GLEN BURNIE BANCORP
Form 10-Q
November 13, 2018
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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 September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-24047

GLEN BURNIE BANCORP

(Exact name of registrant as specified in its charter)

Maryland	52-1782444
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Crain Highway, S.E.
Glen Burnie, Maryland 21061
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (410) 766-3300

Inapplicable

(Former name, former address and former fiscal year if changed from 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 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 such files).

Yes No

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

Large accelerated filer	Accelerated filer
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

The number of shares of the registrant's common stock outstanding as of November 5, 2018 was 2,814,157.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	September 30, 2018 (unaudited)	December 31, 2017 (audited)
ASSETS		
Cash and due from banks	$ 5,282	$ 2,610
Interest-bearing deposits in other financial institutions	10,208	9,995
Cash and Cash Equivalents	15,490	12,605
Investment securities available for sale, at fair value	84,029	89,349
Restricted equity securities, at cost	2,073	1,232
Loans, net of deferred fees and costs	294,981	271,612
Less: Allowance for loan losses	(2,455)	(2,589)
Loans, net	292,526	269,023
Real estate acquired through foreclosure	705	114
Premises and equipment, net	3,154	3,371
Bank owned life insurance	7,818	8,713
Deferred tax assets, net	2,863	2,429
Accrued interest receivable	1,233	1,133
Accrued taxes receivable	—	465
Prepaid expenses	516	433
Other assets	958	583
Total Assets	$ 411,365	$ 389,450
LIABILITIES		
Noninterest-bearing deposits	$ 107,921	$ 104,017
Interest-bearing deposits	228,926	230,221
Total Deposits	336,847	334,238
Short-term borrowings	40,000	20,000
Defined pension liability	323	335
Accrued Taxes Payable	102	—
Accrued expenses and other liabilities	749	835
Total Liabilities	378,021	355,408
STOCKHOLDERS' EQUITY		
	2,811	2,801

Common stock, par value $1, authorized 15,000,000 shares, issued and outstanding 2,810,961 and 2,801,149 shares as of September 30, 2018 and December 31, 2017 , respectively.		
Additional paid-in capital	10,368	10,267
Retained earnings	21,936	21,605
Accumulated other comprehensive loss	(1,771)	(631)
Total Stockholders' Equity	33,344	34,042
Total Liabilities and Stockholders' Equity	$ 411,365	$ 389,450

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
INTEREST INCOME				
Interest and fees on loans	$ 3,269	$ 2,883	$ 9,100	$ 8,503
Interest and dividends on securities	526	498	1,585	1,523
Interest on deposits with banks and federal funds sold	67	53	165	115
Total Interest Income	3,862	3,434	10,850	10,141
INTEREST EXPENSE				
Interest on deposits	362	324	997	984
Interest on short-term borrowings	198	142	506	309
Interest on long-term borrowings	—	33	—	185
Total Interest Expense	560	499	1,503	1,478
Net Interest Income	3,302	2,935	9,347	8,663
Provision for loan losses	246	78	601	243
Net interest income after provision for loan losses	3,056	2,857	8,746	8,420
NONINTEREST INCOME				
Service charges on deposit accounts	59	72	187	208
Other fees and commissions	216	245	564	573
Gains on redemption of BOLI policies	—	—	308	1
Income on life insurance	41	51	130	151
Gains on sale of OREO	15	—	15	—
Other income	—	—	—	2
Total Noninterest Income	331	368	1,204	935
NONINTEREST EXPENSE				
Salary and benefits	1,710	1,579	5,080	4,615
Occupancy and equipment expenses	272	382	850	865
Legal, accounting and other professional fees	212	180	721	648
Data processing and item processing services	168	130	454	442
FDIC insurance costs	64	64	187	188
Advertising and marketing related expenses	16	38	65	110

Loan collection costs	32	25	153	73
Telephone costs	56	98	181	212
Other expenses	226	217	911	944
Total Noninterest Expenses	2,756	2,713	8,602	8,097
Income before income taxes	631	512	1,348	1,258
Income tax (benefit) expense	89	101	73	194
NET INCOME	$ 542	$ 411	$ 1,275	$ 1,064
Basic and diluted net income per share of common stock	$ 0.19	$ 0.15	$ 0.45	$ 0.38

