SB FINANCIAL GROUP, INC.
Form 10-Q
August 11, 2017

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 THESECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission file number 1-36785

SB FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio	34-1395608
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Clinton Street, Defiance, Ohio 43512

(Address of principal executive offices) (Zip Code)

(419) 783-8950

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth 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 Rule 12b-2 of the Exchange Act). Yes No

Title of each class	**Name of each exchange on which registered**
Common Shares, No Par Value	The NASDAQ Stock Market, LLC
4,798,167 Outstanding at August 10, 2017	(NASDAQ Capital Market)

SB FINANCIAL GROUP, INC.

FORM 10-Q

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

SB Financial Group, Inc.

Condensed Consolidated Balance Sheets
June 30, 2017 and December 31, 2016

($ in Thousands)	June 2017	December 2016
ASSETS	(Unaudited)	
Cash and due from banks	$ 21,385	$ 17,012
Securities available for sale, at fair value	103,347	90,128
Other securities - FRB and FHLB Stock	3,748	3,748
Total investment securities	107,095	93,876
Loans held for sale	9,437	4,434
Loans, net of unearned income	651,589	644,433
Allowance for loan losses	(7,825)	(7,725)
Net loans	643,764	636,708
Premises and equipment, net	20,740	19,129
Cash surrender value of life insurance	13,859	13,725
Goodwill & other intangibles	16,417	16,422
Foreclosed assets held for sale, net	94	994
Mortgage servicing rights	9,217	8,422
Accrued interest receivable	1,411	1,512
Other assets	4,249	3,771
Total assets	$ 847,668	$ 816,005
LIABILITIES AND EQUITY		
Deposits		
Non interest bearing demand	$ 124,213	$ 125,189
Interest bearing demand	127,409	131,598
Savings	104,720	95,594
Money market	130,987	122,976
Time deposits	220,004	197,716
Total deposits	707,333	673,073

Advances from Federal Home Loan Bank	20,500	26,500
Repurchase agreements	11,175	10,532
Trust preferred securities	10,310	10,310
Accrued interest payable	563	408
Other liabilities	8,756	8,634
Total liabilities	758,637	729,457
Commitments & Contingent Liabilities	-	-
Stockholders' Equity		
Preferred stock, Series A	13,983	13,983
Common stock	12,569	12,569
Additional paid-in capital	15,260	15,362
Retained earnings	49,851	46,688
Accumulated other comprehensive income	340	51
Treasury stock, at cost	(2,972)	(2,105)
Total equity	89,031	86,548
Total liabilities and equity	$ 847,668	$ 816,005

See notes to condensed consolidated financial statements (unaudited)

Note: The balance sheet at December 31, 2016 has been derived from the audited consolidated financial statements at that date

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SB FINANCIAL GROUP, INC.

Condensed Consolidated Statements of Income - (Unaudited)

($ in thousands, except share data)	Three Months Ended		Six Months Ended	
	June	June	June	June
Interest income	2017	2016	2017	2016
Loans				
Taxable	$7,243	$6,648	$14,043	$12,908
Nontaxable	21	24	41	33
Securities				
Taxable	569	392	1,030	794
Nontaxable	133	149	266	305
Total interest income	7,966	7,213	15,380	14,040
Interest expense				
Deposits	863	647	1,611	1,192
Repurchase Agreements & Other	6	4	10	9
Federal Home Loan Bank advances	63	77	149	183
Trust preferred securities	71	62	141	121
Total interest expense	1,003	790	1,911	1,505
Net interest income	6,963	6,423	13,469	12,535
Provision for loan losses	200	-	200	250
Net interest income after provision for loan losses	6,763	6,423	13,269	12,285
Noninterest income				
Wealth Management Fees	704	643	1,371	1,276
Customer service fees	667	680	1,307	1,360
Gain on sale of mtg. loans & OMSR’s	2,063	2,284	3,313	3,667
Mortgage loan servicing fees, net	241	(273)	624	(719)
Gain on sale of non-mortgage loans	369	151	799	600
Data service fees	184	233	377	510
Net gain on sale of securities	-	92	-	203
Gain/(loss) on sale/disposal of assets	-	186	2	208
Other income	234	311	471	641
Total non-interest income	4,462	4,307	8,264	7,746
Noninterest expense				
Salaries and employee benefits	4,667	4,314	9,053	8,093
Net occupancy expense	552	524	1,112	1,089
Equipment expense	683	639	1,324	1,234

Data processing fees	396	339	766	644
Professional fees	417	326	780	642
Marketing expense	206	199	401	370
Telephone and communication	113	102	229	201
Postage and delivery expense	59	162	233	359
State, local and other taxes	170	171	337	270
Employee expense	183	128	328	246
Other expenses	360	503	625	1,154
Total non-interest expense	7,806	7,407	15,188	14,302
Income before income tax expense	3,419	3,323	6,345	5,729
Income tax expense	1,102	1,058	2,035	1,809
Net income	$2,317	$2,265	$4,310	$3,920
Preferred Stock Dividends	244	244	488	488
Net income available to common shareholders	2,073	2,021	3,822	3,432
Common share data:				
Basic earnings per common share	$0.43	$0.41	$0.79	$0.70
Diluted earnings per common share	$0.37	$0.35	$0.68	$0.61
Average common shares outstanding (in thousands):				
Basic:	4,827	4,893	4,839	4,894
Diluted:	6,351	6,390	6,366	6,396

