FIRST BUSINESS FINANCIAL SERVICES, INC.
Form 10-Q
April 26, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
þ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2019
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number 001-34095
FIRST BUSINESS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

Wisconsin	39-1576570
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Charmany Drive, Madison, WI	53719
(Address of Principal Executive Offices)	(Zip Code)

(608) 238-8008
Registrant's telephone number, including area code
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company, 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. (Check one):

Large accelerated filer ¨	Accelerated filer þ	Non-accelerated filer ¨	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 þ
The number of shares outstanding of the registrant's sole class of common stock, par value $0.01 per share, on April 22, 2019 was 8,751,132 shares.

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PART I. Financial Information
Item 1. Financial Statements
First Business Financial Services, Inc.
Consolidated Balance Sheets

	March 31, 2019 (Unaudited)	December 31, 2018
	(In Thousands, Except Share Data)	
Assets		
Cash and due from banks	$17,682	$23,319
Short-term investments	38,653	63,227
Cash and cash equivalents	56,335	86,546
Securities available-for-sale, at fair value	156,783	138,358
Securities held-to-maturity, at amortized cost	35,914	37,731
Loans held for sale	5,447	5,287
Loans and leases receivable, net of allowance for loan and lease losses of $20,449 and $20,425, respectively	1,636,197	1,597,230
Premises and equipment, net	3,043	3,284
Foreclosed properties	2,547	2,547
Right-of-use assets	8,180	—
Bank-owned life insurance	41,830	41,538
Federal Home Loan Bank stock, at cost	6,635	7,240
Goodwill and other intangible assets	12,017	12,045
Accrued interest receivable and other assets	40,714	34,651
Total assets	$2,005,642	$1,966,457
Liabilities and Stockholders' Equity		
Deposits	$1,501,706	$1,455,299
Federal Home Loan Bank advances and other borrowings	269,958	298,944
Junior subordinated notes	10,037	10,033
Lease liabilities	8,504	—
Accrued interest payable and other liabilities	30,337	21,474
Total liabilities	1,820,542	1,785,750
Stockholders' equity:		
Preferred stock, $0.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $0.01 par value, 25,000,000 shares authorized, 9,118,929 and 9,069,199 shares issued, 8,765,136 and 8,785,480 shares outstanding at March 31, 2019 and December 31, 2018, respectively	91	91
Additional paid-in capital	79,941	79,623
Retained earnings	115,584	110,310
Accumulated other comprehensive loss	(1,405)	(1,684)
Treasury stock, 353,793 and 283,719 shares at March 31, 2019 and December 31, 2018, respectively, at cost	(9,111)	(7,633)
Total stockholders' equity	185,100	180,707
Total liabilities and stockholders' equity	$2,005,642	$1,966,457

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Income (Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
	(In Thousands, Except Per Share Data)	
Interest income		
Loans and leases	$24,207	$19,661
Securities	1,095	856
Short-term investments	377	205
Total interest income	25,679	20,722
Interest expense		
Deposits	5,796	2,830
Federal Home Loan Bank advances and other borrowings	1,855	1,416
Junior subordinated notes	274	274
Total interest expense	7,925	4,520
Net interest income	17,754	16,202
Provision for loan and lease losses	49	2,476
Net interest income after provision for loan and lease losses	17,705	13,726
Non-interest income		
Trust and investment service fees	1,927	1,898
Gain on sale of Small Business Administration loans	242	269
Service charges on deposits	777	784
Loan fees	414	527
Increase in cash surrender value of bank-owned life insurance	292	292
Commercial loan swap fees	473	633
Other non-interest income	513	264
Total non-interest income	4,638	4,667
Non-interest expense		
Compensation	10,165	9,071
Occupancy	590	529
Professional fees	1,210	1,035
Data processing	581	611
Marketing	482	333
Equipment	389	343
Computer software	799	742
FDIC insurance	293	299
Collateral liquidation costs	(91)	1
Impairment of tax credit investments	2,014	113
SBA recourse provision	481	(295)
Other non-interest expense	829	1,125
Total non-interest expense	17,742	13,907
Income before income tax (benefit) expense	4,601	4,486
Income tax (benefit) expense	(1,298)	837
Net income	$5,899	$3,649
Earnings per common share		

Basic	$0.67	$0.42
Diluted	0.67	0.42
Dividends declared per share	0.15	0.14

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Comprehensive Income (Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
	(In Thousands)	
Net income	$5,899	$3,649
Other comprehensive income, before tax		
Securities available-for-sale:		
Unrealized securities gains (losses) arising during the period	1,311	(1,359)
Securities held-to-maturity:		
Amortization of net unrealized losses transferred from available-for-sale	14	19
Interest rate swaps:		
Unrealized (losses) gains on interest rate swaps arising during the period	(950)	672
Income tax (expense) benefit	(96)	165
Total other comprehensive income (loss)	279	(503)
Comprehensive income	$6,178	$3,146

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	(In Thousands, Except Share Data)						
Balance at January 1, 2018	8,763,539	$ 90	$ 78,620	$ 98,906	$ (1,238)	$ (7,100)	$ 169,278
Net income	—	—	—	3,649	—	—	3,649
Other comprehensive loss	—	—	—	—	(503)	—	(503)
Share-based compensation - restricted shares, net	1,055	—	286	—	—	—	286
Cash dividends ($0.14 per share)	—	—	—	(1,226)	—	—	(1,226)
Treasury stock purchased	(174)	—	—	—	—	(4)	(4)
Balance at March 31, 2018	8,764,420	$ 90	$ 78,906	$ 101,329	$ (1,741)	$ (7,104)	$ 171,480

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	(In Thousands, Except Share Data)						
Balance at January 1, 2019	8,785,480	$ 91	$ 79,623	$ 110,310	$ (1,684)	$ (7,633)	$ 180,707
Cumulative effect of adoption of ASC Topic 842	—	—	—	687	—	—	687
Net income	—	—	—	5,899	—	—	5,899
Other comprehensive income	—	—	—	—	279	—	279
Share-based compensation - restricted shares, net	49,730	—	318	—	—	—	318
Cash dividends ($0.15 per share)	—	—	—	(1,312)	—	—	(1,312)
Treasury stock purchased	(70,074)	—	—	—	—	(1,478)	(1,478)
Balance at March 31, 2019	8,765,136	$ 91	$ 79,941	$ 115,584	$ (1,405)	$ (9,111)	$ 185,100

See accompanying Notes to Unaudited Consolidated Financial Statements.