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$ 542	$ 411	$ 1,275	$ 1,064
Other comprehensive (loss) income :				
Net unrealized gain (loss) on securities available for sale:				
Net unrealized (loss) gain on securities during the period	(662)	(111)	(2,237)	795
Income tax benefit (expense) relating to item above	182	44	616	(313)
Reclassification adjustment for gain on sales of securities included in net income	—	—	—	(1)
Net effect on other comprehensive (loss) income	(480)	(67)	(1,621)	481
Net unrealized gain on interest rate swap:				
Net unrealized gain on interest rate swap during the period	118	—	664	—
Income tax expense relating to item above	(33)	—	(183)	—
Net effect on other comprehensive income	85	—	481	—
Other comprehensive (loss) income	(395)	(67)	(1,140)	481
Comprehensive income	$ 147	$ 344	$ 135	$ 1,545

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)

(unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2016	$ 2,787	$ 10,130	$ 21,708	$ (810)	$ 33,815
Net income	—	—	1,064	—	1,064
Cash dividends, $0.30 per share	—	—	(837)	—	(837)
Dividends reinvested under dividend reinvestment plan	10	103	—	—	113
Other comprehensive income	—	—	—	481	481
Balance, September 30, 2017	$ 2,797	$ 10,233	$ 21,935	$ (329)	$ 34,636

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Total
Balance, December 31, 2017	$ 2,801	$ 10,267	$ 21,605	$ (631)	$ 34,042
Net income	—	—	1,275	—	1,275
Cash dividends, $0.30 per share	—	—	(944)	—	(944)
Dividends reinvested under dividend reinvestment plan	10	101	—	—	111
Other comprehensive loss	—	—	—	(1,140)	(1,140)
Balance, September 30, 2018	$ 2,811	$ 10,368	$ 21,936	$ (1,771)	$ 33,344

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	$ 1,275	$ 1,064
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and accretion of premises and equipment	828	793
Provision for loan losses	601	243
Gain on life insurance	(308)	—
Gain on disposals of assets, net	(15)	(1)
Increase in cash surrender value of bank owned life insurance	(130)	(151)
Decrease in ground rents	8	7
(Increase) in accrued interest receivable	(100)	(6)
Net decrease in other assets	2,010	955
Net decrease (increase) in accrued expenses and other liabilities	5	(237)
Net cash provided by operating activities	4,174	2,667
Cash flows from investing activities:		
Redemptions and maturities of investment securities available for sale	8,048	12,613
Purchases of investment securities available for sale	(5,440)	(7,868)
Net (purchase) sales of Federal Home Loan Bank stock	(841)	2
Net increase in loans	(24,810)	(6,509)
Proceeds from sale of real estate acquired through foreclosure	114	—
Purchases of premises and equipment	(138)	(165)
Net cash used in investing activities	(23,067)	(1,927)
Cash flows from financing activities:		
Net increase in deposits	2,611	859
Increase in short term borrowings	20,000	10,000
Decrease in long term borrowings	—	(10,000)
Cash dividends paid	(944)	(837)
Common stock dividends reinvested	111	113
Net cash provided by financing activities	21,778	135
Net increase in cash and cash equivalents	2,885	875

Cash and cash equivalents at beginning of year	12,605	10,622
Cash and cash equivalents at end of year	$ 15,490	$ 11,497
Supplemental Disclosures of Cash Flow Information:		
Interest paid on deposits and borrowings	$ 1,455	$ 1,621
Net income taxes (refunded) paid	(509)	152
Net (increase) decrease in unrealized depreciation on available for sale securities	(2,237)	795
Net increase in unrealized appreciation on swaps	664	—
Noncash Investing Activities:		
Transfer of loans to real estate acquired through foreclosure	705	—