See notes to condensed consolidated financial statements (unaudited)

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SB Financial Group, Inc.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

($'s in thousands)	Three Months Ended Jun. 30, 2017	Three Months Ended Jun. 30, 2016	Six Months Ended Jun. 30, 2017	Six Months Ended Jun. 30, 2016
Net income	$2,317	$2,265	$4,310	$3,920
Other comprehensive income:				
Available-for-sale investment securities:				
Gross unrealized holding gain arising in the period	309	480	439	1,570
Related tax expense	(105)	(163)	(149)	(534)
Less: Reclassification for gain realized in income	-	(92)	-	(203)
Related tax expense	-	31	-	69
Net effect on other comprehensive income	204	256	290	902
Total comprehensive income	$2,521	$2,521	$4,600	$4,822

See notes to condensed consolidated financial statements (unaudited)

SB Financial Group, Inc.

Condensed Consolidated Statements of Shareholders' Equity (unaudited)

($'s in thousands - except per share data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance, January 1, 2017	$ 13,983	$ 12,569	$ 15,362	$ 46,688	$ 51	$ (2,105)	$ 86,548
Net income				4,310			4,310
Other comprehensive income					289		289
Dividends on common, $0.065 per share				(659)			(659)
Dividends on preferred, $0.1625 per share				(488)			(488)
Restricted stock vesting			(163)			163	-
Stock options exercised			(66)			395	329
Stock buyback						(1,425)	(1,425)
Share based compensation expense			127				127
Balance, June 30, 2017	$ 13,983	$ 12,569	$ 15,260	$ 49,851	$ 340	$ (2,972)	$ 89,031
Balance, January 1, 2016	$ 13,983	$ 12,569	$ 15,438	$ 40,059	$ 650	$ (1,458)	$ 81,241
Net income				3,920			3,920
Other comprehensive income					902		902
Dividends on common, $0.055 per share				(566)			(566)
Dividends on preferred, $0.1625 per share				(488)			(488)
Restricted stock vesting			(87)			87	-
Stock options exercised			(64)			88	24
Stock buyback						(163)	(163)
Share based compensation expense			80				80
Balance, June 30, 2016	$ 13,983	$ 12,569	$ 15,367	$ 42,925	$ 1,552	$ (1,446)	$ 84,950

See notes to condensed consolidated financial statements (unaudited)

SB Financial Group, Inc.

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended Jun. 30,	
($'s in thousands)	2017	2016
Operating Activities		
Net Income	$4,310	$3,920
Items providing/(using) cash		
Depreciation and amortization	753	696
Provision for loan losses	200	250
Expense of share-based compensation plan	127	80
Amortization of premiums and discounts on securities	315	461
Amortization of intangible assets	5	6
Amortization of originated mortgage servicing rights	521	482
Impairment (recovery) of mortgage servicing rights	4	1,236
Proceeds from sale of loans held for sale	123,708	148,995
Originations of loans held for sale	(129,527)	(142,612)
Gain from sale of loans	(4,112)	(4,267)
(Gain)/loss on sale of assets	47	(181)
Changes in		
Interest receivable	101	(137)
Other assets	2,968	(5,870)
Interest payable and other liabilities	155	1,145
Net cash (used in)/provided by operating activities	(425)	4,204
Investing Activities		
Purchases of available-for-sale securities	(25,785)	(11,322)
Proceeds from maturities of available-for-sale securities	12,692	7,145
Proceeds from sales of available-for-sale-securities	-	2,400
Net change in loans	(7,350)	(47,150)
Purchase of premises and equipment and software	(2,364)	(497)
Proceeds from sale of foreclosed assets & equipment	945	661
Net cash used in investing activities	(21,862)	(48,763)
Financing Activities		
Net increase in demand deposits, money market, interest checking and savings accounts	11,972	32,482
Net increase in certificates of deposit	22,288	29,365
Net increase in securities sold under agreements to repurchase	643	5,391
Proceeds from FHLB Advances	5,000	-
Repayments of FHLB Advances	(11,000)	(12,000)

Share repurchase	(1,425)	(163)
Net proceeds from share based compensation plans	329	24
Dividends on Common Stock	(659)	(566)
Dividends on Preferred Stock	(488)	(488)
Net cash provided by financing activities	26,660	54,045
Increase in Cash and Cash Equivalents	4,373	9,486
Cash and Cash Equivalents, Beginning of Year	17,012	20,459
Cash and Cash Equivalents, End of Period	$21,385	$29,945
Supplemental Cash Flows Information		
Interest paid	$1,756	$1,385
Income taxes paid	$2,049	$2,309
Transfer of loans to foreclosed assets	$94	$243

See notes to condensed consolidated financial statements (unaudited)

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SB FINANCIAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—BASIS OF PRESENTATION

SB Financial Group, Inc., an Ohio corporation (the “Company”) is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiaries, The State Bank and Trust Company (“State Bank”), RFCBC, Inc. (“RFCBC”), Rurbanc Data Services, Inc. dba RDSI Banking Systems (“RDSI”), and Rurban Statutory Trust II (“RST II”). In addition, State Bank owns all of the outstanding stock of Rurban Mortgage Company (“RMC”) and State Bank Insurance, LLC (“SBI”).