First Business Financial Services, Inc.
Consolidated Statements of Cash Flows (Unaudited)

	For the Three Months Ended March 31, 2019	2018
	(In Thousands)	
Operating activities		
Net income	$5,899	$3,649
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes, net	(1,150)	(3,903)
Impairment of tax credit investments	2,014	113
Provision for loan and lease losses	49	2,476
Depreciation, amortization and accretion, net	651	362
Share-based compensation	318	286
Increase in value of bank-owned life insurance policies	(292)	(292)
Origination of loans for sale	(9,277)	(24,035)
Sale of loans originated for sale	9,358	23,069
Gain on sale of loans originated for sale	(242)	(269)
Excess tax benefit from share-based compensation	(5)	(5)
Payments on operating leases	(379)	—
Net (increase) decrease in accrued interest receivable and other assets	(6,144)	2,522
Net increase in accrued interest payable and other liabilities	9,863	4,579
Net cash provided by operating activities	10,663	8,552
Investing activities		
Proceeds from maturities, redemptions, and paydowns of available-for-sale securities	5,653	7,179
Proceeds from maturities, redemptions, and paydowns of held-to-maturity securities	1,795	755
Purchases of available-for-sale securities	(22,812)	(10,584)
Purchases of held-to-maturity securities	—	(4,875)
Net increase in loans and leases	(38,893)	(64,892)
Returns of investments in limited partnerships	281	—
Investment in historic development entities	(2,137)	(689)
Investment in Federal Home Loan Bank stock	(1,260)	(4,798)
Proceeds from the sale of Federal Home Loan Bank stock	1,865	1,818
Purchases of leasehold improvements and equipment, net	—	(297)
Net cash used in investing activities	(55,508)	(76,383)
Financing activities		
Net increase (decrease) in deposits	46,407	(23,173)
Repayment of Federal Home Loan Bank advances	(165,000)	(237,000)
Proceeds from Federal Home Loan Bank advances	136,000	309,000
Net increase in Federal Home Loan Bank line of credit	—	29,000
Net increase in long-term borrowed funds	17	17
Cash dividends paid	(1,312)	(1,226)
Purchase of treasury stock	(1,478)	(4)
Net cash provided by financing activities	14,634	76,614
Net (decrease) increase in cash and cash equivalents	(30,211)	8,783
Cash and cash equivalents at the beginning of the period	86,546	52,539
Cash and cash equivalents at the end of the period	$56,335	$61,322

Supplementary cash flow information		
Cash paid during the period for:		
Interest paid on deposits and borrowings	$7,761	$4,159
Income taxes (received) paid	(1)	19
Non-cash investing and financing activities:		
Right-of-use assets obtained in exchange for operating lease liabilities	8,505	—
Transfer from loans to foreclosed properties	—	415

See accompany Notes to Unaudited Consolidated Financial Statements

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Notes to Unaudited Consolidated Financial Statements

Note 1 — Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The accounting and reporting practices of First Business Financial Services, Inc. (the "Corporation"), through our wholly-owned subsidiary, First Business Bank ("FBB" or the "Bank"), have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). FBB operates as a commercial banking institution primarily in the Wisconsin and greater Kansas City markets. FBB also offers trust and investment services through First Business Trust & Investments ("FBTI") and investment portfolio administrative and asset/liability management services through First Business Consulting Services ("FBCS"), both divisions of FBB. The Bank provides a full range of financial services to businesses, business owners, executives, professionals, and high net worth individuals. The Bank is subject to competition from other financial institutions and service providers and is also subject to state and federal regulations. FBB has the following wholly owned subsidiaries: First Business Capital Corp. ("FBCC"), First Madison Investment Corp. ("FMIC"), First Business Equipment Finance, LLC ("FBEF"), ABKC Real Estate, LLC ("ABKC"), FBB Real Estate 2, LLC ("FBB RE 2"), Rimrock Road Investment Fund, LLC ("Rimrock Road"), BOC Investment, LLC ("BOC"), Mitchell Street Apartments Investment, LLC ("Mitchell Street"), and FBB Tax Credit Investment LLC ("FBB Tax Credit"). FMIC is located in and was formed under the laws of the state of Nevada.

Basis of Presentation

The accompanying unaudited Consolidated Financial Statements were prepared in accordance with GAAP and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Corporation's Consolidated Financial Statements and footnotes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2018. The unaudited Consolidated Financial Statements include the accounts of the Corporation and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. In accordance with the provisions of Accounting Standards Codification ("ASC") Topic 810, the Corporation's ownership interest in FBFS Statutory Trust II ("Trust II") has not been consolidated into the financial statements.

Management of the Corporation is required 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 as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that could significantly change in the near-term include the value of securities and interest rate swaps, level of the allowance for loan and lease losses, lease residuals, property under operating leases, goodwill, level of the Small Business Administration ("SBA") recourse reserve, and income taxes. The results of operations for the three month period ended March 31, 2019 are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2019. Certain amounts in prior periods may have been reclassified to conform to the current presentation. Subsequent events have been evaluated through the date of the issuance of the unaudited Consolidated Financial Statements. No significant subsequent events have occurred through this date requiring adjustment to the financial statements or disclosures.

The Corporation has not changed its significant accounting and reporting policies from those disclosed in the Corporation's Form 10-K for the year ended December 31, 2018.

Adoption of New Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." The ASU intends to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities and disclosing key information about leasing arrangements. The ASU will require lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessees' obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) 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. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new lease guidance simplifies the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) may apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may also elect to apply the amendments in the ASU through a cumulative-

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effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The ASU is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Corporation adopted the accounting standard during the first quarter of 2019 retrospectively through a cumulative-effect adjustment to retained earnings as of January 1, 2019.

The Corporation leases office space, loan production offices, and specialty financing production offices under noncancelable operating leases which expire on various dates through 2028. The Corporation also leases office equipment. As part of the adoption of the accounting standard, we elected to not recognize short-term leases on the Consolidated Balance Sheets. As such, the Corporation applied the accounting standard to six office spaces. All non-lease components, such as common area maintenance, were excluded. When calculating the lease liability on a discounted bases, the Corporation utilized the incremental borrowing rate as the rate implicit in the leases was not readily determinable. The Federal Home Loan Bank fixed advance rate as of January 2, 2019 that most closely resembled the remaining term was used as the incremental borrowing rate. While several leases contained options to extend and terminate, it is not reasonably certain that either option will be utilized and therefore, only the payments in the initial term of the leases were included in the lease liability and right-of-use asset. The impact of adoption was an $8.8 million lease liability with an offsetting $8.5 million right-of-use asset, which is net of $312,000 of lease incentives, and a $687,000 cumulative-effect adjustment to increase retained earnings on the Consolidated Balance Sheets as of January 1, 2019.

In June 2018, the FASB issued ASU No. 2018-07, “Compensation- Stock Compensation (Topic 718).” The ASU expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The Corporation adopted the accounting standard during the first quarter of 2019. The adoption of the standard did not have a material impact on the Corporation’s results of operations, financial position, and liquidity.

