Consumer	68	68	—	72	6
Total	$42,502	$42,513	$ 776	$44,060	$ 1,524

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Dollars in thousands	June 30, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$343	$343	$ —	$362	$ 42
Commercial real estate					
Owner-occupied	10,101	10,100	—	8,156	598
Non-owner occupied	6,938	6,940	—	6,333	566
Construction and development					
Land & land development	11,139	11,139	—	11,916	672
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,307	3,316	—	3,345	318
Jumbo	4,933	4,931	—	7,472	474
Home equity	710	709	—	709	61
Consumer	74	75	—	77	14
Total without a related allowance	$37,545	$37,553	$ —	$38,370	$ 2,745
With a related allowance					
Commercial	$—	$—	$ —	$—	$ —
Commercial real estate					
Owner-occupied	4,569	4,569	232	4,577	378
Non-owner occupied	806	807	64	799	55
Construction and development					
Land & land development	133	133	133	534	63
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,948	2,950	331	2,959	239
Jumbo	1,600	1,604	71	1,600	89
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$10,056	$10,063	$ 831	$10,469	$ 824
Total					
Commercial	$34,029	$34,031	$ 429	$32,677	$ 2,374
Residential real estate	13,498	13,510	402	16,085	1,181
Consumer	74	75	—	77	14
Total	$47,601	$47,616	$ 831	$48,839	$ 3,569

A modification of a loan is considered a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of both. A loan continues to be classified as a TDR for the life of the loan. Included in impaired loans are TDRs of $29.9 million, of which $28.6 million were current with respect to restructured contractual payments at June 30, 2016, and $30.5 million, of which $28.9 million were current with respect to restructured contractual payments at December 31, 2015. There were no commitments to lend additional funds under these restructurings at either balance sheet date.

The following table presents by class the TDRs that were restructured during the three and six months ended June 30, 2016, there were no loans restructured during the three and six months ended June 30, 2015 . Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

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Dollars in thousands	For the Three Months Ended June 30, 2016 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment	For the Six Months Ended June 30, 2016 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment
Commercial	—	$ —	$ —	—	$ —	$ —
Commercial real estate						
Owner-occupied	—	—	—	—	—	—
Non-owner occupied	—	—	—	—	—	—
Construction and development						
Land & land development	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Residential real estate						
Non-jumbo	2	145	145	3	395	395
Jumbo	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—	—
Consumer	1	2	2	1	2	2
Total	3	$ 147	$ 147	4	$ 397	$ 397

The following table presents defaults during the stated period of TDRs that were restructured during the past twelve months. For purposes of these tables, a default is considered as either the loan was past due 30 days or more at any time during the period, or the loan was fully or partially charged off during the period.

Dollars in thousands	For the Three Months Ended June 30, 2016 Number of Defaults	Recorded Investment at Default Date	For the Six Months Ended June 30, 2016 Number of Defaults	Recorded Investment at Default Date
Commercial	—	$ —	—	$ —
Commercial real estate				
Owner-occupied	—	—	—	—
Non-owner occupied	—	—	—	—
Construction and development				
Land & land development	1	1,182	1	1,182
Construction	—	—	—	—
Residential real estate				
Non-jumbo	2	145	2	145
Jumbo	—	—	—	—
Home equity	—	—	—	—
Mortgage warehouse lines	—	—	—	—
Consumer	1	2	1	2
Total	4	$ 1,329	4	$ 1,329

The following table details the activity regarding TDRs by loan type for the three months and six months ended June 30, 2016, and the related allowance on TDRs.