The consolidated financial statements include the accounts of the Company, State Bank, RFCBC, RDSI, RMC, and SBI. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements reflect all adjustments that are, in the opinion of management, necessary to fairly present the financial position, results of operations and cash flows of the Company. Those adjustments consist only of normal recurring adjustments. Results of operations for the six months ended June 30, 2017, are not necessarily indicative of results for the complete year.

The condensed consolidated balance sheet of the Company as of December 31, 2016 has been derived from the audited consolidated balance sheet of the Company as of that date.

For further information, refer to the consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

The following paragraphs summarize the impact of new accounting pronouncements:

Accounting Standards Update (ASU) No. 2017-08: Premium Amortization on Purchased Callable Debt

This ASU amends the amortization period for certain purchased callable debt securities held at a premium. The Board is shortening the amortization period to the earliest call date. Currently, entities generally amortize the Financial Accounting Standard premium as an adjustment of yield over the contractual life of the instrument. The amendments in this ASU are effective for reporting periods beginning after December 15, 2018, and management does not believe the changes will have a material effect on the Company's consolidated financial statements.

ASU No. 2017-04: Intangibles – Goodwill and Other (Topic 350)

This ASU simplifies the test for goodwill impairment. Specifically, these amendments eliminate Step 2 from the goodwill impairment test, and also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. The amendments in this ASU are effective for annual goodwill impairment tests in fiscal years beginning after December 15, 2019, and management does not believe the changes will have a material effect on the Company's accounting and disclosures.

ASU No. 2017-03: Accounting Changes and Error Corrections (Topic 250)

This amendment includes the text of "SEC Staff Announcement: Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of a Registrant When Such Standards are Adopted in a Future Period." This staff announcement applies to ASU No. 2014-09, ASU No. 2016-02 and ASU 2016-03. The Company has enhanced its disclosures regarding the impact that recently issued accounting standards adopted in a future period will have on its accounting and disclosures in this footnote.

ASU No. 2016-15: Statement of Cash Flows (Topic 230)

This ASU provides specific guidance for eight cash flow classifications. The intention is to ensure that this ASU will eliminate any current or future diversity in classification and reporting. The amendments in this ASU are effective for reporting periods beginning after December 15, 2017, and management does not believe the changes will have a material effect on the Company's consolidated financial statements.

ASU No. 2016-13: Financial Instruments – Credit Losses (Topic 326)

This ASU replaces the current GAAP incurred impairment methodology regarding credit losses with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this update affect an entity to varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. The amendments in this ASU are effective for reporting periods beginning after December 15, 2019, and management will need further study to determine the impact on the Company's consolidated financial statements.

ASU No. 2016-09: Stock Compensation (Topic 718)

This ASU affects all entities that issue share-based payment awards to their employees. The update is intended to simplify the accounting for these transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Company adopted the amendments in this ASU, and management has determined that the impact on the Company's consolidated financial statements is immaterial.

ASU No. 2014-09: Revenue from Contracts with Customers (Topic 606)

This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are within the scope of other standards. The core principle is that an entity should recognize revenue in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Management has determined that this update will not have a material impact on the Company's consolidated financial statements.

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NOTE 2—EARNINGS PER SHARE

Earnings per share (EPS) have been computed based on the weighted average number of common shares outstanding during the periods presented. There were no anti-dilutive shares in 2017. For the period ended June 30, 2016, share-based awards totaling 33,924 common shares were not considered in computing diluted EPS as they were anti-dilutive. Included in the diluted EPS for June 30, 2017 is the impact of the full conversion of the Company's depository shares. Based upon the current conversion price of $10.2784, the 1,500,000 outstanding depository shares are convertible into an aggregate of 1,459,376 common shares. The average number of common shares used in the computation of basic and diluted earnings per share were:

	Three Months Ended Jun., 30	
($ in thousands - except per share data)	2017	2016
Distributed earnings allocated to common shares	$344	$296
Undistributed earnings allocated to common shares	1,727	1,723
Net earnings allocated to common shares	2,071	2,019
Net earnings allocated to participating securities	2	2
Dividends on convertible preferred shares	244	244
Net Income allocated to common shares and participating securities	$2,317	$2,265
Weighted average shares outstanding for basic earnings per share	4,827	4,893
Dilutive effect of stock compensation	65	45
Dilutive effect of convertible shares	1,459	1,452
Weighted average shares outstanding for diluted earnings per share	6,351	6,390
Basic earnings per common share	$0.43	$0.41
Diluted earnings per common share	$0.36	$0.35

	Six Months Ended Jun., 30	
($ in thousands - except per share data)	2017	2016
Distributed earnings allocated to common shares	$663	$566
Undistributed earnings allocated to common shares	3,153	2,861
Net earnings allocated to common shares	3,816	3,427
Net earnings allocated to participating securities	6	5