Recent Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments- Credit Losses (Topic 326).” The ASU replaces the incurred loss impairment methodology for recognizing credit losses with a methodology that reflects all expected credit losses. The ASU also requires consideration of a broader range of information to inform credit loss estimates, including such factors as past events, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, and any other financial asset not excluded from the scope that have the contractual right to receive cash. Entities will apply the amendments in the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The ASU is effective for public companies for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal years beginning after December 15, 2018. The Corporation intends to adopt the accounting standard during the first quarter of 2020, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity. A cross-functional committee has been established and a third-party software solution has been implemented to assist with the adoption of the standard. Management has gathered all necessary data, reviewed potential methods to calculate the expected credit losses, and is currently calculating sample expected loss computations.

In August 2018, the FASB issued ASU No. 2018-15, “Intangibles-Goodwill and Other Internal-Use Software (Subtopic 350-40).” The ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). Implementation costs incurred in the application development stage are capitalized depending on the nature of the costs, while costs incurred during the preliminary project and post implementation stages are expensed as the activities are performed. The amendment also requires entities to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement and in the same income statement line item as the fees associated with the hosting element. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. The Corporation is in the process of evaluating the impact of this standard but does not expect this standard to have a material impact on its results of operations, financial position, and liquidity.

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Note 2 — Earnings per Common Share

Earnings per common share are computed using the two-class method. Basic earnings per common share are computed by dividing net income allocated to common shares by the weighted-average number of shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities receive non-forfeitable dividends, or dividend equivalents, at the same rate as holders of the Corporation's common stock. Diluted earnings per share are computed by dividing net income allocated to common shares, adjusted for reallocation of undistributed earnings of unvested restricted shares, by the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

	For the Three Months Ended March 31,	
	2019	2018
	(Dollars in Thousands, Except Share Data)	
Basic earnings per common share		
Net income	$5,899	$ 3,649
Less: earnings allocated to participating securities	108	54
Basic earnings allocated to common stockholders	$5,791	$ 3,595
Weighted-average common shares outstanding, excluding participating securities	8,621,221	8,633,278
Basic earnings per common share	$0.67	$ 0.42
Diluted earnings per common share		
Earnings allocated to common stockholders, diluted	$5,791	$ 3,595
Weighted-average diluted common shares outstanding, excluding participating securities	8,621,221	8,633,278
Diluted earnings per common share	$0.67	$ 0.42

Note 3 — Share-Based Compensation

The Corporation adopted the 2012 Equity Incentive Plan (the "Plan") during the quarter ended June 30, 2012. The Plan is administered by the Compensation Committee of the Board of Directors of the Corporation and provides for the grant of equity ownership opportunities through incentive stock options and nonqualified stock options, restricted stock awards, restricted stock units, dividend equivalent units, and any other type of award permitted by the Plan. As of March 31, 2019, 71,871 shares were available for future grants under the Plan. Shares covered by awards that expire, terminate, or lapse will again be available for the grant of awards under the Plan. The Corporation may issue new shares and shares from its treasury stock for shares delivered under the Plan.

Restricted Stock

Under the Plan, the Corporation may grant restricted stock awards, restricted stock units, and other stock-based awards to plan participants, subject to forfeiture upon the occurrence of certain events until the dates specified in the participant's award agreement. While restricted stock is subject to forfeiture, restricted stock award participants may exercise full voting rights and will receive all dividends and other distributions paid with respect to the restricted shares. Restricted stock units do not have voting rights and are provided dividend equivalents. The restricted stock granted under the Plan is typically subject to a vesting period. Compensation expense for restricted stock is recognized over the requisite service period of generally four years for the entire award on a straight-line basis. Upon vesting of restricted stock, the benefit of tax deductions in excess of recognized compensation expense is reflected as an income tax benefit in the unaudited Consolidated Statements of Income.

Beginning in 2019, the Corporation issued a combination of performance based restricted stock units and restricted stock awards to its executive officers. Vesting of the performance based restricted stock units will be measured on Total Shareholder Return ("TSR") and Return on Equity ("ROE") and will cliff-vest after a three-year measurement period based on the Corporation's performance relative to a custom peer group. At the end of the performance period, the number of actual shares to be awarded varies between 0% and 200% of target amounts. The restricted stock awards issued to executive officers will vest ratably over a three-year period. Compensation expense is recognized for performance based restricted stock units over the requisite service and performance period of generally three years for the entire expected award on a straight-line basis. The

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compensation expense for the awards expected to vest for the percentage of performance based restricted stock units subject to the ROE metric will be adjusted if there is a change in the expectation of ROE. The compensation expense for the awards expected to vest for the percentage of performance based restricted stock units subject to the TSR metric should never be adjusted, and are amortized utilizing the accounting fair value provided using the Monte Carlo pricing model.

Restricted stock activity for the year ended December 31, 2018 and the three months ended March 31, 2019 was as follows:

	Number of Restricted Shares/Units	Weighted Average Grant-Date Fair Value
Nonvested balance as of January 1, 2018	130,441	$ 21.43
Granted	66,498	20.57
Vested	(46,034)	21.01
Forfeited	(19,284)	22.25
Nonvested balance as of December 31, 2018	131,621	21.02
Granted (1)	71,405	23.52
Vested	(901)	23.51
Forfeited	(165)	21.35
Nonvested balance as of March 31, 2019	201,960	$ 21.89

(1) The number of restricted shares/units shown includes the shares that would be granted if the target level of performance is achieved related to the performance based restricted stock units. The number of shares actually issued may vary.

As of March 31, 2019, the Corporation had $3.9 million of deferred unvested compensation expense, which the Corporation expects to recognize over a weighted-average period of approximately 2.97 years.

For the three months ended March 31, 2019 and 2018, share-based compensation expense related to restricted stock included in the unaudited Consolidated Statements of Income was $318,000 and $286,000, respectively.

Note 4 — Securities

The amortized cost and fair value of securities available-for-sale and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows:

	As of March 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. government agency securities - government-sponsored enterprises	$999	$ —	$ (5)	$994
Municipal securities	5,836	12	(28)	5,820
Mortgage backed securities - government issued	40,299	125	(301)	40,123
Mortgage backed securities - government-sponsored enterprises	108,112	525	(961)	107,676
Other securities	2,205	—	(35)	2,170
	$157,451	$ 662	$ (1,330)	$156,783

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	As of December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. government agency securities - government-sponsored enterprises	$999	$ —	$ (9)	$990
Municipal securities	5,953	2	(69)	5,886
Mortgage backed securities - government issued	20,007	47	(426)	19,628
Mortgage backed securities - government-sponsored enterprises	110,928	279	(1,729)	109,478
Other securities	2,450	—	(74)	2,376
	$140,337	$ 328	$ (2,307)	$138,358

The amortized cost and fair value of securities held-to-maturity and the corresponding amounts of gross unrealized gains and losses were as follows:

	As of March 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Held-to-maturity:				
Municipal securities	$20,597	$ 200	$ (7)	$20,790
Mortgage backed securities - government issued	7,035	—	(80)	6,955
Mortgage backed securities - government-sponsored enterprises	8,282	67	(89)	8,260
	$35,914	$ 267	$ (176)	$36,005

	As of December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Held-to-maturity:				
Municipal securities	$21,066	$ 72	$ (59)	$21,079
Mortgage backed securities - government issued	7,358	—	(172)	7,186
Mortgage backed securities - government-sponsored enterprises	9,307	2	(165)	9,144
	$37,731	$ 74	$ (396)	$37,409

U.S. government agency securities - government-sponsored enterprises represent securities issued by the Federal Home Loan Bank ("FHLB"), the Federal Home Loan Mortgage Corporation ("FHLMC"), and the Federal National Mortgage Association ("FNMA"). Municipal securities include securities issued by various municipalities located primarily within the State of Wisconsin and are primarily general obligation bonds that are tax-exempt in nature. Mortgage backed securities - government issued represent securities guaranteed by the Government National Mortgage Association and the SBA. Mortgage backed securities - government-sponsored enterprises include securities guaranteed by FHLMC and FNMA. Other securities represent certificates of deposit of insured banks and savings institutions with an original maturity greater than three months. No sales of available-for-sale securities occurred during the three months ended March 31, 2019 and 2018.

At March 31, 2019 and December 31, 2018, securities with a fair value of $12.0 million and $11.5 million, respectively, were pledged to secure various obligations, including interest rate swap contracts and municipal deposits.

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The amortized cost and fair value of securities by contractual maturity at March 31, 2019 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay certain obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)			
Due in one year or less	$1,716	$1,717	$1,267	$1,267
Due in one year through five years	20,200	20,030	12,346	12,422
Due in five through ten years	27,184	27,038	16,428	16,461
Due in over ten years	108,351	107,998	5,873	5,855
	$157,451	$156,783	$35,914	$36,005

The tables below show the Corporation's gross unrealized losses and fair value of available-for-sale investments aggregated by investment category and length of time that individual investments were in a continuous loss position at March 31, 2019 and December 31, 2018. At March 31, 2019, the Corporation held 123 available-for-sale securities that were in an unrealized loss position. Such securities have not experienced credit rating downgrades; however, they have primarily declined in value due to the current interest rate environment. At March 31, 2019, the Corporation held 122 available-for-sale securities that had been in a continuous unrealized loss position for twelve months or greater.

The Corporation also has not specifically identified available-for-sale securities in a loss position that it intends to sell in the near term and does not believe that it will be required to sell any such securities. The Corporation reviews its securities on a quarterly basis to monitor its exposure to other-than-temporary impairment. Consideration is given to such factors as the length of time and extent to which the security has been in an unrealized loss position, changes in security ratings, and an evaluation of the present value of expected future cash flows, if necessary. Based on the Corporation's evaluation, it is expected that the Corporation will recover the entire amortized cost basis of each security. Accordingly, no other-than-temporary impairment was recorded in the unaudited Consolidated Statements of Income for the three months ended March 31, 2019 and 2018.

A summary of unrealized loss information for securities available-for-sale, categorized by security type and length of time for which the security has been in a continuous unrealized loss position, follows:

	As of March 31, 2019					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Available-for-sale:						
U.S. government agency securities - government-sponsored enterprises	$—	$ —	$995	$ 5	$995	$ 5
Municipal securities	—	—	3,072	28	3,072	28
Mortgage backed securities - government issued	—	—	13,461	301	13,461	301
Mortgage backed securities - government-sponsored enterprises	1,850	2	67,300	959	69,150	961
Other securities	—	—	2,170	35	2,170	35
	$1,850	$ 2	$86,998	$ 1,328	$88,848	$ 1,330

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	As of December 31, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Available-for-sale:						
U.S. government agency securities - government-sponsored enterprises	$—	$ —	$990	$ 9	$990	$ 9
Municipal securities	—	—	4,371	69	4,371	69
Mortgage backed securities - government issued	—	—	13,748	426	13,748	426
Mortgage backed securities - government-sponsored enterprises	8,178	46	69,602	1,683	77,780	1,729
Other securities	238	7	2,138	67	2,376	74
	$8,416	$ 53	$90,849	$ 2,254	$99,265	$ 2,307

The tables below show the Corporation’s gross unrealized losses and fair value of held-to-maturity investments, aggregated by investment category and length of time that individual investments were in a continuous loss position at March 31, 2019 and December 31, 2018. At March 31, 2019, the Corporation held 25 held-to-maturity securities that were in an unrealized loss position. Such securities have not experienced credit rating downgrades; however, they have primarily declined in value due to the current interest rate environment. There were 21 held-to-maturity securities that had been in a continuous loss position for twelve months or greater as of March 31, 2019. It is expected that the Corporation will recover the entire amortized cost basis of each held-to-maturity security based upon an evaluation of aforementioned factors. Accordingly, no other-than-temporary impairment was recorded in the unaudited Consolidated Statements of Income for the three months ended March 31, 2019 and 2018.

A summary of unrealized loss information for securities held-to-maturity, categorized by security type and length of time for which the security has been in a continuous unrealized loss position, follows:

	As of March 31, 2019					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Held-to-maturity:						
Municipal securities	$677	$ 1	$1,194	$ 6	$1,871	$ 7
Mortgage backed securities - government issued	—	—	6,955	80	6,955	80
Mortgage backed securities - government-sponsored enterprises	—	—	4,142	89	4,142	89
	$677	$ 1	$12,291	$ 175	$12,968	$ 176

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	As of December 31, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Held-to-maturity:						
Municipal securities	$6,876	$ 14	$4,364	$ 45	$11,240	$ 59
Mortgage backed securities - government issued	—	—	7,186	172	7,186	172
Mortgage backed securities - government-sponsored enterprises	4,038	24	4,338	141	8,376	165
	$10,914	$ 38	$15,888	$ 358	$26,802	$ 396

Note 5 — Loan and Lease Receivables, Impaired Loans and Leases and Allowance for Loan and Lease Losses

Loan and lease receivables consist of the following:

	March 31, 2019	December 31, 2018
	(In Thousands)	
Commercial real estate:		
Commercial real estate — owner occupied	$212,698	$ 203,476
Commercial real estate — non-owner occupied	479,061	484,427
Land development	47,503	42,666
Construction	169,894	161,562
Multi-family	184,490	167,868
1-4 family	33,255	34,340
Total commercial real estate	1,126,901	1,094,339
Commercial and industrial	466,277	462,321
Direct financing leases, net	32,724	33,170
Consumer and other:		
Home equity and second mortgages	8,377	8,438
Other	23,367	20,789
Total consumer and other	31,744	29,227
Total gross loans and leases receivable	1,657,646	1,619,057
Less:		
Allowance for loan and lease losses	20,449	20,425
Deferred loan fees	1,000	1,402
Loans and leases receivable, net	$1,636,197	$ 1,597,230

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The total amount of the Corporation's ownership of SBA loans comprised of the following:

	March 31, 2019	December 31, 2018
	(In Thousands)	
Retained, unguaranteed portions of sold SBA loans	$23,403	$ 23,898
Other SBA loans(1)	22,880	22,024
Total SBA loans	$46,283	$ 45,922

(1) Primarily consisted of SBA CAPLine, Express, and impaired loans that were repurchased from the secondary market, all of which are not saleable.