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATIONAL

Nature of Business

Glen Burnie Bancorp (the "Company") is a bank holding company organized in 1990 under the laws of the State of Maryland. The Company owns all the outstanding shares of capital stock of The Bank of Glen Burnie (the "Bank"), a commercial bank organized in 1949 under the laws of the State of Maryland (the "State"). The Bank provides financial services to individuals and corporate customers located in Anne Arundel County and surrounding areas of Central Maryland, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

NOTE 2 – BASIS OF PRESENTATION

In management's opinion, the accompanying unaudited consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim period reporting, reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial position at September 30, 2018 and December 31, 2017, the results of operations for the three- and nine-month periods ended September 30, 2018 and 2017, and the statements of cash flows for the three- and nine-month periods ended September 30, 2018 and 2017. The operating results for the three- and nine-month period ended September 30, 2018 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2018 or any future interim period. The consolidated balance sheet at December 31, 2017 has been derived from the audited financial statements included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (the "SEC") on April 2, 2018. The unaudited consolidated financial statements for September 30, 2018 and 2017, the consolidated balance sheet at December 31, 2017, and accompanying notes should be read in conjunction with the Company's audited consolidated financial statements and the accompanying notes thereto that are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, The Bank of Glen Burnie and GBB Properties. Consolidation resulted in the elimination of all intercompany accounts and transactions.

Cash Flow Presentation

In the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, Federal Home Loan Bank of Atlanta ("FHLB Atlanta") overnight deposits, and federal funds sold. Generally, federal funds are sold for one-day periods.

Reclassifications

Certain items in the 2017 consolidated financial statements have been reclassified to conform to the 2018 classifications. The reclassifications had no effect on previously reported results of operations or retained earnings.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses (the "allowance"); the fair value of financial instruments,

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such as loans and investment securities; benefit plan obligations and expenses; and the valuation of deferred tax assets and liabilities.

NOTE 3 – EARNINGS PER SHARE

Basic earnings per common share (“EPS”) is computed by dividing net income available to common shareholders by the weighted average common shares outstanding during the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average common shares outstanding, plus the effect of common stock equivalents (for example, stock options computed using the treasury stock method).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Basic and diluted earnings per share:				
Net income	$ 542,118	$ 410,403	$ 1,275,273	$ 1,064,116
Weighted average common shares outstanding	2,809,834	2,796,099	2,806,341	2,792,544
Basic and dilutive net income per share	$ 0.19	$ 0.15	$ 0.45	$ 0.38

Diluted earnings per share calculations were not required for the three- and nine-month periods ended September 30, 2018 and 2017, as there were no stock options outstanding.

NOTE 4 – INVESTMENT SECURITIES

Investment securities are accounted for according to their purpose and holding period. Trading securities are those that are bought and held principally for the purpose of selling them in the near term. The Company held no trading securities at September 30, 2018 or December 31, 2017. Available-for-sale investment securities, comprised of debt and mortgage-backed securities, are those that may be sold before maturity due to changes in the Company's interest rate risk profile or funding needs, and are reported at fair value with unrealized gains and losses, net of taxes, reported as a component of other comprehensive income. Held-to-maturity investment securities are those that management has the positive intent and ability to hold to maturity and are reported at amortized cost. The Company held no held-to-maturity securities at September 30, 2018 or December 31, 2017.

Realized gains and losses are recorded in noninterest income and are determined on a trade date basis using the specific identification method. Interest and dividends on investment securities are recognized in interest income on an accrual basis. Premiums and discounts are amortized or accreted into interest income using the interest method over the expected lives of the individual securities.

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The following table summarizes the amortized cost and estimated fair value of the Company's investment securities portfolio at September 30, 2018 and December 31, 2017:

	At September 30, 2018			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Collateralized mortgage obligations	$ 21,580	$ 13	$ (1,028)	$ 20,565
Agency mortgage-backed securities	26,838	6	(1,230)	25,614
Municipal securities	35,268	27	(849)	34,446
U.S. Government agency securities	1,999	—	(80)	1,919
U.S. Treasury securities	1,501	—	(16)	1,485
Total securities available for sale	$ 87,186	$ 46	$ (3,203)	$ 84,029

	At December 31, 2017			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Collateralized mortgage obligations	$ 24,063	$ 20	$ (569)	$ 23,514
Agency mortgage-backed securities	25,725	4	(500)	25,229
Municipal securities	35,453	339	(159)	35,633
U.S. Government agency securities	3,526	—	(46)	3,480
U.S. Treasury securities	1,501	—	(8)	1,493
Total securities available for sale	$ 90,268	$ 363	$ (1,282)	$ 89,349

The gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2018 and December 31, 2017 are as follows:

September 30, 2018	Less than 12 months		12 months or more		Total	
Securities available for sale:	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in thousands)					
	$ 3,634	$ (115)	$ 15,792	$ (914)	$ 19,426	$ (1,029)

Collateralized mortgage obligations						
Agency mortgage-backed securities	8,072	(340)	17,364	(889)	25,436	(1,229)
Municipal securities	21,078	(588)	6,034	(261)	27,112	(849)
U.S. Government agency securities	—	—	1,919	(80)	1,919	(80)
U.S. Treasury securities	985	(16)	500	—	1,485	(16)
	$ 33,769	$ (1,059)	$ 41,609	$ (2,144)	$ 75,378	$ (3,203)

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December 31, 2017	Less than 12 months		12 months or more		Total	
Securities available for sale:	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in thousands)					
Collateralized mortgage obligations	$ 6,531	$ (63)	$ 15,678	$ (507)	$ 22,209	$ (570)
Agency mortgage-backed securities	6,802	(80)	18,218	(420)	25,020	(500)
Municipal securities	2,396	(11)	6,230	(148)	8,626	(159)
U.S. Government agency securities	2,965	(37)	515	(9)	3,480	(46)
U.S. Treasury securities	1,494	(7)	—	—	1,494	(7)
	$ 20,188	$ (198)	$ 40,641	$ (1,084)	$ 60,829	$ (1,282)

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary-impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2018, the Company recorded unrealized losses in its portfolio of debt securities totaling $3.2 million related to one hundred sixty securities, which resulted from increases in market interest rates, spread volatility, and other factors that management deems to be temporary. Management does not believe the securities are impaired due to reasons of credit quality. Since management believes that it is more likely than not that the Company will not be required to sell these securities prior to maturity or a full recovery of the amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

At December 31, 2017, the Company recorded unrealized losses in its portfolio of debt securities totaling $1.3 million related to one hundred fourteen securities, which resulted from increases in market interest rates, spread volatility, and other factors that management deems to be temporary. Management does not believe the securities are impaired due to reasons of credit quality. Since management believes that it is more likely than not that the Company will not be required to sell these securities prior to maturity or a full recovery of the amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

Shown below are contractual maturities of debt securities at September 30, 2018. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	At September 30, 2018		
(dollars in thousands)	Amortized Cost	Fair Value	Yield (1), (2)
Available for sale securities maturing:			
Within one year	$ 1,935	$ 1,937	3.62 %
Over one to five years	2,467	2,452	2.30 %
Over five to ten years	20,141	19,378	2.13 %
Over ten years	62,643	60,262	2.86 %
Total debt securities	$ 87,186	$ 84,029	

(1) Yields are stated as book yields which are adjusted for amortization and accretion of purchase premiums and discounts, respectively.

(2) Yields on tax-exempt obligations are computed on a tax-equivalent basis.

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NOTE 5 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The fundamental lending business of the Company is based on understanding, measuring, and controlling the credit risk inherent in the loan portfolio. The Company's loan portfolio is subject to varying degrees of credit risk. These risks entail both general risks, which are inherent in the lending process, and risks specific to individual borrowers. The Company's credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry or collateral type.

The Company currently manages its credit products and the respective exposure to loan losses by the following specific portfolio segments, which are levels at which the Company develops and documents its systematic methodology to determine the allowance for loan losses. The Company considers each loan type to be a portfolio segment having unique risk characteristics.