Dividends on convertible preferred shares	488	488
Net Income allocated to common shares and participating securities	$4,310	$3,920
Weighted average shares outstanding for basic earnings per share	4,839	4,894
Dilutive effect of stock compensation	69	50
Dilutive effect of convertible shares	1,458	1,452
Weighted average shares outstanding for diluted earnings per share	6,366	6,396
Basic earnings per common share	$0.79	$0.70
Diluted earnings per common share	$0.68	$0.61

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Note 3 - Securities

The amortized cost and appropriate fair values, together with gross unrealized gains and losses, of securities at June 30, 2017 and December 31, 2016 were as follows:

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
June 30, 2017				
U.S. Treasury and Government agencies	$ 17,668	$ 136	$ (47)	$ 17,757
Mortgage-backed securities	70,762	228	(377)	70,613
State and political subdivisions	14,332	593	(18)	14,907
Equity securities	70	-	-	70
	$ 102,832	$ 957	$ (442)	$ 103,347

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
December 31, 2016:				
U.S. Treasury and Government agencies	$ 13,341	$ 69	$ (52)	$ 13,358
Mortgage-backed securities	62,035	204	(636)	61,603
State and political subdivisions	14,606	530	(39)	15,097
Equity securities	70	-	-	70
	$ 90,052	$ 803	$ (727)	$ 90,128

The amortized cost and fair value of securities available for sale at June 30, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
($ in thousands)	Amortized Cost	Fair Value

Within one year	$846	$868
Due after one year through five years	12,025	12,158
Due after five years through ten years	11,923	12,126
Due after ten years	7,206	7,512
	32,000	32,664
Mortgage-backed securities & equity securities	70,832	70,683
Totals	$102,832	$103,347

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The fair value of securities pledged as collateral, to secure public deposits and for other purposes, was $58.3 million at June 30, 2017 and $44.3 million at December 31, 2016. The fair value of securities delivered for repurchase agreements was $13.9 million at June 30, 2017 and $14.6 million at December 31, 2016.

There were no realized gains and losses from sales of available-for-sale securities for the six months ended June 30, 2017. For the six months ended June 30, 2016, there were gross gains of $0.20 million resulting from sales of available-for-sale securities, which was a reclassification from accumulated other comprehensive income (OCI) and was included in the net gain on sale of securities. The related $0.07 million in tax expense was a reclassification from OCI and was included in the income tax expense line item in the income statement.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments was $53.8 million at June 30, 2017, and $52.2 million at December 31, 2016, which was approximately 52 and 58 percent, respectively, of the Company's available-for-sale investment portfolio at such dates. Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

Securities with unrealized losses, aggregated by investment class and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2017 and December 31, 2016 are as follows:

($ in thousands)	Less than 12 Months		12 Months or Longer		Total	
June 30, 2017	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities:						
U.S. Treasury and Government agencies	$6,997	$ (47)	$-	$ -	$6,997	$ (47)
Mortgage-backed securities	44,877	(357)	637	(20)	45,514	(377)
State and Political subdivisions	1,307	(18)	-	-	1,307	(18)
	$53,181	$ (422)	$637	$ (20)	$53,818	$ (442)

($ in thousands)	Less than 12 Months		12 Months or Longer		Total	
December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities:						

U.S. Treasury and Government agencies	$6,044	$(52)	$-	$-	$6,044	$(52)
Mortgage-backed securities	44,344	(607)	703	(29)	45,047	(636)
State and political subdivisions	1,095	(39)	-	-	1,095	(39)
	$51,483	$(698)	$703	$(29)	$52,186	$(727)

The total potential unrealized loss as of June 30, 2017 in the securities portfolio was $0.44 million, which was down from the $0.73 million unrealized loss at December 31, 2016. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to not sell the investment and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost. Management has determined there is no other-than-temporary-impairment on these securities.

NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoffs, are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, all loan classes are placed on non-accrual status not later than 90 days past due, unless the loan is well-secured and in the process of collection. All interest accrued, but not collected, for loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the non-collectability of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as new information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected on the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that State Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration each of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial, agricultural, and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price or the fair value of the collateral if the loan is collateral dependent.

When State Bank moves a loan to non-accrual status, total unpaid interest accrued to date is reversed from income. Subsequent payments are applied to the outstanding principal balance with the interest portion of the payment recorded on the balance sheet as a contra-loan. Interest received on impaired loans may be realized once all contractual principal amounts are received or when a borrower establishes a history of six consecutive timely principal and interest payments. It is at the discretion of management to determine when a loan is placed back on accrual status upon receipt of six consecutive timely payments.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, State Bank does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Categories of loans at June 30, 2017 and December 31, 2016 include:

($ in thousands)	Total Loans Jun. 2017	Dec. 2016	Non-Accrual Loans Jun. 2017	Dec. 2016
Commercial & Industrial	$106,898	$108,752	129	190
Commercial RE & Construction	296,116	284,084	1,049	1,194
Agricultural & Farmland	52,107	52,475	3	4
Residential Real Estate	137,214	142,452	1,115	1,162
Consumer & Other	58,833	56,335	154	187
Total Loans	$651,168	$644,098	$2,450	$2,737
Unearned Income	$421	$335		
Total Loans, net of unearned income	$651,589	$644,433		
Allowance for loan losses	$(7,825)	$(7,725)		

The following tables present the activity in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of June 30, 2017, December 31, 2016 and June 30, 2016.