As of March 31, 2019 and December 31, 2018, $14.7 million and $13.2 million of SBA loans were considered impaired, respectively.

Loans transferred to third parties consist of the guaranteed portions of SBA loans which the Corporation sold in the secondary market and participation interests in other, non-SBA originated loans. The total principal amount of the guaranteed portions of SBA loans sold during the three months ended March 31, 2019 and 2018 was $2.3 million and $3.1 million, respectively. Each of the transfers of these financial assets met the qualifications for sale accounting, and therefore all of the loans transferred during the three months ended March 31, 2019 and 2018 have been derecognized in the unaudited Consolidated Financial Statements. The guaranteed portions of SBA loans were transferred at their fair value and the related gain was recognized upon the transfer as non-interest income in the unaudited Consolidated Financial Statements. The total outstanding balance of sold SBA loans at March 31, 2019 and December 31, 2018 was $81.4 million and $83.3 million, respectively.

The total principal amount of transferred participation interests in other, non-SBA originated loans during the three months ended March 31, 2019 and 2018 was $6.8 million and $19.7 million, respectively, all of which were treated as sales and derecognized under the applicable accounting guidance at the time of transfer. No gain or loss was recognized on participation interests in other, non-SBA originated loans as they were transferred at or near the date of loan origination and the payments received for servicing the portion of the loans participated represents adequate compensation. The total outstanding balance of these transferred loans at March 31, 2019 and December 31, 2018 was $130.9 million and $129.7 million, respectively. As of March 31, 2019 and December 31, 2018, the total amount of the Corporation's partial ownership of these transferred loans on the unaudited Consolidated Balance Sheets was $212.8 million and $208.9 million, respectively. No loans in this participation portfolio were considered impaired as of March 31, 2019 and December 31, 2018. The Corporation does not share in the participant's portion of any potential charge-offs. The total amount of loan participations purchased on the unaudited Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018 was $550,000 and $569,000, respectively.

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The following tables illustrate ending balances of the Corporation's loan and lease portfolio, including impaired loans by class of receivable, and considering certain credit quality indicators:

	March 31, 2019				
	Category				
	I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$182,067	$17,097	$8,368	$5,166	$212,698
Commercial real estate — non-owner occupied	442,930	35,142	958	31	479,061
Land development	44,393	960	—	2,150	47,503
Construction	169,720	—	174	—	169,894
Multi-family	184,490	—	—	—	184,490
1-4 family	31,151	1,238	698	168	33,255
Total commercial real estate	1,054,751	54,437	10,198	7,515	1,126,901
Commercial and industrial	385,166	19,228	45,991	15,892	466,277
Direct financing leases, net	25,251	3,943	3,530	—	32,724
Consumer and other:					
Home equity and second mortgages	8,253	75	49	—	8,377
Other	23,065	—	—	302	23,367
Total consumer and other	31,318	75	49	302	31,744
Total gross loans and leases receivable	$1,496,486	$77,683	$59,768	$23,709	$1,657,646
Category as a % of total portfolio	90.28 %	4.69 %	3.60 %	1.43 %	100.00 %

	December 31, 2018				
	Category				
	I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$177,222	$15,085	$5,506	$5,663	$203,476
Commercial real estate — non-owner occupied	458,185	24,873	1,338	31	484,427
Land development	39,472	981	—	2,213	42,666
Construction	161,360	—	202	—	161,562
Multi-family	167,868	—	—	—	167,868
1-4 family	32,004	1,451	707	178	34,340
Total commercial real estate	1,036,111	42,390	7,753	8,085	1,094,339
Commercial and industrial	374,371	19,370	51,474	17,106	462,321
Direct financing leases, net	26,013	6,090	1,067	—	33,170
Consumer and other:					
Home equity and second mortgages	8,385	3	50	—	8,438
Other	20,499	—	—	290	20,789
Total consumer and other	28,884	3	50	290	29,227
Total gross loans and leases receivable	$1,465,379	$67,853	$60,344	$25,481	$1,619,057
Category as a % of total portfolio	90.51 %	4.19 %	3.73 %	1.57 %	100.00 %

Each credit is evaluated for proper risk rating upon origination, at the time of each subsequent renewal, upon receipt and evaluation of updated financial information from the Corporation's borrowers, or as other circumstances dictate. The Corporation primarily uses a nine grade risk rating system to monitor the ongoing credit quality of its loans and leases. The risk

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rating grades follow a consistent definition and are then applied to specific loan types based on the nature of the loan. Each risk rating is subjective and, depending on the size and nature of the credit, subject to various levels of review and concurrence on the stated risk rating. In addition to its nine grade risk rating system, the Corporation groups loans into four loan and related risk categories which determine the level and nature of review by management.

Category I — Loans and leases in this category are performing in accordance with the terms of the contract and generally exhibit no immediate concerns regarding the security and viability of the underlying collateral, financial stability of the borrower, integrity or strength of the borrowers' management team, or the industry in which the borrower operates. The Corporation monitors Category I loans and leases through payment performance, continued maintenance of its personal relationships with such borrowers, and continued review of such borrowers' compliance with the terms of their respective agreements.

Category II — Loans and leases in this category are beginning to show signs of deterioration in one or more of the Corporation's core underwriting criteria such as financial stability, management strength, industry trends, or collateral values. Management will place credits in this category to allow for proactive monitoring and resolution with the borrower to possibly mitigate the area of concern and prevent further deterioration or risk of loss to the Corporation. Category II loans are considered performing but are monitored frequently by the assigned business development officer and by subcommittees of the Bank's Loan Committee.

Category III — Loans and leases in this category are identified by management as warranting special attention. However, the balance in this category is not intended to represent the amount of adversely classified assets held by the Bank. Category III loans and leases generally exhibit undesirable characteristics, such as evidence of adverse financial trends and conditions, managerial problems, deteriorating economic conditions within the related industry, or evidence of adverse public filings and may exhibit collateral shortfall positions. Management continues to believe that it will collect all contractual principal and interest in accordance with the original terms of the contracts relating to the loans and leases in this category, and therefore Category III loans are considered performing with no specific reserves established for this category. Category III loans are monitored by management and subcommittees of the Bank's Loan Committee on a monthly basis.