	September 30, 2018		December 31, 2017	
(dollars in thousands)	Amount	%	Amount	%
Consumer	$ 14,602	5	$ 16,112	6
Residential real estate	82,705	28	81,926	30
Indirect	110,192	38	85,186	32
Commercial	13,266	4	11,257	4
Construction	2,677	1	3,536	1
Commercial real estate	71,539	24	73,595	27
Loans, net of deferred fees and costs	294,981	100	271,612	100
Less: Allowance for loan losses	(2,455)		(2,589)	
Loans, net	$ 292,526		$ 269,023	

The Bank's net loans totaled $292.5 million at September 30, 2018, compared to $269.0 million at December 31, 2017, an increase of $23.5 million, or 8.74%. Consumer loans decreased from $16.1 million at December 31, 2017 to $14.6 million at September 30, 2018, a decrease of $1.5 million, or 9.37%. Residential real estate loans increased by $0.8 million, or 0.95%, from $81.9 million at December 31, 2017 to $82.7 million at September 30, 2018. Indirect loans increased from $85.2 million at December 31, 2017 to $110.2 million at September 30, 2018, an increase of $25.0 million, or 29.36%. Commercial loans increased $2.0 million, or 17.85%, to $13.3 million at September 30, 2018 compared to $11.3 million at December 31, 2017. Construction loans decreased by $0.9 million, or 24.27% to $2.7 million at September 30, 2018, compare to $3.5 million at December 31, 2017. Commercial real estate loans decreased from $73.6 million at December 31, 2017 to $71.5 million at September 30, 2018, a decrease of $2.0 million or 2.79%.

Credit Risk and Allowance for Loan Losses. Credit risk is the risk of loss arising from the inability of a borrower to meet his or her obligations and entails both general risks, which are inherent in the process of lending, and risks specific to individual borrowers. Credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry, or collateral type. Residential mortgage and home equity loans and lines generally have the lowest credit loss experience. Loans secured by personal property, such as auto loans, generally experience medium credit losses. Unsecured loan products, such as personal revolving credit, have the highest credit loss experience and for that reason, the Bank has chosen not to engage in a significant amount of this type of lending. Credit risk in commercial lending can vary significantly, as losses as a percentage of outstanding loans can shift widely during economic cycles and are particularly sensitive to changing economic conditions. Generally, improving economic conditions result in improved operating results on the part of commercial customers, enhancing their ability to meet their particular debt service requirements. Improvements, if any, in operating cash flows can be offset by the impact of rising interest rates that may occur during improved economic times. Inconsistent economic conditions may have an adverse effect on the operating results of commercial customers, reducing their ability to meet debt service obligations.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance, based on evaluations of the collectability of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible.

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The evaluations are performed for each class of loans and take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, value of collateral securing the loans and current economic conditions and trends that may affect the borrowers' ability to pay. For example, delinquencies in unsecured loans and indirect automobile installment loans will be reserved for at significantly higher ratios than loans secured by real estate. Based on that analysis, the Bank deems its allowance for loan losses in proportion to the total nonaccrual loans and past due loans to be sufficient.

For purposes of determining the allowance for loan losses, the Bank segments the loan portfolio into the following classifications:

- Consumer
- Residential Real Estate
- Indirect
- Commercial
- Construction
- Commercial Real Estate

Each of these segments are reviewed and analyzed quarterly using the average historical charge-offs over a forty-eight to sixty month period for their respective segments as well as the following qualitative factors:

- Changes in asset quality metrics including past due loans (30 - 89 days), nonaccrual loans, classified assets, watch list loans all in relation to total loans. Also policy exceptions in relationship to loan volume.
- Changes in the rate and direction of the loan volume by portfolio segment.
- Concentration of credit including the concentration percentages, changes in concentration and concentrations relative to goals.
- Changes in macro-economic factors including the rates and direction of unemployment, median income and population.
- Changes in internal factors including external loan review required reserve changes, internal review penetration, internal required reserve changes, and weighted required reserve trends.
- Changes in rate and direction of charge offs and recoveries.

Transactions in the allowance for loan losses for the nine months ended September 30, 2018 and the year ended December 31, 2017 were as follows:

September 30, 2018 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Unallocated	Total
	$ 214	$ 1,061	$ 774	$ 237	$ 12	$ 291	$ —	$ 2,589

Balance, beginning of year								
Charge-offs	(96)	(589)	(256)	(13)	—	—	—	(954)
Recoveries	46	2	171	—	—	—	—	219
Provision for loan losses	40	353	234	18	(9)	(35)	—	601
Balance, end of year	$ 204	$ 827	$ 923	$ 242	$ 3	$ 256	$ —	$ 2,455
Individually evaluated for impairment:								
Balance in allowance	$ 74	$ —	$ —	$ 208	$ —	$ —	$ —	$ 282
Related loan balance	280	1,282	—	208	—	1,085	—	2,855
Collectively evaluated for impairment:								
Balance in allowance	$ 130	$ 827	$ 923	$ 34	$ 3	$ 256	$ —	$ 2,173
Related loan balance	14,322	81,423	110,192	13,058	2,677	70,454	—	292,126

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December 31, 2017 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Unallocated	Total
Balance, beginning of year	$ 182	$ 1,042	$ 693	$ 284	$ 10	$ 259	$ 14	$ 2,484
Charge-offs	(96)	(3)	(458)	(9)	—	—	—	(566)
Recoveries	8	27	286	—	—	14	—	335
Provision for loan losses	120	(5)	253	(38)	2	18	(14)	336
Balance, end of year	$ 214	$ 1,061	$ 774	$ 237	$ 12	$ 291	$ —	$ 2,589
Individually evaluated for impairment:								
Balance in allowance	$ 52	$ 513	$ —	$ 217	$ —	$ —	$ —	$ 782
Related loan balance	160	2,345	—	217	—	1,176	—	3,898
Collectively evaluated for impairment:								
Balance in allowance	$ 162	$ 548	$ 774	$ 20	$ 12	$ 291	$ —	$ 1,807
Related loan balance	15,952	79,580	85,186	11,040	3,536	72,420	—	267,714

Management believes the allowance for credit losses is at an appropriate level to absorb inherent probable losses in the portfolio.

(dollars in thousands)	September 30, 2018	September 30, 2017
Average loans	$ 283,005	$ 269,333
Net charge offs to average loans (annualized)	0.35 %	0.05 %

During the nine-month period ending September 30, 2018, loans to 43 borrowers and related entities totaling approximately $954,000 were determined to be uncollectible and were charged off. During the nine-month period ending September 30, 2017, loans to 48 borrowers and related entities totaling approximately $356,000 were determined to be uncollectible and were charged off.

Reserve for Unfunded Commitments. Loan commitments and unused lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The Bank generally requires collateral to support financial instruments with credit risk on the same basis as it does for on-balance sheet instruments. The collateral requirement is based on management's credit evaluation of the counter party. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

As of September 30, 2018 and 2017, the Bank had outstanding commitments totaling $31.4 million and $21.3 million, respectively. These outstanding commitments consisted of letters of credit, undrawn lines of credit, and other

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loan commitments. The following table shows the Bank's reserve for unfunded commitments arising from these transactions:

(dollars in thousands)	Nine Months Ended September 30, 2018	2017
Beginning balance	$ 24	$ 25
Reduction of unfunded reserve	(45)	(29)
Provisions charged to operations	46	17
Ending balance	$ 25	$ 13

Contractual Obligations and Commitments. No material changes, outside the normal course of business, have been made during 2018.

Asset Quality. The following tables set forth the amount of the Bank's current, past due, and non-accrual loans by categories of loans and restructured loans, at the dates indicated.

At September 30, 2018 (dollars in thousands)	Current	30-89 Days Past Due	90 Days or More and Still Accruing	Nonaccrual	Total
Consumer	$ 14,187	$ 81	$ —	$ 334	$ 14,602
Residential Real Estate	81,335	409	28	933	82,705
Indirect	109,380	677	—	135	110,192
Commercial	13,266	—	—	—	13,266
Construction	2,449	—	—	228	2,677
Commercial Real Estate	71,007	—	—	532	71,539
	$ 291,624	$ 1,167	$ 28	$ 2,162	$ 294,981

At December 31, 2017 (dollars in thousands)	Current	30-89 Days Past Due	90 Days or More and Still Accruing	Nonaccrual	Total

Consumer	$ 15,823	$ 80	$ 24	$ 185	$ 16,112
Residential Real Estate	79,205	597	—	2,124	81,926
Indirect	83,932	1,166	—	88	85,186
Commercial	11,203	—	6	48	11,257
Construction	3,188	—	30	318	3,536
Commercial Real Estate	73,088	—	—	507	73,595
	$ 266,439	$ 1,843	$ 60	$ 3,270	$ 271,612

The balances in the above charts have not been reduced by the allowance for loan loss. For the period ending September 30, 2018, the allowance for loan loss is $2.5 million. For the period ending December 31, 2017, the allowance for loan loss is $2.6 million.

At September 30, 2018, there was $1.0 million in loans outstanding, that were in an accrual status, but known information about possible credit problems of borrowers caused management to have doubts as to the ability of such borrowers to comply with present loan repayment terms. Such loans consist of loans which were not 90 days or more past due but where the borrower is in bankruptcy or has a history of delinquency, or the loan to value ratio is considered excessive due to deterioration of the collateral or other factors. The three loans outstanding, totaling $1.0 million are as follows: $626,000 Commercial Real Estate loan where the guarantor is in bankruptcy and the loan has an accelerated

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payoff since we have an assignment of rents from the property which has a very long-term national tenant; $158,000 Home Equity Line of Credit which is paying as agreed, however the borrower has defaulted on other commercial loans which have been satisfied; and a $208,000 Commercial loan with a loan to value ratio which has deteriorated, which has a complete specific reserve of $208,000. All three of these loans are classified with a risk rating of Substandard.

Non-accrual loans with specific reserves at September 30, 2018 are comprised of:

Consumer loans – Three loans to three borrowers that totaled $230,677 with specific reserves of $74,149 established for the loans. One of these loans totaling $44,401 with a specific reserve in the amount of $15,953 was also a Troubled Debt Restructured loan.

Below is a summary of the recorded investment amount and related allowance for losses of the Bank's impaired loans at September 30, 2018 and December 31, 2017.

September 30, 2018 (dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Interest Income Recognized	Specific Reserve	Average Recorded Investment
Impaired loans with specific reserves:					
Consumer	$ 231	$ 231	$ 5	$ 74	$ 274
Commercial	208	208	6	208	212
Total impaired loans with specific reserves	438	438	11	282	486
Impaired loans with no specific reserve:					
Consumer	$ 104	$ 104	$ 1	$ —	$ 50
Residential Real Estate	1,090	1,516	10	—	1,660
Indirect	108	108	—	—	—
Construction	228	228	—	—	236
Commercial Real Estate	1,158	1,468	27	—	1,643
Total impaired loans with no specific reserve	$ 2,688	$ 3,424	$ 38	—	$ 3,589

December 31, 2017 (dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Interest Income Recognized	Specific Reserve	Average Recorded Investment
Impaired loans with specific reserves:					
Consumer	$ 160	$ 160	$ 5	$ 52	$ 205
Residential Real Estate	1,294	1,322	—	513	1,312
Commercial	217	217	—	217	223
Total impaired loans with specific reserves	1,671	1,699	5	782	1,740

Impaired loans with no specific reserve:					
Consumer	$ 49	$ 49	$ —	—	$ —
Residential Real Estate	992	1,760	11	—	1,572
Indirect	88	88	—	—	—
Commercial	2	2	—	—	2
Construction	318	318	—	—	322
Commercial Real Estate	1,194	1,194	39	—	1,632
Total impaired loans with no specific reserve	$ 2,643	$ 3,411	$ 50	—	$ 3,528

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(dollars in thousands)	September 30, 2018	December 31, 2017
Troubled debt restructured loans	$ 252	$ 263
Non-accrual and 90+ days past due and still accruing loans to average loans	0.85 %	1.32 %
Allowance for loan losses to nonaccrual & 90+ days past due and still accruing loans	112.1 %	77.7 %

At September 30, 2018, there were two troubled debt restructured loans consisting of a commercial loan of $208,000 and a consumer loan of $44,000. The consumer loan is in a nonaccrual status.

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The following table shows the activity for non-accrual loans for the quarters ended September 30, 2017 and 2018.

(dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Totals
December 31, 2016	403	2,508	193	—	—	647	3,751
Transfers into nonaccrual	6	524	624	48	84	132	1,418
Loans paid down/payoffs	(77)	(183)	(113)	—	(86)	(147)	(606)
Loans returned to accrual status	(47)	(132)	(162)	—	—	—	(341)
Loans charged off	(4)	(3)	(349)	—	—	—	(356)
September 30, 2017	281	2,714	193	48	(2)	632	3,866
December 31, 2017	185	2,124	88	48	318	507	3,270
Transfers into nonaccrual	261	183	464	—	—	2,082	2,989
Loans paid down/payoffs	(20)	(595)	(90)	(48)	(90)	(2,057)	(2,900)
Loans returned to accrual status	—	(191)	(71)	—	—	—	(262)
Loans charged off	(92)	(588)	(256)	—	—	—	(936)
September 30, 2018	334	933	135	—	228	532	2,162

Other Real Estate Owned. At September 30, 2018, the Company had $705,000 in real estate acquired in partial or total satisfaction of debt, compared to $114,000 at December 31, 2017. The $591,000 increase was due to the sale of one property and the addition of one new property. All such properties are initially recorded at the lower of cost or fair value (net realizable value) at the date acquired and carried on the balance sheet as other real estate owned. Losses arising at the date of acquisition are charged against the allowance for credit losses. Subsequent write-downs that may be required and expense of operation are included in noninterest expense. Gains and losses realized from the sale of other real estate owned were included in noninterest income.

Credit Quality Information

In addition to monitoring the performance status of the loan portfolio, the Company utilizes a risk rating scale (1-8) to evaluate loan asset quality for all loans. Loans that are rated 1-4 are classified as pass credits. For the pass rated loans, management believes there is a low risk of loss related to these loans and, as necessary, credit may be strengthened through improved borrower performance and/or additional collateral.

The Bank's internal risk ratings are as follows:

1 Superior – minimal risk. (normally supported by pledged deposits, United States government securities, etc.)
2 Above Average - low risk. (all of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
3 Average – moderately low risk. (most of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
4 Acceptable – moderate risk. (the weighted overall risk associated with this credit based on each of the bank's creditworthiness criteria is acceptable)

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5 Other Assets Especially Mentioned – moderately high risk. (possesses deficiencies which corrective action by the bank would remedy; potential watch list)
6 Substandard – (the bank is inadequately protected and there exists the distinct possibility of sustaining some loss if not corrected)
7 Doubtful – (weaknesses make collection or liquidation in full, based on currently existing facts, improbable)
8 Loss – (of little value; not warranted as a bankable asset)

The following tables provides information with respect to the Company's credit quality indicators by loan portfolio segment at September 30, 2018 and December 31, 2017:

September 30, 2018 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Total
Pass	$ 14,191	$ 81,142	$ 109,785	$ 13,058	$ 2,677	$ 70,412	$ 291,265
Special mention	—	172	47	—	—	—	219
Substandard	411	1,391	340	208	—	1,127	3,477
Doubtful	—	—	20	—	—	—	20
Loss	—	—	—	—	—	—	—
	$ 14,602	$ 82,705	$ 110,192	$ 13,266	$ 2,677	$ 71,539	$ 294,981
Nonaccrual	334	933	135	—	228	532	2,162
Troubled debt restructures	44	—	—	208	—	—	252
Number of TDRs accounts	1	—	—	1	—	—	2
Non-performing TDRs	44	—	—	—	—	—	44
Number of non-performing TDR accounts	1	—	—	—	—	—	1