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						
For the Three Months Ended - June 30, 2017						
Beginning balance	$ 998	$ 3,196	$ 469	$ 2,013	$ 1,003	$7,679
Charge Offs	(50)	-	-	-	(19)	$(69)
Recoveries	5	2	1	4	3	15
Provision	42	254	42	(29)	(109)	200
Ending Balance	$ 995	$ 3,452	$ 512	$ 1,988	$ 878	$7,825
For the Six Months Ended - June 30, 2017						
Beginning balance	$ 1,204	$ 3,321	$ 347	$ 1,963	$ 890	$7,725
Charge Offs	(50)	-	-	(22)	(48)	$(120)
Recoveries	6	2	2	4	6	20

Provision	(165)	129	163	43	30	200
Ending Balance	$ 995	$ 3,452	$ 512	$ 1,988	$ 878	$7,825

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($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
Loans Receivable at June 30, 2017						
Allowance:						
Ending balance: individually evaluated for impairment	$ -	$ 96	$ -	$ 117	$ 7	$ 220
Ending balance: collectively evaluated for impairment	$ 995	$ 3,356	$ 512	$ 1,871	$ 871	$ 7,605
Loans:						
Ending balance: individually evaluated for impairment	$ -	$ 1,424	$ -	$ 1,675	$ 230	$ 3,329
Ending balance: collectively evaluated for impairment	$ 106,898	$ 294,692	$ 52,107	$ 135,539	$ 58,603	$ 647,839
Loans Receivable at December 31, 2016						
Allowance:						
Ending balance: individually evaluated for impairment	$ 50	$ 119	$ -	$ 124	$ 7	$ 300
Ending balance: collectively evaluated for impairment	$ 1,154	$ 3,202	$ 347	$ 1,839	$ 883	$ 7,425
Loans:						
Ending balance: individually evaluated for impairment	$ 50	$ 1,578	$ -	$ 1,919	$ 248	$ 3,795
Ending balance: collectively evaluated for impairment	$ 108,702	$ 282,506	$ 52,475	$ 140,533	$ 56,087	$ 640,303

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES For the Three Months Ended - June 30, 2016						
Beginning balance	$ 925	$ 4,120	$ 188	$ 1,342	$ 630	$7,205
Charge Offs	-	-	-	-	(2)	$(2)
Recoveries	212	6	1	-	28	247
Provision	-	-	-	-	-	-
Ending Balance	$ 1,137	$ 4,126	$ 189	$ 1,342	$ 656	$7,450

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES For the Six Months Ended - June 30, 2016						
Beginning balance	$ 914	$ 3,886	$ 204	$ 1,312	$ 674	$6,990
Charge Offs	(92)	-	-	-	(4)	$(96)
Recoveries	247	6	1	-	52	306
Provision	68	234	(16)	30	(66)	250
Ending Balance	$ 1,137	$ 4,126	$ 189	$ 1,342	$ 656	$7,450

The risk characteristics of each loan portfolio segment are as follows:

Commercial and Agricultural

Commercial and agricultural loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate including Construction

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The characteristics of properties securing the Company's commercial real estate portfolio are diverse, but with geographic location almost entirely in the Company's market area. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. In general, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate versus non-owner-occupied loans.

Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews and financial analysis of the developers and property owners. Construction loans are generally based on estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Residential and Consumer

Residential and consumer loans consist of two segments – residential mortgage loans and personal loans. Residential mortgage loans are secured by 1-4 family residences and are generally owner-occupied, and the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer personal loans are secured by consumer personal assets, such as automobiles or recreational vehicles. Some consumer personal loans are unsecured, such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas, such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that these loans are of smaller individual amounts and spread over a large number of borrowers.

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of June 30, 2017 and December 31, 2016.

June 30, 2017 ($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
1-2	$ 1,341	$ 24	$ 9	$ 232	$ 1	$ 1,607
3	29,351	93,165	9,312	105,513	56,155	293,496
4	75,224	200,066	42,640	28,981	2,388	349,299
Total Pass (1 - 4)	105,916	293,255	51,961	134,726	58,544	644,402
Special Mention (5)	425	1,114	146	835	87	2,607
Substandard (6)	7	683	-	615	82	1,387
Doubtful (7)	550	1,064	-	1,038	120	2,772
Loss (8)	-	-	-	-	-	-
Total Loans	$ 106,898	$ 296,116	$ 52,107	$ 137,214	$ 58,833	$ 651,168

December 31, 2016 ($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
1-2	$ 1,149	$ 33	$ 9	$ 234	$ 3	$ 1,428
3	28,461	89,406	9,985	113,403	53,386	294,641
4	78,517	188,007	42,481	26,510	2,625	338,140
Total Pass (1 - 4)	108,127	277,446	52,475	140,147	56,014	634,209
Special Mention (5)	-	5,030	-	518	123	5,671
Substandard (6)	150	1,291	-	625	61	2,127

Doubtful (7)	475	317	-	1,162	137	2,091
Loss (8)	-	-	-	-	-	-
Total Loans	$ 108,752	$ 284,084	$ 52,475	$ 142,452	$ 56,335	$644,098

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis.