Category IV — Loans and leases in this category are considered to be impaired. Impaired loans and leases, with the exception of performing troubled debt restructurings, have been placed on non-accrual as management has determined that it is unlikely that the Bank will receive the contractual principal and interest in accordance with the original terms of the agreement. Impaired loans are individually evaluated to assess the need for the establishment of specific reserves or charge-offs. When analyzing the adequacy of collateral, the Corporation obtains external appraisals at least annually for impaired loans and leases. External appraisals are obtained from the Corporation's approved appraiser listing and are independently reviewed to monitor the quality of such appraisals. To the extent a collateral shortfall position is present, a specific reserve or charge-off will be recorded to reflect the magnitude of the impairment. Loans and leases in this category are monitored by management and subcommittees of the Bank's Loan Committee on a monthly basis.

The delinquency aging of the loan and lease portfolio by class of receivable was as follows:

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	March 31, 2019					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans and Leases
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$—	$—	$—	$—	$207,532	$207,532
Non-owner occupied	—	—	—	—	479,030	479,030
Land development	—	—	—	—	45,353	45,353
Construction	—	—	—	—	169,894	169,894
Multi-family	—	—	—	—	184,490	184,490
1-4 family	—	—	—	—	33,255	33,255
Commercial and industrial	757	—	—	757	449,628	450,385
Direct financing leases, net	—	—	—	—	32,724	32,724
Consumer and other:						
Home equity and second mortgages	2	—	—	2	8,375	8,377
Other	—	—	—	—	23,066	23,066
Total	759	—	—	759	1,633,347	1,634,106
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	—	—	4,809	4,809	357	5,166
Non-owner occupied	—	—	31	31	—	31
Land development	—	—	119	119	2,031	2,150
Construction	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—
Commercial and industrial	933	3,035	11,581	15,549	343	15,892
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	—	—	—	—
Other	—	—	265	265	36	301
Total	933	3,035	16,805	20,773	2,767	23,540
Total loans and leases						
Commercial real estate:						
Owner occupied	—	—	4,809	4,809	207,889	212,698
Non-owner occupied	—	—	31	31	479,030	479,061
Land development	—	—	119	119	47,384	47,503
Construction	—	—	—	—	169,894	169,894
Multi-family	—	—	—	—	184,490	184,490
1-4 family	—	—	—	—	33,255	33,255
Commercial and industrial	1,690	3,035	11,581	16,306	449,971	466,277
Direct financing leases, net	—	—	—	—	32,724	32,724
Consumer and other:						
Home equity and second mortgages	2	—	—	2	8,375	8,377
Other	—	—	265	265	23,102	23,367
Total	$1,692	$3,035	$16,805	$21,532	$1,636,114	$1,657,646
Percent of portfolio	0.10 %	0.18 %	1.02 %	1.30 %	98.70 %	100.00 %

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	December 31, 2018					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans and Leases
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$157	$—	$—	$157	$197,656	$197,813
Non-owner occupied	—	2,272	—	2,272	482,124	484,396
Land development	—	—	—	—	40,453	40,453
Construction	14,824	—	—	14,824	146,738	161,562
Multi-family	—	—	—	—	167,868	167,868
1-4 family	363	60	—	423	33,917	34,340
Commercial and industrial	826	247	—	1,073	444,144	445,217
Direct financing leases, net	—	—	—	—	33,170	33,170
Consumer and other:						
Home equity and second mortgages	—	—	—	—	8,438	8,438
Other	—	—	—	—	20,499	20,499
Total	16,170	2,579	—	18,749	1,575,007	1,593,756
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	483	—	5,180	5,663	—	5,663
Non-owner occupied	—	—	31	31	—	31
Land development	—	—	119	119	2,094	2,213
Construction	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—
Commercial and industrial	2,322	—	12,108	14,430	2,674	17,104
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	—	—	—	—
Other	—	—	279	279	11	290
Total	2,805	—	17,717	20,522	4,779	25,301
Total loans and leases						
Commercial real estate:						
Owner occupied	640	—	5,180	5,820	197,656	203,476
Non-owner occupied	—	2,272	31	2,303	482,124	484,427
Land development	—	—	119	119	42,547	42,666
Construction	14,824	—	—	14,824	146,738	161,562
Multi-family	—	—	—	—	167,868	167,868
1-4 family	363	60	—	423	33,917	34,340
Commercial and industrial	3,148	247	12,108	15,503	446,818	462,321
Direct financing leases, net	—	—	—	—	33,170	33,170
Consumer and other:						
Home equity and second mortgages	—	—	—	—	8,438	8,438
Other	—	—	279	279	20,510	20,789
Total	$18,975	$2,579	$17,717	$39,271	$1,579,786	$1,619,057
Percent of portfolio	1.17 %	0.16 %	1.09 %	2.42 %	97.58 %	100.00 %

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The Corporation’s total impaired assets consisted of the following:

	March 31, 2019	December 31, 2018
	(In Thousands)	
Non-accrual loans and leases		
Commercial real estate:		
Commercial real estate — owner occupied	$5,166	$ 5,663
Commercial real estate — non-owner occupied	31	31
Land development	2,150	2,213
Construction	—	—
Multi-family	—	—
1-4 family	—	—
Total non-accrual commercial real estate	7,347	7,907
Commercial and industrial	15,892	17,104
Direct financing leases, net	—	—
Consumer and other:		
Home equity and second mortgages	—	—
Other	301	290
Total non-accrual consumer and other loans	301	290
Total non-accrual loans and leases	23,540	25,301
Foreclosed properties, net	2,547	2,547
Total non-performing assets	26,087	27,848
Performing troubled debt restructurings	169	180
Total impaired assets	$26,256	$ 28,028

	March 31, 2019	December 31, 2018
Total non-accrual loans and leases to gross loans and leases	1.42 %	1.56 %
Total non-performing assets to total gross loans and leases plus foreclosed properties, net	1.57	1.72
Total non-performing assets to total assets	1.30	1.42
Allowance for loan and lease losses to gross loans and leases	1.23	1.26
Allowance for loan and lease losses to non-accrual loans and leases	86.87	80.73

As of March 31, 2019 and December 31, 2018, $9.6 million and $7.6 million of the non-accrual loans and leases were considered troubled debt restructurings, respectively. There were no unfunded commitments associated with troubled debt restructured loans and leases as of March 31, 2019.

All loans and leases modified as a troubled debt restructuring are measured for impairment. The nature and extent of the impairment of restructured loans, including those which have experienced a default, is considered in the determination of an appropriate level of the allowance for loan and lease losses.