For the Three Months Ended June 30, 2016

	Construction & Land Development			Commercial Real Estate		Residential Real Estate						
Dollars in thousands	Land & Land Develop-ment	Construc-tion	Commer-cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con-sumer	Other	Total
Troubled debt restructurings												
Balance April 1, 2016	$ 3,997	$ —	$ 200	$ 9,282	$ 6,014	$ 5,664	$ 4,607	$ 523	$ —	$ 62	$ —	$ 30,349
Additions	—	—	—	—	—	145	—	—	—	1	—	146
Charge-offs	—	—	—	(127)	—	—	—	—	—	—	—	(127)
Net (paydowns) advances	(41)	—	(2)	(37)	(13)	(352)	(32)	—	—	(9)	—	(486)
Transfer into foreclosed properties	—	—	—	—	—	—	—	—	—	—	—	—
Refinance out of TDR status	—	—	—	—	—	—	—	—	—	—	—	—
Balance, June 30, 2016	$ 3,956	$ —	$ 198	$ 9,118	$ 6,001	$ 5,457	$ 4,575	$ 523	$ —	$ 54	$ —	$ 29,882
Allowance related to troubled debt restructurings	$ —	$ —	$ —	$ 149	$ 7	$ 179	$ 28	$ —	$ —	$ —	$ —	$ 363

For the Six Months Ended June 30, 2016

	Construction & Land Development			Commercial Real Estate		Residential Real Estate						
Dollars in thousands	Land & Land Develop-ment	Construc-tion	Commer-cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con-sumer	Other	Total
Troubled debt restructurings												
Balance January 1, 2016	$ 4,188	$ —	$ 242	$ 9,314	$ 6,059	$ 5,496	$ 4,634	$ 523	$ —	$ 68	$ —	$ 30,524
Additions	—	—	—	—	—	395	—	—	—	1	—	396
Charge-offs	—	—	—	(127)	—	(52)	—	—	—	—	—	(179)
Net (paydowns) advances	(232)	—	(44)	(69)	(58)	(382)	(59)	—	—	(15)	—	(859)
Transfer into foreclosed properties	—	—	—	—	—	—	—	—	—	—	—	—
Refinance out of TDR status	—	—	—	—	—	—	—	—	—	—	—	—
Balance, June 30, 2016	$ 3,956	$ —	$ 198	$ 9,118	$ 6,001	$ 5,457	$ 4,575	$ 523	$ —	$ 54	$ —	$ 29,882
	$ —	$ —	$ —	$ 149	$ 7	$ 179	$ 28	$ —	$ —	$ —	$ —	$ 363

Allowance related to
troubled debt
restructurings

We categorize loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We analyze loans individually by classifying the loans as to credit risk. We internally grade all commercial loans at the time of loan origination. In addition, we perform an annual loan review on all non-homogenous commercial loan relationships with an aggregate exposure of $2.5 million, at which time these loans are re-graded.

We use the following definitions for our risk grades:

Pass: Loans graded as Pass are loans to borrowers of acceptable credit quality and risk. They are higher quality loans that do not fit any of the other categories described below.

OLEM (Special Mention): Commercial loans categorized as OLEM are potentially weak. The credit risk may be relatively minor yet represent a risk given certain specific circumstances. If the potential weaknesses are not monitored or mitigated, the asset may weaken or inadequately protect our position in the future.

Substandard: Commercial loans categorized as Substandard are inadequately protected by the borrower’s ability to repay, equity, and/or the collateral pledged to secure the loan. These loans have identified weaknesses that could hinder normal repayment or collection of the debt. These loans are characterized by the distinct possibility that we will sustain some loss if the identified weaknesses are not mitigated.

Doubtful: Commercial loans categorized as Doubtful have all the weaknesses inherent in those loans classified as Substandard, with the added elements that the full collection of the loan is improbable and the possibility of loss is high.

Loss: Loans classified as loss are considered to be non-collectible and of such little value that their continuance as a bankable asset is not warranted. This does not mean that the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future.

The following table presents the recorded investment in construction and development, commercial, and commercial real estate loans which are generally evaluated based upon the internal risk ratings defined above.

Loan Risk Profile by Internal Risk Rating

	Construction and Development						Commercial Real Estate					
	Land and Land Development		Construction		Commercial		Owner Occupied		Non-Owner Occupied		Mortgage Warehouse Lines	
Dollars in thousands	6/30/2016	12/31/2015	6/30/2016	12/31/2015	6/30/2016	12/31/2015	6/30/2016	12/31/2015	6/30/2016	12/31/2015	6/30/2016	12/31/2015
Pass	$57,398	$ 57,155	$8,506	$ 9,970	$ 99,462							