Credit Risk Profile

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $100 thousand and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Pass (grades 1 – 4): Loans which management has determined to be performing as expected and in agreement with the terms established at the time of loan origination.

Special Mention (5): Assets have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company’s credit position at some future date. Special mention assets are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (6): Loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful (7): Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

Loss (8): Loans are considered uncollectable and of such little value that continuing to carry them as assets on the Company’s financial statement is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

The following tables present the Company’s loan portfolio aging analysis as of June 30, 2017 and December 31, 2016.

($ in thousands) June 30, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Commercial & Industrial	$551	$81	$94	$726	$106,172	$106,898
Commercial RE & Construction	19	-	804	823	295,293	296,116
Agricultural & Farmland	-	-	-	-	52,107	52,107
Residential Real Estate	106	182	77	365	136,849	137,214
Consumer & Other	208	-	114	322	58,511	58,833
Total Loans	$884	$263	$1,089	$2,236	$648,932	$651,168

($ in thousands) December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Commercial & Industrial	$35	$50	$ 104	$189	$108,563	$108,752
Commercial RE & Construction	254	883	59	1,196	282,888	284,084
Agricultural & Farmland	-	-	-	-	52,475	52,475
Residential Real Estate	123	201	115	439	142,013	142,452
Consumer & Other	185	45	148	378	55,957	56,335
Total Loans	$597	$1,179	$ 426	$2,202	$641,896	$644,098

All loans past due 90 days are systematically placed on nonaccrual status.

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable State Bank will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The following tables present impaired loan information as of and for the three and six months ended June 30, 2017 and 2016, and for the twelve months ended December 31, 2016:

Six Months Ended June 30, 2017 ($'s in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial & Industrial	$ -	$ -	$ -	$ -	$ -
Commercial RE & Construction	735	735	-	758	22
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	1,114	1,157	-	1,351	35
Consumer & Other	118	118	-	145	5
All Impaired Loans < $100,000	375	375	-	375	-
With a specific allowance recorded:					
Commercial & Industrial	-	-	-	-	-
Commercial RE & Construction	689	689	96	738	(2)
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	561	561	117	634	13
Consumer & Other	112	112	7	118	3
Totals:					
Commercial & Industrial	$ -	$ -	$ -	$ -	$ -
Commercial RE & Construction	$ 1,424	$ 1,424	$ 96	$ 1,496	$ 20
Agricultural & Farmland	$ -	$ -	$ -	$ -	$ -
Residential Real Estate	$ 1,675	$ 1,718	$ 117	$ 1,985	$ 48
Consumer & Other	$ 230	$ 230	$ 7	$ 263	$ 8
All Impaired Loans < $100,000	$ 375	$ 375	$ -	$ 375	$ -

Three Months Ended June 30, 2017	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:		
Commercial & Industrial	$ -	$ -
Commercial RE & Construction	756	9
Agricultural & Farmland	-	-
Residential Real Estate	1,346	16
Consumer & Other	143	2
All Impaired Loans < $100,000	375	-
With a specific allowance recorded:		
Commercial & Industrial	-	-
Commercial RE & Construction	689	-
Agricultural & Farmland	-	-
Residential Real Estate	631	6
Consumer & Other	117	2

Totals:		
Commercial & Industrial	$ -	$ -
Commercial RE & Construction	$ 1,445	$ 9
Agricultural & Farmland	$ -	$ -
Residential Real Estate	$ 1,977	$ 22
Consumer & Other	$ 260	$ 4
All Impaired Loans < $100,000	$ 375	$ -

Twelve Months Ended December 31, 2016 ($'s in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial & Industrial	$ -	$ -	$ -	$ -	$ -
Commercial RE & Construction	637	637	-	655	24
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	1,248	1,290	-	1,470	70
Consumer & Other	129	129	-	151	11
All Impaired Loans < $100,000	452	452	-	452	-
With a specific allowance recorded:					
Commercial & Industrial	50	50	50	50	3
Commercial RE & Construction	941	941	119	1,010	45
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	671	672	124	751	30
Consumer & Other	119	118	7	123	7
Totals:					
Commercial & Industrial	$ 50	$ 50	$ 50	$ 50	$ 3
Commercial RE & Construction	$ 1,578	$ 1,578	$ 119	$ 1,665	$ 69
Agricultural & Farmland	$ -	$ -	$ -	$ -	$ -
Residential Real Estate	$ 1,919	$ 1,962	$ 124	$ 2,221	$ 100
Consumer & Other	$ 248	$ 247	$ 7	$ 274	$ 18
All Impaired Loans < $100,000	$ 452	$ 452	$ -	$ 452	$ -

	Six Months Ended		Three Months Ended	
June 30, 2016 ($'s in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial & Industrial	$-	$ -	$-	$ -
Commercial RE & Construction	766	11	761	6
Agricultural & Farmland	-	-	-	-
Residential Real Estate	1,199	34	1,195	16
Consumer & Other	96	4	94	2
All Impaired Loans < $100,000	438	-	438	-
Commercial & Industrial	-	-	-	-
Commercial RE & Construction	4,924	-	4,924	-
Agricultural & Farmland	-	-	-	-
Residential Real Estate	962	19	958	10
Consumer & Other	274	9	272	4
Commercial & Industrial	$-	$ -	$-	$ -
Commercial RE & Construction	$5,690	$ 11	$5,685	$ 6
Agricultural & Farmland	$-	$ -	$-	$ -

Residential Real Estate	$2,161	$ 53	$2,153	$ 26
Consumer & Other	$370	$ 13	$366	$ 6
All Impaired Loans < $100,000	$438	$ -	$438	$ -

Impaired loans less than $100,000 are included in groups of homogenous loans. These loans are evaluated based on delinquency status.

Interest income recognized on a cash basis does not materially differ from interest income recognized on an accrual basis.

Troubled Debt Restructured (TDR) Loans

TDRs are modified loans where a concession was provided to a borrower experiencing financial difficulties. Loan modifications are considered TDRs when the concessions provided are not available to the borrower through either normal channels or other sources. However, not all loan modifications are TDRs.

TDR Concession Types

The Company's standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet a borrower's specific circumstances at a point in time. All loan modifications, including those classified as TDRs, are reviewed and approved by the Senior Lender. The types of concessions provided to borrowers include:

Interest rate reduction: A reduction of the stated interest rate to a nonmarket rate for the remaining original life of the loan. The Company also may grant interest rate concessions for a limited timeframe on a case by case basis.

Amortization or maturity date change: A change in the amortization or maturity date beyond what the collateral supports, including a concession that does any of the following:

(1) Lengthens the amortization period of the amortized principal beyond market terms. This concession reduces the minimum monthly payment and increases the amount of the balloon payment at the end of the term of the loan. Principal is generally not forgiven.

(2) Reduces the amount of loan principal to be amortized. This concession also reduces the minimum monthly payment and increases the amount of the balloon payment at the end of the term of the loan. Principal is generally not forgiven.

(3) Extends the maturity date or dates of the debt beyond what the collateral supports. This concession generally applies to loans without a balloon payment at the end of the term of the loan. In addition, there may be instances where renewing loans potentially require non-market terms and would then be reclassified as TDRs.

Other: A concession that is not categorized as one of the concessions described above. These concessions include, but are not limited to: principal forgiveness, collateral concessions, covenant concessions, and reduction of accrued interest. Principal forgiveness may result from any TDR modification of any concession type.

During the three and six months ended June 30, 2017, the Company had no new TDR activity and none of the TDR's modified during the past 12 months have subsequently defaulted.

For the three months ended June 30, 2016, the Company had no new TDR activity. For the six months ended June 30, 2016, there was one loan modified to a TDR. The loan, which was a consumer product with a principal balance of $222,000, had its term modified.

NOTE 5 – DERIVATIVE FINANCIAL INSTRUMENTS AND REPURCHASE AGREEMENTS

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company manages its exposures to a wide variety of business and operational risks primarily through management of its core business activities. The Company manages economic risks, including interest rate, liquidity and credit risk, primarily by managing the amount, sources and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing and duration of the Company's known or expected cash payments principally related to certain variable-rate assets.

Non-designated Hedges

The Company does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and result from a service the Company provides to certain customers. The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously offset by interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of June 30, 2017 and December 31, 2016, the notional amount of customer-facing swaps was approximately $29.1 million and $33.2 million, respectively. The same amounts were offset with third party counterparties, as described above.

The Company has minimum collateral posting thresholds with its derivative counterparties. As of June 30, 2017 and December 31, 2016, the Company had posted cash as collateral in the amount of $0.1 million and $0.1 million, respectively.

The table below presents the fair value of the Company’s derivative financial instruments, as well as their classification on the balance sheet, as of June 30, 2017 and December 31, 2016.

	Asset Derivatives June 30, 2017		Liability Derivatives June 30, 2017	
($ in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments:				
Interest rate contracts	Other Assets	$ 525	Other Liabilities	$ 525

	Asset Derivatives December 31, 2016		Liability Derivatives December 31, 2016	
($ in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments:				
Interest rate contracts	Other Assets	$ 623	Other Liabilities	$ 623

The Company’s derivative financial instruments had no net effect on the income statements for the three and six months ended June 30, 2017 and 2016.

Securities Sold Under Repurchase Agreements

State Bank has retail repurchase agreements to facilitate cash management transactions with commercial customers. These obligations are secured by agency and mortgage-backed securities and such collateral is held by the Federal Home Loan Bank. The agreements mature within one month. These repurchase agreements are secured by agency securities and mortgage-backed securities with corresponding liabilities of $4.8 million and of $9.1 million. These securities have various maturity dates beyond 2017.

NOTE 6 – FAIR VALUE OF ASSETS AND LIABILITIES

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis, recognized in the accompanying balance sheets, as well as the general classifications of such assets pursuant to the valuation hierarchy.

Available-for-Sale Securities

The fair values of available-for-sale securities are determined by various valuation methodologies. Level 1 securities include money market mutual funds. Level 1 inputs include quoted prices in an active market. Level 2 securities include U.S. treasury and government agencies, mortgage-backed securities, obligations of political and state subdivisions and equity securities. Level 2 inputs do not include quoted prices for individual securities in active markets; however, they do include inputs that are either directly or indirectly observable for the individual security being valued. Such observable inputs include interest rates and yield curves at commonly quoted intervals, volatilities, prepayment speeds, credit risks and default rates. Also included are inputs derived principally from or corroborated by observable market data by correlation or other means.

Interest Rate Contracts

The fair values of interest rate contracts are based upon the estimated amount the Company would receive or pay to terminate the contracts or agreements, taking into account underlying interest rates, creditworthiness of underlying customers for credit derivatives and, when appropriate, the creditworthiness of the counterparties.

The following table presents the fair value measurements of assets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2017 and December 31, 2016.

Fair Value Measurements Using:

($ in thousands) **Available-for-Sale Securities:**	Fair Values at 6/30/17	(Level 1)	(Level 2)	(Level 3)
U.S. Treasury and Government Agencies	$17,757	$ -	$17,757	$ -
Mortgage-backed securities	70,613	-	70,613	-
State and political subdivisions	14,907	-	14,907	-
Equity securities	70	-	70	-
Interest rate contracts - assets	525	-	525	-
Interest rate contracts - liabilities	(525)	-	(525)	-

Fair Value Measurements Using:

($ in thousands) **Available-for-Sale Securities:**	Fair Values at 12/31/2016	(Level 1)	(Level 2)	(Level 3)
U.S. Treasury and Government Agencies	$ 13,358	$ -	$13,358	$ -
Mortgage-backed securities	61,603	-	61,603	-
State and political subdivisions	15,097	-	15,097	-
Equity securities	70	-	70	-
Interest rate contracts - assets	623	-	623	-
Interest rate contracts - liabilities	(623)	-	(623)	-

Level 1 – Quoted Prices in Active Markets for Identical Assets

Level 2 – Significant Other Observable Inputs

Level 3 – Significant Unobservable Inputs

The following is a description of the valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Collateral-dependent Impaired Loans, NET of ALLL

Loans for which it is probable the Company will not collect all principal and interest due according to contractual terms are measured for impairment. The estimated fair value of collateral-dependent impaired loans is based on the appraised value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy. This method requires obtaining an independent appraisal of the collateral, which is reviewed for accuracy and consistency by Credit Administration. These appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by applying a discount factor to the value based on the Company's loan review policy. All impaired loans held by the Company were collateral dependent at June 30, 2017 and December 31, 2016.

Mortgage Servicing Rights

Mortgage servicing rights do not trade in an active, open market with readily observable prices. Accordingly, fair value is estimated using discounted cash flow models associated with the servicing rights and discounting the cash flows using discount market rates, prepayment speeds and default rates. The servicing portfolio has been valued using all relevant positive and negative cash flows including servicing fees; miscellaneous income and float; marginal costs of servicing; the cost of carry of advances; and foreclosure losses; and applying certain prevailing assumptions used in the marketplace. Due to the nature of the valuation inputs, mortgage servicing rights are classified within Level 3 of the hierarchy. These mortgage servicing rights are tested for impairment on a quarterly basis.

Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements.

($ in thousands) **Description**	Fair Values at 6/30/2017	(Level 1)	(Level 2)	(Level 3)
Impaired loans	$ 592	$ -	$ -	$ 592
Mortgage Servicing Rights	3,132	-	-	3,132

($ in thousands) **Description**	Fair Values at 12/31/2016	(Level 1)	(Level 2)	(Level 3)
Impaired loans	$ 786	$ -	$ -	$ 786
Mortgage Servicing Rights	1,993	-	-	1,993

Level 1 - Quoted Prices in Active Markets for Identical Assets

Level 2 - Significant Other Observable Inputs

Level 3 - Significant Unobservable Inputs

($'s in thousands)	Fair Value at 6/30/2017	Valuation Technique	Unobservable Inputs		Range (Weighted Average)	
Collateral-dependent impaired loans	$ 592	Market comparable properties	Comparability adjustments	(%)	Not available	
Mortgage servicing rights	3,132	Discounted cash flow	Discount Rate		9.64	%
			Constant prepayment rate		8.50	%
			P&I earnings credit		1.22	%
			T&I earnings credit		1.90	%
			Inflation for cost of servicing		1.50	%

	Fair Value at	Valuation		Range (Weighted

($'s in thousands)	12/31/2016	Technique	Unobservable Inputs	Average)	
Collateral-dependent impaired loans	$ 786	Market comparable properties	Comparability adjustments (%)	Not available	
Mortgage servicing rights	1,993	Discounted cash flow	Discount Rate	9.65	%
			Constant prepayment rate		