The following table provides the number of loans modified in a troubled debt restructuring and the pre- and post-modification recorded investment by class of receivable:

	For the Three Months Ended March 31, 2019		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
	(Dollars in Thousands)		
Commercial and industrial	4	$ 2,077	$ 2,077

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During the three months ended March 31, 2018, no loans were modified to a troubled debt restructuring. There were no loans and leases modified in a troubled debt restructuring during the previous 12 months which subsequently defaulted during the three months ended March 31, 2019 and 2018.

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The following represents additional information regarding the Corporation’s impaired loans and leases, including performing troubled debt restructurings, by class:

	As of and for the Three Months Ended March 31, 2019						
	Recorded Investment[1]	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment[2]	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$776	$776	$ —	$ 4,725	$ 21	$ 355	$ (334)
Non-owner occupied	31	71	—	229	1	—	1
Land development	2,150	6,447	—	2,198	16	—	16
Construction	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
1-4 family	168	173	—	171	—	6	(6)
Commercial and industrial	3,794	4,337	—	12,172	140	307	(167)
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	265	931	—	252	13	—	13
Total	7,184	12,735	—	19,747	191	668	(477)
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	4,390	5,749	690	680	107	—	107
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—	—
Commercial and industrial	12,098	12,211	3,984	3,805	420	—	420
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	37	37	37	20	—	—	—
Total	16,525	17,997	4,711	4,505	527	—	527
Total:							
Commercial real estate:							
Owner occupied	5,166	6,525	690	5,405	128	355	(227)
Non-owner occupied	31	71	—	229	1	—	1
Land development	2,150	6,447	—	2,198	16	—	16
Construction	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
1-4 family	168	173	—	171	—	6	(6)
Commercial and industrial	15,892	16,548	3,984	15,977	560	307	253
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	302	968	37	272	13	—	13

Grand total	$23,709	$30,732	$ 4,711	$ 24,252	$ 718	$ 668	$ 50

(1) The recorded investment represents the unpaid principal balance net of any partial charge-offs.
(2) Average recorded investment is calculated primarily using daily average balances.

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	As of and for the Year Ended December 31, 2018						
	Recorded Investment[1]	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment[2]	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$1,273	$1,273	$ —	$ 6,638	$ 756	$ 197	$ 559
Non-owner occupied	31	72	—	33	2	—	2
Land development	2,213	6,510	—	2,366	68	—	68
Construction	—	—	—	2,148	219	—	219
Multi-family	—	—	—	—	—	—	—
1-4 family	178	183	—	808	42	81	(39)
Commercial and industrial	6,828	7,527	—	8,809	1,058	980	78
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	1	—	46	(46)
Other	279	945	—	305	55	—	55
Total	10,802	16,510	—	21,108	2,200	1,304	896
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	4,390	5,749	675	635	182	—	182
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—	—
Commercial and industrial	10,278	10,278	3,710	4,687	1,096	—	1,096
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	11	11	11	1	—	—	—
Total	14,679	16,038	4,396	5,323	1,278	—	1,278
Total:							
Commercial real estate:							
Owner occupied	5,663	7,022	675	7,273	938	197	741
Non-owner occupied	31	72	—	33	2	—	2
Land development	2,213	6,510	—	2,366	68	—	68
Construction	—	—	—	2,148	219	—	219
Multi-family	—	—	—	—	—	—	—
1-4 family	178	183	—	808	42	81	(39)
Commercial and industrial	17,106	17,805	3,710	13,496	2,154	980	1,174
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	1	—	46	(46)
Other	290	956	11	306	55	—	55
Grand total	$25,481	$32,548	$ 4,396	$ 26,431	$ 3,478	$ 1,304	$ 2,174

(1) The recorded investment represents the unpaid principal balance net of any partial charge-offs.

(2) Average recorded investment is calculated primarily using daily average balances.

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The difference between the recorded investment of loans and leases and the unpaid principal balance of $7.0 million and $7.1 million as of March 31, 2019 and December 31, 2018, respectively, represents partial charge-offs of loans and leases resulting from losses due to the appraised value of the collateral securing the loans and leases being below the carrying values of the loans and leases. Impaired loans and leases also included $169,000 and $180,000 of loans as of March 31, 2019 and December 31, 2018, respectively, that were performing troubled debt restructurings, and although not on non-accrual, were reported as impaired due to the concession in terms. When a loan is placed on non-accrual, interest accrual is discontinued and previously accrued but uncollected interest is deducted from interest income. Cash payments collected on non-accrual loans are first applied to such loan's principal. Foregone interest represents the interest that was contractually due on the loan but not received or recorded. To the extent the amount of principal on a non-accrual loan is fully collected and additional cash is received, the Corporation will recognize interest income.

To determine the level and composition of the allowance for loan and lease losses, the Corporation categorizes the portfolio into segments with similar risk characteristics. First, the Corporation evaluates loans and leases for potential impairment classification. The Corporation analyzes each loan and lease determined to be impaired on an individual basis to determine a specific reserve based upon the estimated value of the underlying collateral for collateral-dependent loans, or alternatively, the present value of expected cash flows. The Corporation applies historical trends from established risk factors to each category of loans and leases that has not been individually evaluated for the purpose of establishing the general portion of the allowance.

A summary of the activity in the allowance for loan and lease losses by portfolio segment is as follows:

	As of and for the Three Months Ended March 31, 2019			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(In Thousands)			
Beginning balance	$11,662	$ 8,079	$ 684	$20,425
Charge-offs	—	(48)	—	(48)
Recoveries	1	19	3	23
Net recoveries (charge-offs)	1	(29)	3	(25)
Provision for loan and lease losses	(458)	435	72	49
Ending balance	$11,205	$ 8,485	$ 759	$20,449

	As of and for the Three Months Ended March 31, 2018			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(In Thousands)			
Beginning balance	$10,131	$ 8,225	$ 407	$18,763
Charge-offs	(2,175)	(490)	(20)	(2,685)
Recoveries	13	2	69	84
Net (charge-offs) recoveries	(2,162)	(488)	49	(2,601)
Provision for loan and lease losses	2,021	414	41	2,476
Ending balance	$9,990	$ 8,151	$ 497	$18,638

The following tables provide information regarding the allowance for loan and lease losses and balances by type of allowance methodology.

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	As of March 31, 2019			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(In Thousands)			
Allowance for loan and lease losses:				
Collectively evaluated for impairment	$10,515	$ 4,501	$ 722	$15,738
Individually evaluated for impairment	690	3,984	37	4,711
Loans acquired with deteriorated credit quality	—	—	—	—
Total	$11,205	$ 8,485	$ 759	$20,449
Loans and lease receivables:				
Collectively evaluated for impairment	$1,119,386	$ 483,109	$ 31,442	$1,633,937
Individually evaluated for impairment	7,368	15,890	302	23,560
Loans acquired with deteriorated credit quality	147	2	—	149
Total	$1,126,901	$ 499,001	$ 31,744	$1,657,646

	As of December 31, 2018			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(In Thousands)			
Allowance for loan and lease losses:				
Collectively evaluated for impairment	$10,987	$ 4,369	$ 673	$16,029
Individually evaluated for impairment	675	3,710	11	4,396
Loans acquired with deteriorated credit quality	—	—	—	—
Total	$11,662	$ 8,079	$ 684	$20,425
Loans and lease receivables:				
Collectively evaluated for impairment	$1,086,254	$ 478,385	$ 28,937	$1,593,576
Individually evaluated for impairment	7,914	17,104	290	25,308
Loans acquired with deteriorated credit quality	171	2	—	173
Total	$1,094,339	$ 495,491	$ 29,227	$1,619,057

Note 6 — Leases

The Corporation leases various office spaces, loan production offices, and specialty financing production offices under non-canceable operating leases which expire on various dates through 2028. The Corporation also leases office equipment. The Corporation recognizes an operating lease liability and a right-of-use for all leases, with the exception of short-term leases. The lease payments on short-term leases are recognized as rent expense on a straight-line basis.

Quantitative information regarding the Corporation’s operating leases is as follows:

	For the Three Months Ended March 31, 2019
	(Dollars in Thousands)
Total operating lease cost	$ 391
Weighted-average remaining lease term (in years)	7.10

Weighted-average discount rate	3.10	%

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The following maturity analysis shows the undiscounted cash flows due on the Corporation's operating leases liabilities:

(In Thousands)	
2019	$1,148
2020	1,541
2021	1,382
2022	1,373
2023	1,015
Thereafter	3,063
Total undiscounted cash flows	9,522
Discount on cash flows	(1,018)
Total lease liability	$8,504

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Note 7 — Other Assets

A summary of accrued interest receivable and other assets was as follows:

	March 31, 2019	December 31, 2018
	(In Thousands)	
Accrued interest receivable	$6,392	$ 5,684
Net deferred tax asset	3,151	3,172
Investment in historic development entities	1,889	1,653
Investment in a community development entity	5,954	6,081
Investment in limited partnerships	4,127	4,176
Investment in Trust II	315	315
Fair value of interest rate swaps	8,337	4,637
Prepaid expenses	2,952	2,894
Other assets	7,597	6,039
Total accrued interest receivable and other assets	$40,714	$ 34,651

Note 8 — Deposits

The composition of deposits is shown below. Average balances represent year to date averages.

	March 31, 2019			December 31, 2018		
	Balance	Average Balance	Average Rate	Balance	Average Balance	Average Rate
	(Dollars in Thousands)					
Non-interest-bearing transaction accounts	$286,345	$257,222	— %	$280,769	$241,529	— %
Interest-bearing transaction accounts	206,360	215,400	1.62	229,612	269,943	0.99
Money market accounts	579,539	555,692	1.82	516,045	491,756	1.09
Certificates of deposit	167,250	159,600	2.40	153,022	94,172	1.70
Wholesale deposits	262,212	267,791	2.16	275,851	302,440	1.95
Total deposits	$1,501,706	$1,455,705	1.59	$1,455,299	$1,399,840	1.11

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Note 9 — FHLB Advances, Other Borrowings and Junior Subordinated Notes

The composition of borrowed funds is shown below. Average balances represent year to date averages.

	March 31, 2019			December 31, 2018		
	Balance	Weighted Average Balance	Weighted Average Rate	Balance	Weighted Average Balance	Weighted Average Rate
	(Dollars in Thousands)					
Federal funds purchased	$—	$—	— %	$—	$119	2.43 %
FHLB advances	245,500	267,989	2.16	274,500	274,382	2.06
Line of credit	—	—	—	—	3	4.47
Other borrowings	675	675	8.00	675	675	7.94
Subordinated notes payable	23,783	23,774	6.63	23,769	23,739	6.64
Junior subordinated notes	10,037	10,034	10.92	10,033	10,025	11.10
	$279,995	$302,472	2.82	$308,977	$308,943	2.72
Short-term borrowings	$119,000			$136,500		
Long-term borrowings	160,995			172,477		
	$279,995			$308,977		

As of March 31, 2019 and December 31, 2018, the Corporation was in compliance with its debt covenants under its third-party secured senior line of credit. Per the promissory note dated February 19, 2019, the Corporation pays a commitment fee on this line of credit. During both the three months ended March 31, 2019 and 2018, the Corporation incurred interest expense due to this fee of $3,000.

Note 10 — Commitments and Contingencies

In the normal course of business, various legal proceedings involving the Corporation are pending. Management, based upon advice from legal counsel, does not anticipate any significant losses as a result of these actions. Management believes that any liability arising from any such proceedings currently existing or threatened will not have a material adverse effect on the Corporation's financial position, results of operations, and cash flows.

The Corporation sells the guaranteed portions of SBA loans, as well as participation interests in other, non-SBA originated loans, to third parties. The Corporation has a continuing involvement in each of the transferred lending arrangements by way of relationship management and servicing the loans, as well as being subject to normal and customary requirements of the SBA loan program and standard representations and warranties related to sold amounts. In the event of a loss resulting from default and a determination by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced by the Corporation, the SBA may require the Corporation to repurchase the loan, deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of the principal loss related to the deficiency from the Corporation. The Corporation must comply with applicable SBA regulations in order to maintain the guaranty. In addition, the Corporation retains the option to repurchase the sold guaranteed portion of an SBA loan if the loan defaults.

Management has assessed estimated losses inherent in the outstanding guaranteed portions of SBA loans sold in accordance with ASC 450, Contingencies, and determined a recourse reserve based on the probability of future losses for these loans to be $3.3 million at March 31, 2019, which is reported in accrued interest payable and other liabilities on the unaudited Consolidated Balance Sheet.

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The summary of the activity in the SBA recourse reserve is as follows:

	As of and for the Three Months Ended	
	March 31, 2019	March 31, 2018
	(In Thousands)	
Balance at the beginning of the period	$2,956	$ 2,849
SBA recourse provision	481	(295)
Charge-offs, net	(161)	(38)
Balance at the end of the period	$3,276	$ 2,516

Note 11 — Fair Value Disclosures

The Corporation determines the fair values of its financial instruments based on the fair value hierarchy established in ASC Topic 820, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is defined as the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date and is based on exit prices. Fair value includes assumptions about risk, such as nonperformance risk in liability fair values, and is a market-based measurement, not an entity-specific measurement. The standard describes three levels of inputs that may be used to measure fair value.

Level 1 — Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

Level 2 — Level 2 inputs are inputs, other than quoted prices included with Level 1, that are observable for the asset or liability either directly or indirectly, 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 — Level 3 inputs are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Assets and liabilities measured at fair value on a recurring basis, segregated by fair value hierarchy level, are summarized below: