C & F FINANCIAL CORP
Form 10-Q
November 07, 2018
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the transition period from _________ to _________

Commission File Number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Virginia<br>(State or other jurisdiction of incorporation or organization) | 54-1680165<br>(I.R.S. Employer Identification No.) |
| 802 Main Street West Point, VA<br>(Address of principal executive offices) | 23181<br>(Zip Code) |

(804) 843-2360

(Registrant's telephone number, including area code)

N/A

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company Emerging growth company

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

At November 5, 2018, the latest practicable date for determination, 3,501,741 shares of common stock, $1.00 par value, of the registrant were outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

Part I – FINANCIAL INFORMATION

ITEM 1.FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except for per share amounts)

| | September 30, 2018 (unaudited) | December 31, 2017 * |
|---|---|---|
| Assets | | |
| Cash and due from banks | $ 12,440 | $ 14,070 |
| Interest-bearing deposits in other banks | 96,709 | 105,353 |
| Total cash and cash equivalents | 109,149 | 119,423 |
| Securities—available for sale at fair value, amortized cost of $220,753 and $218,168, respectively | 217,114 | 218,976 |
| Loans held for sale, at fair value | 45,979 | 55,384 |
| Loans, net of allowance for loan losses of $34,959 and $35,726, respectively | 1,002,423 | 992,062 |
| Restricted stock, at cost | 3,247 | 3,298 |
| Corporate premises and equipment, net | 37,053 | 36,969 |
| Other real estate owned, net of valuation allowance of $57 and $57, respectively | 188 | 168 |
| Accrued interest receivable | 7,354 | 7,589 |
| Goodwill | 14,425 | 14,425 |
| Core deposit and other amortizable intangible assets, net | 1,234 | 1,594 |
| Bank-owned life insurance | 15,869 | 15,589 |
| Net deferred tax asset | 12,953 | 12,093 |
| Other assets | 32,616 | 31,486 |
| Total assets | $ 1,499,604 | $ 1,509,056 |
| | | |
| Liabilities | | |
| Deposits | | |
| Noninterest-bearing demand deposits | $ 276,298 | $ 247,669 |
| Savings and interest-bearing demand deposits | 535,915 | 575,807 |
| Time deposits | 346,242 | 347,953 |
| Total deposits | 1,158,455 | 1,171,429 |
| Short-term borrowings | 15,030 | 20,621 |
| Long-term borrowings | 119,529 | 122,029 |
| Trust preferred capital notes | 25,237 | 25,210 |
| Accrued interest payable | 916 | 838 |

| | | |
|---|---|---|
| Other liabilities | 30,778 | 27,227 |
| Total liabilities | 1,349,945 | 1,367,354 |
| | | |
| Commitments and contingent liabilities (Note 9) | | |
| | | |
| Shareholders' Equity | | |
| Common stock ($1.00 par value, 8,000,000 shares authorized, 3,503,399 and 3,495,845 shares issued and outstanding, respectively, includes 132,905 and 137,880 of unvested shares, respectively) | 3,370 | 3,358 |
| Additional paid-in capital | 13,619 | 12,800 |
| Retained earnings | 137,851 | 127,431 |
| Accumulated other comprehensive loss, net | (5,181) | (1,887) |
| Total shareholders' equity | 149,659 | 141,702 |
| Total liabilities and shareholders' equity | $ 1,499,604 | $ 1,509,056 |

* Derived from audited consolidated financial statements.

See notes to consolidated financial statements.

3

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except for per share amounts)

| | Three Months Ended September 30, 2018 | 2017 | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Interest income | | | | |
| Interest and fees on loans | $ 21,673 | $ 20,971 | $ 63,116 | $ 62,036 |
| Interest on interest-bearing deposits and federal funds sold | 527 | 314 | 1,544 | 801 |
| Interest and dividends on securities | | | | |
| U.S. government agencies and corporations | 90 | 89 | 265 | 253 |
| Mortgage-backed securities | 528 | 380 | 1,516 | 1,088 |
| Tax-exempt obligations of states and political subdivisions | 675 | 773 | 2,086 | 2,453 |
| Taxable obligations of states and political subdivisions | 84 | 64 | 229 | 176 |
| Corporate bonds and other | 114 | 112 | 330 | 340 |
| Total interest income | 23,691 | 22,703 | 69,086 | 67,147 |
| Interest expense | | | | |
| Savings and interest-bearing deposits | 411 | 292 | 1,123 | 860 |
| Time deposits | 1,020 | 907 | 2,957 | 2,634 |
| Borrowings | 1,081 | 992 | 3,102 | 2,750 |
| Trust preferred capital notes | 291 | 300 | 861 | 862 |
| Total interest expense | 2,803 | 2,491 | 8,043 | 7,106 |
| Net interest income | 20,888 | 20,212 | 61,043 | 60,041 |
| Provision for loan losses | 2,400 | 4,435 | 7,700 | 11,935 |
| Net interest income after provision for loan losses | 18,488 | 15,777 | 53,343 | 48,106 |
| Noninterest income | | | | |
| Gains on sales of loans | 1,752 | 2,156 | 6,399 | 6,718 |
| Service charges on deposit accounts | 1,031 | 1,178 | 3,121 | 3,356 |
| Other service charges and fees | 1,296 | 1,327 | 3,900 | 3,951 |
| Net gains on calls of available for sale securities | 5 | 2 | 9 | 10 |
| Wealth management services income, net | 441 | 382 | 1,325 | 1,132 |
| Interchange income | 981 | 850 | 2,868 | 2,559 |
| Other | 1,121 | 947 | 2,692 | 2,805 |
| Total noninterest income | 6,627 | 6,842 | 20,314 | 20,531 |
| Noninterest expenses | | | | |

| | | | | |
|---|---|---|---|---|
| Salaries and employee benefits | 10,967 | 10,854 | 32,773 | 32,838 |
| Occupancy | 2,207 | 1,908 | 6,262 | 5,756 |
| Other | 5,500 | 5,609 | 16,939 | 16,156 |
| Total noninterest expenses | 18,674 | 18,371 | 55,974 | 54,750 |
| Income before income taxes | 6,441 | 4,248 | 17,683 | 13,887 |
| Income tax expense | 1,340 | 1,231 | 3,620 | 4,000 |
| Net income | $ 5,101 | $ 3,017 | $ 14,063 | $ 9,887 |
| Net income per share - basic | $ 1.46 | $ 0.87 | $ 4.02 | $ 2.84 |
| Net income per share - assuming dilution | $ 1.46 | $ 0.87 | $ 4.02 | $ 2.84 |
| Weighted average number of shares outstanding - basic | 3,503,371 | 3,487,170 | 3,502,550 | 3,485,725 |
| Weighted average number of shares outstanding - assuming dilution | 3,503,371 | 3,487,170 | 3,502,550 | 3,485,830 |

See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | $ 5,101 | $ 3,017 | $ 14,063 | $ 9,887 |
| Other comprehensive (loss) income: | | | | |
| Defined benefit plan: | | | | |
| Reclassification of recognized net actuarial losses into net income[1] | 32 | 41 | 93 | 115 |
| Related income tax effects | (7) | (16) | (20) | (41) |
| Amortization of prior service credit into net income[1] | (16) | (15) | (46) | (45) |
| Related income tax effects | 4 | 5 | 10 | 16 |
| Defined benefit plan, net of tax | 13 | 15 | 37 | 45 |
| Cash flow hedges: | | | | |
| Unrealized holding (losses) gains arising during the period | (5) | 57 | 245 | 54 |
| Related income tax effects | 1 | (23) | (63) | (22) |
| Cash flow hedges, net of tax | (4) | 34 | 182 | 32 |
| Securities available for sale: | | | | |
| Unrealized holding (losses) gains arising during the period | (1,252) | (263) | (4,438) | 308 |
| Related income tax effects | 263 | 92 | 932 | (108) |
| Reclassification of net realized gains into net income[2] | (5) | (2) | (9) | (10) |
| Related income tax effects | 1 | 1 | 2 | 4 |
| Securities available for sale, net of tax | (993) | (172) | (3,513) | 194 |
| Other comprehensive (loss) income, net of tax | (984) | (123) | (3,294) | 271 |
| Comprehensive income | $ 4,117 | $ 2,894 | $ 10,769 | $ 10,158 |

[1] These items are included in the computation of net periodic benefit cost and are included in “Noninterest income-Other” on the Consolidated Statements of Income. See “Note 6: Employee Benefit Plans,” for additional information.

[2] These items are included in “Net gains on calls of available for sale securities” on the Consolidated Statements of Income.

See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands, except for per share amounts)

| | Common Stock | Additional Paid - In Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|---|---|---|---|---|
| Balance December 31, 2017 | $ 3,358 | $ 12,800 | $ 127,431 | $ (1,887) | $ 141,702 |
| Comprehensive income: | | | | | |
| Net income | — | — | 14,063 | — | 14,063 |
| Other comprehensive loss | — | — | — | (3,294) | (3,294) |
| Share-based compensation | — | 956 | — | — | 956 |
| Restricted stock vested | 15 | (15) | — | — | — |
| Common stock issued | 1 | 106 | — | — | 107 |
| Common stock purchased | (4) | (228) | — | — | (232) |
| Cash dividends declared – common stock ($1.04 per share) | — | — | (3,643) | — | (3,643) |
| Balance September 30, 2018 | $ 3,370 | $ 13,619 | $ 137,851 | $ (5,181) | $ 149,659 |

| | Common Stock | Additional Paid - In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|
| Balance December 31, 2016 | $ 3,331 | $ 11,705 | $ 125,162 | $ (984) | $ 139,214 |
| Comprehensive income: | | | | | |
| Net income | — | — | 9,887 | — | 9,887 |
| Other comprehensive income | — | — | — | 271 | 271 |
| Stock options exercised | 2 | 81 | — | — | 83 |
| Share-based compensation | — | 1,075 | — | — | 1,075 |
| Restricted stock vested | 17 | (17) | — | — | — |
| Common stock issued | 3 | 109 | — | — | 112 |
| Common stock purchased | (4) | (181) | — | — | (185) |
| | — | — | (3,451) | — | (3,451) |

| | | | | | |
|---|---|---|---|---|---|
| Cash dividends declared – common stock ($0.99 per share) | | | | | |
| Balance September 30, 2017 | $ 3,349 | $ 12,772 | $ 131,598 | $ (713) | $ 147,006 |

See notes to consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| Operating activities: | | |
| Net income | $ 14,063 | $ 9,887 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 2,345 | 2,034 |
| Provision for loan losses | 7,700 | 11,935 |
| Provision for indemnifications | 53 | 140 |
| Share-based compensation | 956 | 1,075 |
| Pension expense | 315 | 470 |
| Pension contribution | (3,000) | (1,500) |
| Net accretion of certain acquisition-related discounts | (2,329) | (1,319) |
| Accretion of discounts and amortization of premiums on securities, net | 1,349 | 1,236 |
| Amortization of intangible assets | 360 | 527 |
| Net realized gains on calls of securities available for sale | (9) | (10) |
| Net realized gains on sales of other real estate owned | — | (10) |
| Net realized gains on sale of corporate premises and equipment | (205) | (16) |
| Income from bank-owned life insurance | (248) | (253) |
| Origination of loans held for sale | (538,704) | (556,829) |
| Proceeds from sales of loans held for sale | 554,508 | 566,197 |
| Gains on sales of loans held for sale | (6,399) | (6,718) |
| Change in other assets and liabilities: | | |
| Accrued interest receivable | 235 | 156 |
| Other assets | 2,501 | (434) |
| Accrued interest payable | 78 | 103 |
| Other liabilities | 2,644 | (1,002) |
| Net cash provided by operating activities | 36,213 | 25,669 |
| Investing activities: | | |
| Proceeds from maturities and calls of securities available for sale and payments on mortgage-backed securities | 35,267 | 33,960 |
| Purchases of securities available for sale | (39,192) | (33,855) |
| Net proceeds from sales (purchases) of restricted stock | 51 | (40) |
| Purchases of loans held for investment by non-bank affiliates | (103,759) | (91,267) |
| Repayments on loans held for investment by non-bank affiliates | 87,644 | 88,907 |
| Net decrease (increase) in retail banking loans held for investment | 471 | (34,737) |
| Proceeds from sales of other real estate owned | — | 245 |
| Purchases of corporate premises and equipment | (2,447) | (2,404) |
| Proceeds from sales of corporate premises and equipment | 223 | 53 |
| Net cash used in investing activities | (21,742) | (39,138) |

| | | |
|---|---|---|
| Financing activities: | | |
| Net (decrease) increase in demand, interest-bearing demand and savings deposits | (11,263) | 23,372 |
| Net decrease in time deposits | (1,711) | (672) |
| Net (decrease) increase in short-term borrowings | (5,591) | 1,293 |
| Repayments of long-term borrowings | (2,500) | — |
| Issuance of common stock | 107 | 112 |
| Proceeds from exercise of stock options | — | 83 |
| Cash dividends paid | (3,643) | (3,451) |
| Other financing activities | (144) | — |
| Net cash (used in) provided by financing activities | (24,745) | 20,737 |
| Net (decrease) increase in cash and cash equivalents | (10,274) | 7,268 |
| Cash and cash equivalents at beginning of period | 119,423 | 103,201 |
| Cash and cash equivalents at end of period | $ 109,149 | $ 110,469 |
| Supplemental disclosure | | |
| Interest paid | $ 7,938 | $ 6,976 |
| Income taxes paid | 190 | 4,616 |
| Supplemental disclosure of noncash investing and financing activities | | |
| Unrealized (losses) gains on securities available for sale | $ (4,447) | $ 298 |
| Transfers from loans to other real estate owned | 20 | 208 |
| Value of shares withheld at vesting for employee taxes | 232 | 185 |
| Unrealized gains on cash flow hedging instruments | 245 | 54 |

See notes to consolidated financial statements.

7

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Summary of Significant Accounting Policies

Principles of Consolidation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission (the SEC). They do not include all of the information and notes required by U.S. GAAP for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the C&F Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2017.

The unaudited consolidated financial statements include the accounts of C&F Financial Corporation (the Corporation) and its wholly-owned subsidiary, Citizens and Farmers Bank (the Bank or C&F Bank). All significant intercompany accounts and transactions have been eliminated in consolidation. In addition, the Corporation owns C&F Financial Statutory Trust I, C&F Financial Statutory Trust II and Central Virginia Bankshares Statutory Trust I, all of which are unconsolidated subsidiaries. The subordinated debt owed to these trusts is reported as liabilities of the Corporation. The accounting and reporting policies of C&F Financial Corporation and Subsidiary conform to U.S. GAAP and to predominant practices within the banking industry.

Nature of Operations: The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia.

C&F Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Wealth Management Corporation (C&F Wealth Management), C&F Insurance Services, Inc. and CVB Title Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan production services for residential appraisals. C&F Finance, acquired on September 1, 2002, is a finance company purchasing automobile, boat and recreational vehicle (RV) loans through indirect lending programs. C&F Wealth Management, organized in April 1995, is a full-service brokerage firm offering a comprehensive range of wealth management services and insurance products through third-party service providers. C&F Insurance Services, Inc. was organized in July 1999 for the primary purpose of owning an equity interest in an independent insurance agency that operates in Virginia and North Carolina. CVB Title Services, Inc. was organized for the primary purpose of owning an equity interest in a full service title and settlement agency. Business segment data is presented in Note 8.

Basis of Presentation: The preparation of financial statements in conformity with U.S. GAAP 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 from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the allowance for indemnifications, impairment of loans, impairment of securities, the valuation of other real estate owned (OREO), the projected benefit obligation under the defined benefit pension plan, the valuation of deferred taxes and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made.

Reclassification: Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation.  None of these reclassifications are considered material.

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the Consolidated Balance Sheets. The Corporation’s derivative financial instruments include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be sold in the secondary market on a best efforts basis and the related forward commitments to sell mortgage loans, (2) interest rate swaps with certain qualifying

Table of Contents

commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify and are designated as cash flow hedges on the Corporation's trust preferred capital notes. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are not designated as hedging instruments, adjustments to reflect unrealized gains and losses resulting from changes in the fair value of these instruments are reported as noninterest income or noninterest expense, as applicable. The gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period(s) during which the hedged transactions affect earnings. The Corporation's derivative financial instruments are described more fully in Note 10.

Share-Based Compensation: Shared-based compensation expense, net of forfeitures, for the third quarter of 2018 and the first nine months of 2018 was $316,000 ($235,000 after tax) and $956,000 ($710,000 after tax), respectively, for restricted stock granted during 2013 through 2018. As of September 30, 2018, there was $2.65 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

A summary of activity for restricted stock awards during the first nine months of 2018 and 2017 is presented below:

| | 2018 | |
|---|---|---|
| | Shares | Weighted-Average Grant Date Fair Value |
| Unvested, December 31, 2017 | 137,880 | $ 43.52 |
| Granted | 11,610 | 58.30 |
| Vested | (14,625) | 40.47 |
| Forfeited | (1,960) | 43.26 |
| Unvested, September 30, 2018 | 132,905 | 45.14 |

| | 2017 | |
|---|---|---|
| | Shares | Weighted-Average Grant Date Fair Value |
| Unvested, December 31, 2016 | 141,755 | $ 39.77 |
| Granted | 15,725 | 45.46 |
| Vested | (17,260) | 35.40 |

| | | |
|---|---|---|
| Forfeited | (1,690) | 43.16 |
| Unvested, September 30, 2017 | 138,530 | 40.91 |

Recently Adopted Accounting Pronouncements:

On January 1, 2018, the Corporation adopted Accounting Standards Update (ASU) 2014-09, “Revenue from Contracts with Customers (Topic 606),” and all amendments thereto (collectively, ASU 2014-09), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain/loss from the transfer of nonfinancial assets, such as OREO. The Corporation adopted ASU 2014-09 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASU 2014-09, while prior period amounts continue to be reported in accordance with pronouncements in effect prior to January 1, 2018. The adoption of ASU 2014-09 did not result in a change to the accounting for any of the in-scope revenue streams; therefore, no cumulative effect adjustment was recorded.

Table of Contents

Most revenue associated with the Corporation's financial instruments, including interest income and gains/losses on investment securities, derivatives and sales of financial instruments are outside the scope of ASU 2014-09. The Corporation's services that fall within the scope of ASU 2014-09 are presented within noninterest income and are recognized as revenue as the Corporation satisfies its obligation to the customer. A description of the Corporation's primary revenue streams accounted for under ASU 2014-09 follows:

Service Charges on Deposit Accounts.  The Corporation earns fees from its deposit customers for overdraft and account maintenance services. Overdraft fees are recognized when the overdraft occurs. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation.

Other Service Charges and Fees.  The Corporation earns fees from its customers for transaction-based services. Such services include safe deposit box, ATM, stop payment and wire transfer fees at the retail banking segment and on-line payment processing and statement request fees at the consumer finance segment. In each case, these service charges and fees are recognized in income at the time or within the same period that the Corporation's performance obligation is satisfied.

Interchange Income.  The Corporation earns interchange fees from debit and affinity credit cardholder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services.

Wealth Management Services Income. The Corporation earns wealth management services income by providing investment brokerage services and health and life insurance products to its customers through third-party service providers. Fees that are transaction-based (e.g., execution of trades) are recognized on a monthly basis. Other fees, or commissions, are earned over time as the contracted monthly or quarterly services are provided and are generally assessed based on either account activity or the market value of assets under management at month or quarter end.

Gains/Losses on Sales of OREO. The Corporation records a gain/loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform the obligations under the contract and whether collectability of the transaction price is probable. In determining the gain/loss on the sale, the Corporation adjusts the transaction price and the related gain/loss on sale if a significant financing component is present.

On January 1, 2018, the Corporation adopted ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 makes targeted improvements to several areas of U.S. GAAP including the disclosure of the fair value of financial instruments that are not measured at fair value on a recurring basis. The new guidance, among other things, (i) eliminates the requirements to disclose the methods and significant assumptions used to estimate the fair value and the description of the changes therein, if any, during the period, (ii) requires the use of the exit price notion in calculating the fair values of financial instruments not measured at fair value on a recurring basis and (iii) eliminates the guidance that allowed the use of the entry price notion to calculate the fair value of certain financial instruments, such as loans and long-term debt. Accordingly, the Corporation began disclosing the fair value of these financial instruments using an exit price notion rather than an entry price notion in the first quarter of 2018 (see "Note 7: Fair Value of Assets and Liabilities").

On January 1, 2018, the Corporation adopted ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." ASU 2017-07 requires that the service cost component of the net periodic benefit cost be presented with other employee compensation costs and that the remaining components be presented in the aggregate with noninterest income or noninterest expense, as appropriate. This guidance is required to be applied on a retrospective basis. Accordingly, income of $116,000 and $370,000 was reclassified from "Salaries and employee benefits" to "Noninterest income – Other" on the Consolidated Statements of Income for the three and nine months ended September 30, 2017, respectively.

Table of Contents

In the third quarter of 2018, the Corporation adopted ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.” ASU 2017-12 improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements by expanding the types of risk management activities to which hedge accounting can be applied and by simplifying its application. As a result of the adoption of ASU 2017-12, any ineffectiveness in qualifying and designated cash flow hedging relationships will be recorded in other comprehensive income rather than in earnings. The adoption of ASU 2017-12 did not have a significant effect on the financial statements, and most of its provisions are effective for the Corporation on a prospective basis.

In the third quarter of 2018, the Corporation adopted ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities,” which requires all entities that hold investments in callable debt securities at a premium to amortize the premium to the earliest call date. The amendments in ASU 2017-08 were applied on a modified retrospective basis as of January 1, 2018 and did not have a significant effect on the financial statements.

Recent Significant Accounting Pronouncements:

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02, “Leases (Topic 842).” Subsequently, this ASU was amended when the FASB issued other updates, including ASU 2018-10, “Codification Improvements to Topic 842, Leases” and ASU 2018-11, “Leases (Topic 842)” (collectively, ASC 842). Among other things in the amendments in ASC 842, lessees will be required 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 lessee’s 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 amendments in ASC 842 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach by either applying the new guidance as of the beginning of the earliest comparative period presented in the financial statements or by electing an optional transition method that will apply the new guidance as of the beginning of the period of adoption. Under the optional transition method, prior periods will continue to be reported under current guidance. The modified retrospective approach would not require any transition accounting for leases that expired before application date under either method. Lessees and lessors may not apply a full retrospective transition approach.

The Corporation has completed an inventory of its leases, which comprise primarily leases of real estate and office equipment in which the Corporation is the lessee, and all of which are accounted for as operating leases under current guidance. The Corporation will adopt ASC 842 effective January 1, 2019 using the optional transition method. Under a practical expedient available for transition, the classification of leases will remain the same upon adoption of ASC 842. Upon transition, the Corporation will record a lease liability of approximately $3 million for its remaining payment obligations as of January 1, 2019 for leases in effect at that time and a corresponding right of use asset. This estimate of the required lease liability is based on leases in effect as of September 30, 2018. The measurement of the lease liability will continue to be refined as the implementation process is completed. The Corporation expects to finalize its controls and procedures for accounting for leases under ASC 842 in the fourth quarter of 2018. Adoption of ASC 842 is not expected to change the pattern of recognition of expense for the Corporation's leases in effect as of September 30, 2018.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," as part of its project on financial instruments. ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. For public business entities that are SEC filers, the new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The amendments will be applied on a modified retrospective basis, with the cumulative effect of

Table of Contents

adopting the new standard being recorded as an adjustment to opening retained earnings in the period of adoption. The Corporation has established a working group that is in the process of gathering historical data and evaluating appropriate portfolio segmentation and modeling methods. The Corporation has not yet determined an estimate of the effect that ASU 2016-13 will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for public business entities that are SEC filers for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-04 to have a material effect on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." These amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2018-13 to have a material effect on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, "Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans." These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Certain disclosure requirements have been deleted while the following disclosure requirements have been added: the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments also clarify the disclosure requirements regarding the projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets and the accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets. The amendments are effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2018-14 to have a material effect on its consolidated financial statements.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not currently expected to have a material effect on the Corporation's financial position, results of operations or cash flows.

NOTE 2: Securities

The Corporation's debt securities, all of which are classified as available for sale, are summarized as follows:

| | September 30, 2018 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government agencies and corporations | $ 17,011 | $ — | $ (822) | $ 16,189 |
| Mortgage-backed securities | 106,940 | 29 | (3,239) | 103,730 |
| Obligations of states and political subdivisions | 96,802 | 831 | (438) | 97,195 |
| | $ 220,753 | $ 860 | $ (4,499) | $ 217,114 |

Table of Contents

| | December 31, 2017 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government agencies and corporations | $ 16,514 | $ — | $ (341) | $ 16,173 |
| Mortgage-backed securities | 97,677 | 142 | (761) | 97,058 |
| Obligations of states and political subdivisions | 103,977 | 2,022 | (254) | 105,745 |
| | $ 218,168 | $ 2,164 | $ (1,356) | $ 218,976 |

The amortized cost and estimated fair value of securities at September 30, 2018, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

| | September 30, 2018 | |
|---|---|---|
| (Dollars in thousands) | Amortized Cost | Fair Value |
| Due in one year or less | $ 53,133 | $ 52,987 |
| Due after one year through five years | 150,514 | 147,076 |
| Due after five years through ten years | 11,769 | 11,711 |
| Due after ten years | 5,337 | 5,340 |
| | $ 220,753 | $ 217,114 |

The following table presents the gross realized gains and losses on and the proceeds from maturities, calls and paydowns of securities. There were no sales of securities during the periods presented.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2018 | 2017 |
| Realized gains and losses from calls of securities: | | | | |
| Gross realized gains | $ 5 | $ 2 | $ 10 | $ 14 |
| Gross realized losses | — | — | (1) | (4) |
| Net realized gains | $ 5 | $ 2 | $ 9 | $ 10 |
| Proceeds from maturities, calls and paydowns of securities | $ 12,865 | $ 12,472 | $ 35,267 | $ 33,960 |

The Corporation pledges securities primarily to secure public deposits and repurchase agreements. Securities with an aggregate amortized cost of $93.24 million and aggregate fair value of $91.90 million were pledged at September 30, 2018. Securities with an aggregate amortized cost of $118.70 million and an aggregate fair value of $119.26 million were pledged at December 31, 2017.

Table of Contents

Securities in an unrealized loss position at September 30, 2018, by duration of the period of the unrealized loss, are shown below.

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government agencies and corporations | $ 749 | $ 1 | $ 15,440 | $ 821 | $ 16,189 | $ 822 |
| Mortgage-backed securities | 53,707 | 1,290 | 44,876 | 1,949 | 98,583 | 3,239 |
| Obligations of states and political subdivisions | 27,814 | 182 | 12,944 | 256 | 40,758 | 438 |
| Total temporarily impaired securities | $ 82,270 | $ 1,473 | $ 73,260 | $ 3,026 | $ 155,530 | $ 4,499 |

There were 270 debt securities totaling $155.53 million considered temporarily impaired at September 30, 2018. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. Interest rates have increased consistently across the United States Treasury security yield curve during 2018, thereby increasing unrealized losses on the Corporation’s debt securities. The Corporation’s mortgage-backed securities are entirely issued by either U.S. government agencies or U.S. government-sponsored enterprises. Collectively, these entities provide a guarantee, which is either explicitly or implicitly supported by the full faith and credit of the U.S. government, that investors in such mortgage-backed securities will receive timely principal and interest payments. At September 30, 2018, approximately 97 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated “A” or better by Standard & Poor's (S&P) or Moody's Investors Service (Moody’s). Of those in a net unrealized loss position, approximately 99 percent were rated “A” or better by S&P or Moody’s, as measured by market value, at September 30, 2018. For the approximately one percent not rated “A” or better, as measured by market value at September 30, 2018, the Corporation considers these to meet regulatory credit quality standards, meaning that the securities have low risk of default by the obligor and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more-likely-than-not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at September 30, 2018 and no other-than-temporary impairment loss has been recognized in net income.

Securities in an unrealized loss position at December 31, 2017, by duration of the period of the unrealized loss, are shown below.

| Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|
| Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |

| (Dollars in thousands) | Value | Loss | Value | Loss | Value | Loss |
|---|---|---|---|---|---|---|
| U.S. government agencies and corporations | $ 2,972 | $ 31 | $ 13,201 | $ 310 | $ 16,173 | $ 341 |
| Mortgage-backed securities | 57,116 | 341 | 22,545 | 420 | 79,661 | 761 |
| Obligations of states and political subdivisions | 18,644 | 117 | 9,363 | 137 | 28,007 | 254 |
| Total temporarily impaired securities | $ 78,732 | $ 489 | $ 45,109 | $ 867 | $ 123,841 | $ 1,356 |

The Corporation's investment in restricted stock totaled $3.25 million at September 30, 2018 and consisted of Federal Home Loan Bank (FHLB) stock. Restricted stock is generally viewed as a long-term investment, which is carried at cost because there is no market for the stock other than the FHLBs. Therefore, when evaluating restricted stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing any temporary decline in value. The Corporation does not consider its investment in restricted stock to be other-than-temporarily impaired at September 30, 2018 and no impairment has been recognized.

Table of Contents

NOTE 3: Loans

Major classifications of loans are summarized as follows:

| (Dollars in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Real estate – residential mortgage | $ 184,362 | $ 184,863 |
| Real estate – construction 1 | 55,650 | 44,782 |
| Commercial, financial and agricultural 2 | 426,310 | 437,884 |
| Equity lines | 55,655 | 55,237 |
| Consumer | 15,464 | 13,018 |
| Consumer finance | 299,941 | 292,004 |
| | 1,037,382 | 1,027,788 |
| Less allowance for loan losses | (34,959) | (35,726) |
| Loans, net | $ 1,002,423 | $ 992,062 |

1 Includes the Corporation's real estate construction lending and consumer real estate lot lending.
2 Includes the Corporation’s commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Consumer loans included $216,000 and $290,000 of demand deposit overdrafts at September 30, 2018 and December 31, 2017, respectively.

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of Central Virginia Bank (CVB) on October 1, 2013 (or acquired loans) that were recorded at fair value at the acquisition date and are included in the Consolidated Balance Sheets are as follows:

| | September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Acquired Loans - Purchased Credit Impaired | Acquired Loans - Purchased Performing | Acquired Loans - Total | Acquired Loans - Purchased Credit Impaired | Acquired Loans - Purchased Performing | Acquired Loans - Total |
| | $ 10,253 | $ 40,140 | $ 50,393 | $ 12,856 | $ 45,083 | $ 57,939 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Outstanding principal balance | | | | | | |
| Carrying amount | | | | | | |
| Real estate – residential mortgage | $ 439 | $ 9,166 | $ 9,605 | $ 492 | $ 10,855 | $ 11,347 |
| Commercial, financial and agricultural[1] | 1,593 | 19,778 | 21,371 | 2,472 | 22,305 | 24,777 |
| Equity lines | 116 | 9,216 | 9,332 | 139 | 9,621 | 9,760 |
| Consumer | — | 6 | 6 | — | 12 | 12 |
| Total acquired loans | $ 2,148 | $ 38,166 | $ 40,314 | $ 3,103 | $ 42,793 | $ 45,896 |

[1] Includes acquired loans classified by the Corporation as commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Table of Contents

Loans on nonaccrual status were as follows:

| (Dollars in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Real estate – residential mortgage | $ 611 | $ 830 |
| Commercial, financial and agricultural: | | |
| Commercial real estate lending | 1,206 | 3,796 |
| Commercial business lending | 24 | 34 |
| Equity lines | 912 | 651 |
| Consumer | — | — |
| Consumer finance | 1,025 | 764 |
| Total loans on nonaccrual status | $ 3,778 | $ 6,075 |

The past due status of loans as of September 30, 2018 was as follows:

| (Dollars in thousands) | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90+ Days Past Due | Total Past Due | PCI | Current1 | Total Loans | 90+ Days Past Due and Accruing 2 |
|---|---|---|---|---|---|---|---|---|
| Real estate – residential mortgage | $ 405 | $ — | $ 294 | $ 699 | $ 439 | $ 183,224 | $ 184,362 | $ 194 |
| Real estate – construction: | | | | | | | | |
| Construction lending | — | — | — | — | — | 44,756 | 44,756 | — |
| Consumer lot lending | — | — | — | — | — | 10,894 | 10,894 | — |
| Commercial, financial and agricultural: | | | | | | | | |
| Commercial real estate lending | 65 | 1,397 | 315 | 1,777 | 1,593 | 302,413 | 305,783 | 315 |
| Land acquisition and development lending | — | — | — | — | — | 34,035 | 34,035 | — |
| Builder line lending | 247 | — | — | 247 | — | 27,593 | 27,840 | — |
| Commercial business lending | — | — | 24 | 24 | — | 58,628 | 58,652 | — |
| Equity lines | 250 | 186 | 72 | 508 | 116 | 55,031 | 55,655 | 72 |
| Consumer | 154 | — | — | 154 | — | 15,310 | 15,464 | — |
| Consumer finance | 9,892 | 1,974 | 1,025 | 12,891 | — | 287,050 | 299,941 | — |
| Total | $ 11,013 | $ 3,557 | $ 1,730 | $ 16,300 | $ 2,148 | $ 1,018,934 | $ 1,037,382 | $ 581 |

[1] For the purposes of the table above, "Current" includes loans that are 1-29 days past due.
[2] Includes purchased credit impaired (PCI) loans of $78,000.

The table above includes the following:

- nonaccrual loans that are current of $942,000, 30-59 days past due of $218,000, 60-89 days past due of $1.39 million and 90+ days past due of $1.23 million.
- performing loans purchased in the acquisition of CVB that are current of $37.97 million, 30-59 days past due of $120,000 and 90+ days past due of $72,000.

Table of Contents

The past due status of loans as of December 31, 2017 was as follows:

| (Dollars in thousands) | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90+ Days Past Due | Total Past Due | PCI | Current[1] | Total Loans | 90+ Days Past Due and Accruing[2] |
|---|---|---|---|---|---|---|---|---|
| Real estate – residential mortgage | $ 1,905 | $ 14 | $ 245 | $ 2,164 | $ 492 | $ 182,207 | $ 184,863 | $ 90 |
| Real estate – construction: | | | | | | | | |
| Construction lending | — | — | — | — | — | 41,449 | 41,449 | — |
| Consumer lot lending | — | — | — | — | — | 3,333 | 3,333 | — |
| Commercial, financial and agricultural: | | | | | | | | |
| Commercial real estate lending | 241 | — | 3,874 | 4,115 | 2,472 | 297,903 | 304,490 | 78 |
| Land acquisition and development lending | — | — | — | — | — | 39,844 | 39,844 | — |
| Builder line lending | 685 | — | — | 685 | — | 28,911 | 29,596 | — |
| Commercial business lending | — | — | 2 | 2 | — | 63,952 | 63,954 | 2 |
| Equity lines | 550 | — | 136 | 686 | 139 | 54,412 | 55,237 | 136 |
| Consumer | 9 | — | — | 9 | — | 13,009 | 13,018 | — |
| Consumer finance | 12,273 | 2,061 | 764 | 15,098 | — | 276,906 | 292,004 | — |
| Total | $ 15,663 | $ 2,075 | $ 5,021 | $ 22,759 | $ 3,103 | $ 1,001,926 | $ 1,027,788 | $ 306 |

[1] For the purposes of the table above, “Current” includes loans that are 1-29 days past due.

[2] Includes PCI loans of $90,000.

The table above includes the following:

- nonaccrual loans that are current of $890,000, 30-59 days past due of $458,000, 60 89 days past due of $14,000 and 90+ days past due of $4.71 million.
- performing loans purchased in the acquisition of CVB that are current of $42.53 million, 30-59 days past due of $137,000, 60-89 days past due of $14,000 and 90+ days past due of $115,000.

Loan modifications that were classified as troubled debt restructurings (TDRs) were as follows:

| (Dollars in thousands) | Three Months Ended September 30, 2018 Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | 2017 Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
|---|---|---|---|---|---|---|
| Real estate – residential mortgage – interest rate concession | — | $ — | $ — | 2 | $ 365 | $ 365 |
| Consumer – interest rate concession | 1 | 5 | 5 | — | — | — |
| Total | 1 | $ 5 | $ 5 | 2 | $ 365 | $ 365 |

| (Dollars in thousands) | Nine Months Ended September 30, 2018 Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | 2017 Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
|---|---|---|---|---|---|---|
| Real estate – residential mortgage – interest reduction | — | $ — | $ — | 2 | $ 365 | $ 365 |
| Commercial, financial and agricultural: | | | | | | |
| Commercial real estate lending – interest rate and term concession | — | — | — | 3 | 4,646 | 4,646 |
| Commercial real estate lending – interest rate concession | — | — | — | 4 | 2,154 | 2,154 |
| Consumer – interest rate concession | 1 | 5 | 5 | — | — | — |
| Total | 1 | $ 5 | $ 5 | 9 | $ 7,165 | $ 7,165 |

A TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due. All TDRs are considered impaired loans and are individually evaluated in the determination of the allowance for loan losses. The specific reserve associated with a TDR is reevaluated

Table of Contents

when a TDR payment default occurs. There were no TDR payment defaults during the three and nine months ended September 30, 2018. During the three and nine months ended September 30, 2017, TDR payment defaults occurred on three loans totaling $4.65 million that were part of a single commercial relationship and were more than 90 days past due.

Impaired loans, which included TDRs of $6.96 million, and the related allowance at September 30, 2018 were as follows:

| (Dollars in thousands) | Unpaid Principal Balance | Recorded Investment in Loans without Specific Reserve | Recorded Investment in Loans with Specific Reserve | Related Allowance | Average Balance- Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|---|
| Real estate – residential mortgage | $ 3,020 | $ 1,153 | $ 1,768 | $ 99 | $ 3,010 | $ 109 |
| Commercial, financial and agricultural: | | | | | | |
| Commercial real estate lending | 4,245 | 1,639 | 2,335 | 674 | 4,845 | 108 |
| Commercial business lending | 33 | 25 | — | — | 26 | — |
| Equity lines | 365 | 31 | 327 | 326 | 360 | 1 |
| Consumer | 5 | — | 5 | 5 | 5 | — |
| Total | $ 7,668 | $ 2,848 | $ 4,435 | $ 1,104 | $ 8,246 | $ 218 |

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2017 were as follows:

| (Dollars in thousands) | Unpaid Principal Balance | Recorded Investment in Loans without Specific Reserve | Recorded Investment in Loans with Specific Reserve | Related Allowance | Average Balance- Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|---|
| Real estate – residential mortgage | $ 3,745 | $ 1,603 | $ 2,033 | $ 214 | $ 3,743 | $ 184 |
| Commercial, financial and agricultural: | | | | | | |
| Commercial real estate lending | 6,981 | 2,841 | 4,031 | 615 | 7,818 | 168 |
| Commercial business lending | 41 | 35 | — | — | 45 | — |
| Equity lines | 32 | 31 | — | — | 32 | 2 |
| Consumer | 321 | 322 | — | — | 321 | 13 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total | $ 11,120 | $ 4,832 | $ 6,064 | $ 829 | $ 11,959 | $ 367 |

PCI loans had an unpaid principal balance of $10.25 million and a carrying value of $2.15 million at September 30, 2018. Determining the fair value of PCI loans required the Corporation to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of the cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the effect of estimated credit losses and is called the nonaccretable difference, and is not recorded. In accordance with U.S. GAAP, there was no carry-over of the previously established allowance for loan losses for acquired loans.

The following table presents a summary of the change in the accretable yield of the PCI loan portfolio:

| | Nine Months Ended September 30, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Accretable yield, balance at beginning of period | $ 7,304 | $ 8,637 |
| Accretion | (2,892) | (2,176) |
| Reclassification of nonaccretable difference due to improvement in expected cash flows | 1,410 | 1,022 |
| Other changes, net | (324) | 306 |
| Accretable yield, balance at end of period | $ 5,498 | $ 7,789 |

Table of Contents

NOTE 4: Allowance for Loan Losses

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2018:

| (Dollars in thousands) | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial & Agricultural | Equity Lines | Consumer | Consumer Finance | Total |
|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | |
| Balance at December 31, 2017 | $ 2,371 | $ 605 | $ 7,478 | $ 688 | $ 231 | $ 24,353 | $ 35,726 |
| Provision charged (credited) to operations | (122) | 174 | (625) | 450 | 123 | 7,700 | 7,700 |
| Loans charged off | — | — | (2) | — | (248) | (11,743) | (11,993) |
| Recoveries of loans previously charged off | 52 | — | 46 | — | 174 | 3,254 | 3,526 |
| Balance at September 30, 2018 | $ 2,301 | $ 779 | $ 6,897 | $ 1,138 | $ 280 | $ 23,564 | $ 34,959 |

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2017:

| (Dollars in thousands) | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial & Agricultural | Equity Lines | Consumer | Consumer Finance | Total |
|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | |
| Balance at December 31, 2016 | $ 2,559 | $ 816 | $ 7,393 | $ 685 | $ 261 | $ 25,352 | $ 37,066 |
| Provision charged (credited) to operations | (69) | (278) | 500 | 23 | 24 | 11,735 | 11,935 |
| Loans charged off | (154) | — | (273) | (20) | (224) | (15,464) | (16,135) |
| Recoveries of loans previously charged off | 59 | — | 18 | 2 | 143 | 3,247 | 3,469 |
| Balance at September 30, 2017 | $ 2,395 | $ 538 | $ 7,638 | $ 690 | $ 204 | $ 24,870 | $ 36,335 |

The following table presents, as of September 30, 2018, the total allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

| (Dollars in thousands) | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial & Agricultural | Equity Lines | Consumer | Consumer Finance | Total |
|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | |
| Ending balance at September 30, 2018 | $ 2,301 | $ 779 | $ 6,897 | $ 1,138 | $ 280 | $ 23,564 | $ 34,959 |
| Ending balance: individually evaluated for impairment | $ 99 | $ — | $ 674 | $ 326 | $ 5 | $ — | $ 1,104 |
| Ending balance: collectively evaluated for impairment | $ 2,202 | $ 779 | $ 6,223 | $ 812 | $ 275 | $ 23,564 | $ 33,855 |
| Ending balance: acquired loans - PCI | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Loans: | | | | | | | |
| Ending balance at September 30, 2018 | $ 184,362 | $ 55,650 | $ 426,310 | $ 55,655 | $ 15,464 | $ 299,941 | $ 1,037,382 |
| Ending balance: individually evaluated for impairment | $ 2,921 | $ — | $ 3,999 | $ 358 | $ 5 | $ — | $ 7,283 |
| Ending balance: collectively evaluated for impairment | $ 181,002 | $ 55,650 | $ 420,718 | $ 55,181 | $ 15,459 | $ 299,941 | $ 1,027,951 |
| Ending balance: acquired loans - PCI | $ 439 | $ — | $ 1,593 | $ 116 | $ — | $ — | $ 2,148 |

Table of Contents

The following table presents, as of December 31, 2017, the total allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

| (Dollars in thousands) | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial & Agricultural | Equity Lines | Consumer | Consumer Finance | Total |
|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | |
| Ending balance at December 31, 2017 | $ 2,371 | $ 605 | $ 7,478 | $ 688 | $ 231 | $ 24,353 | $ 35,726 |
| Ending balance: individually evaluated for impairment | $ 214 | $ — | $ 615 | $ — | $ — | $ — | $ 829 |
| Ending balance: collectively evaluated for impairment | $ 2,157 | $ 605 | $ 6,863 | $ 688 | $ 231 | $ 24,353 | $ 34,897 |
| Ending balance: acquired loans - PCI | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Loans: | | | | | | | |
| Ending balance at December 31, 2017 | $ 184,863 | $ 44,782 | $ 437,884 | $ 55,237 | $ 13,018 | $ 292,004 | $ 1,027,788 |
| Ending balance: individually evaluated for impairment | $ 3,636 | $ — | $ 6,907 | $ 31 | $ 322 | $ — | $ 10,896 |
| Ending balance: collectively evaluated for impairment | $ 180,735 | $ 44,782 | $ 428,505 | $ 55,067 | $ 12,696 | $ 292,004 | $ 1,013,789 |
| Ending balance: acquired loans - PCI | $ 492 | $ — | $ 2,472 | $ 139 | $ — | $ — | $ 3,103 |

Loans by credit quality indicators as of September 30, 2018 were as follows:

| (Dollars in thousands) | Pass | Special Mention | Substandard | Substandard Nonaccrual | Total1 |
|---|---|---|---|---|---|
| Real estate – residential mortgage | $ 180,854 | $ 1,223 | $ 1,674 | $ 611 | $ 184,362 |
| Real estate – construction: | | | | | |
| Construction lending | 44,756 | — | — | — | 44,756 |
| Consumer lot lending | 10,044 | 850 | — | — | 10,894 |
| Commercial, financial and agricultural: | | | | | |
| Commercial real estate lending | 298,883 | 5,007 | 687 | 1,206 | 305,783 |

| | | | | | |
|---|---|---|---|---|---|
| Land acquisition and development lending | 24,040 | 9,995 | — | — | 34,035 |
| Builder line lending | 27,840 | — | — | — | 27,840 |
| Commercial business lending | 58,191 | 437 | — | 24 | 58,652 |
| Equity lines | 54,257 | 393 | 93 | 912 | 55,655 |
| Consumer | 15,457 | 1 | 6 | — | 15,464 |
| | $ 714,322 | $ 17,906 | $ 2,460 | $ 2,753 | $ 737,441 |

[1] At September 30, 2018, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVB of $38.49 million pass rated, $1.20 million special mention, $528,000 substandard and $101,000 substandard nonaccrual.

| (Dollars in thousands) | Performing | Non-Performing | Total |
|---|---|---|---|
| Consumer finance | $ 298,916 | $ 1,025 | $ 299,941 |

Loans by credit quality indicators as of December 31, 2017 were as follows:

| (Dollars in thousands) | Pass | Special Mention | Substandard | Substandard Nonaccrual | Total[1] |
|---|---|---|---|---|---|
| Real estate – residential mortgage | $ 179,963 | $ 1,235 | $ 2,835 | $ 830 | $ 184,863 |
| Real estate – construction: | | | | | |
| Construction lending | 41,449 | — | — | — | 41,449 |
| Consumer lot lending | 3,333 | — | — | — | 3,333 |
| Commercial, financial and agricultural: | | | | | |
| Commercial real estate lending | 293,292 | 2,874 | 4,528 | 3,796 | 304,490 |
| Land acquisition and development lending | 24,253 | — | 15,591 | — | 39,844 |
| Builder line lending | 29,596 | — | — | — | 29,596 |
| Commercial business lending | 63,749 | 34 | 137 | 34 | 63,954 |
| Equity lines | 53,870 | 465 | 251 | 651 | 55,237 |
| Consumer | 12,693 | 3 | 322 | — | 13,018 |
| | $ 702,198 | $ 4,611 | $ 23,664 | $ 5,311 | $ 735,784 |

[1] At December 31, 2017, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVB of $42.67 million pass rated, $1.09 million special mention, $1.98 million substandard and $161,000 substandard nonaccrual.

| (Dollars in thousands) | Performing | Non-Performing | Total |
|---|---|---|---|
| Consumer finance | $ 291,240 | $ 764 | $ 292,004 |

NOTE 5: Shareholders’ Equity, Other Comprehensive Income and Earnings Per Share

Shareholders’ Equity

During the first nine months of 2018 and 2017, no shares of the Corporation’s common stock were purchased under the share repurchase program authorized by the Corporation’s Board of Directors. The Corporation withheld 3,947 and

4,049 shares of its common stock from employees to satisfy tax withholding obligations arising upon the vesting of restricted shares during the first nine months of 2018 and 2017, respectively.

Accumulated Other Comprehensive Loss

The following table presents the cumulative balances of the components of accumulated other comprehensive loss, net of deferred taxes of $1.35 million and $491,000 as of September 30, 2018 and December 31, 2017, respectively.

| (Dollars in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Net unrealized (losses) gains on securities | $ (2,875) | $ 638 |
| Net unrecognized gains on cash flow hedges | 306 | 124 |
| Net unrecognized losses on defined benefit plan | (2,612) | (2,649) |
| Total accumulated other comprehensive loss | $ (5,181) | $ (1,887) |

Table of Contents

Earnings Per Share (EPS)

The components of the Corporation's EPS calculations are as follows:

| | Three Months Ended September 30, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Net income | $ 5,101 | $ 3,017 |
| Weighted average number of shares used in earnings per share—basic | 3,503,371 | 3,487,170 |
| Effect of dilutive securities | — | — |
| Weighted average number of shares used in earnings per share—assuming dilution | 3,503,371 | 3,487,170 |

| | Nine Months Ended September 30, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Net income | $ 14,063 | $ 9,887 |
| Weighted average number of shares used in earnings per share—basic | 3,502,550 | 3,485,725 |
| Effect of dilutive securities—stock option awards | — | 105 |
| Weighted average number of shares used in earnings per share—assuming dilution | 3,502,550 | 3,485,830 |

The Corporation has applied the two-class method of computing basic and diluted EPS for each period presented because the Corporation's unvested restricted shares outstanding contain rights to nonforfeitable dividends. Accordingly, the weighted average number of shares used in the calculation of basic and diluted EPS includes both vested and unvested shares outstanding.

Potential shares that may be issued by the Corporation for its stock option awards are determined using the treasury stock method. Accordingly, anti-dilutive shares are not included in computing diluted earnings per share. There were no anti-dilutive stock options outstanding for the three and nine months ended September 30, 2017. There were no stock options outstanding during the first nine months of 2018.

Table of Contents

NOTE 6: Employee Benefit Plans

The components of net periodic benefit cost for the Bank’s non-contributory cash balance pension plan are as follows:

| (Dollars in thousands) | Three Months Ended September 30, 2018 | 2017 | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Components of net periodic benefit cost: | | | | |
| Service cost, included in salaries and employee benefits | $ 309 | $ 274 | $ 923 | $ 840 |
| Other components of net periodic benefit cost: | | | | |
| Interest cost | 138 | 138 | 384 | 414 |
| Expected return on plan assets | (373) | (280) | (1,039) | (854) |
| Amortization of prior service credit | (16) | (15) | (46) | (45) |
| Recognized net actuarial losses | 32 | 41 | 93 | 115 |
| Other components of net periodic benefit cost, included in other noninterest income | (219) | (116) | (608) | (370) |
| Net periodic benefit cost | $ 90 | $ 158 | $ 315 | $ 470 |

NOTE 7: Fair Value of Assets and Liabilities

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. U.S. GAAP also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of the three levels. These levels are:

- Level 1—Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 assets and liabilities include debt and equity securities traded in an active exchange market, as well as U.S. Treasury securities.

·

Level 2—Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

· Level 3—Valuation is determined using model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Corporation's estimates of assumptions that market participants would use in pricing the respective asset or liability. Valuation techniques may include the use of pricing models, discounted cash flow models and similar techniques.

U.S. GAAP allows an entity the irrevocable option to elect fair value (the fair value option) for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Corporation has elected to use fair value accounting for its entire portfolio of loans held for sale (LHFS).

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a recurring basis in the financial statements.

Securities available for sale. The Corporation primarily values its investment portfolio using Level 2 fair value measurements, but may also use Level 1 or Level 3 measurements if required by the composition of the portfolio. At September 30, 2018 and December 31, 2017, the Corporation's entire investment securities portfolio was comprised of securities available for sale, which were valued using Level 2 fair value measurements. The Corporation has contracted with third party portfolio accounting service vendors for valuation of its securities portfolio. The vendors' sources for security valuation are ICE Data Services (ICE) and Thomson Reuters Pricing Service (TRPS). Each source provides opinions, known as evaluated prices, as to the value of individual securities based on model-based pricing techniques that are partially based on available market data, including prices for similar instruments in active markets and prices for identical assets in markets that are not active. ICE provides evaluated prices for the Corporation's obligations of states and political subdivisions category of securities. ICE uses proprietary pricing models and pricing systems, mathematical tools and judgment to determine an evaluated price for a security based upon a hierarchy of market information regarding that security or securities with similar characteristics. TRPS provides evaluated prices for the Corporation's U.S. government agencies and corporations and mortgage-backed categories of securities. Fixed-rate callable securities of the U.S. government agencies and corporations category are individually evaluated on an option adjusted spread basis for callable issues or on a nominal spread basis incorporating the term structure of agency market spreads and the appropriate risk free benchmark curve for non-callable issues. Fixed-rate securities issued by the Small Business Association in the U.S. government agencies and corporations category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Pass-through mortgage-backed securities (MBS) in the mortgage-backed category are grouped into aggregate categories defined by issuer program, weighted average coupon, and weighted average maturity. Each aggregate is benchmarked to a relative mortgage-backed to-be-announced (TBA) or other benchmark price. TBA prices are obtained from market makers and live trading systems. Collateralized mortgage obligations in the mortgage-backed category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Each evaluation is determined using an option adjusted spread and prepayment model based on volatility-driven, multi-dimensional spread tables.

Loans held for sale (LHFS). Fair value of the Corporation's LHFS is based on observable market prices for similar instruments traded in the secondary mortgage loan markets in which the Corporation conducts business. The Corporation's portfolio of LHFS is classified as Level 2.

Derivative asset - IRLCs. The Corporation recognizes IRLCs at fair value. Fair value of IRLCs is based on either (i) the price of the underlying loans obtained from an investor for loans that will be delivered on a best efforts basis or (ii) the observable price for individual loans traded in the secondary market for loans that will be delivered on a mandatory basis. All of the Corporation's IRLCs are classified as Level 2.

Derivative asset/liability – interest rate swaps on loans. The Corporation recognizes interest rate swaps at fair value. The Corporation has contracted with a third party vendor to provide valuations for these interest rate swaps using standard valuation techniques. All of the Corporation’s interest rate swaps on loans are classified as Level 2.

Derivative asset - cash flow hedges. The Corporation recognizes cash flow hedges at fair value. The fair value of the Corporation’s cash flow hedges is determined using the discounted cash flow method. All of the Corporation’s cash flow hedges are classified as Level 2.

Table of Contents

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis.

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets/Liabilities at |
| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
| Assets: | | | | |
| Securities available for sale | | | | |
| U.S. government agencies and corporations | $ — | $ 16,189 | $ — | $ 16,189 |
| Mortgage-backed securities | — | 103,730 | — | 103,730 |
| Obligations of states and political subdivisions | — | 97,195 | — | 97,195 |
| Total securities available for sale | — | 217,114 | — | 217,114 |
| Loans held for sale | — | 45,979 | — | 45,979 |
| Derivative asset - IRLC | — | 939 | — | 939 |
| Derivative asset - interest rate swaps on loans | — | 2,633 | — | 2,633 |
| Derivative asset - cash flow hedges | — | 412 | — | 412 |
| Total assets | $ — | $ 267,077 | $ — | $ 267,077 |
| | | | | |
| Liabilities: | | | | |
| Derivative liability - interest rate swaps on loans | $ — | $ 2,633 | $ — | $ 2,633 |
| Total liabilities | $ — | $ 2,633 | $ — | $ 2,633 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets/Liabilities at |
| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
| Assets: | | | | |
| Securities available for sale | | | | |
| U.S. government agencies and corporations | $ — | $ 16,173 | $ — | $ 16,173 |
| Mortgage-backed securities | — | 97,058 | — | 97,058 |
| Obligations of states and political subdivisions | — | 105,745 | — | 105,745 |
| Total securities available for sale | — | 218,976 | — | 218,976 |
| Loans held for sale | — | 55,384 | — | 55,384 |
| Derivative asset - IRLC | — | 528 | — | 528 |
| Derivative asset - interest rate swaps on loans | — | 1,261 | — | 1,261 |
| Derivative asset - cash flow hedges | — | 166 | — | 166 |
| Total assets | $ — | $ 276,315 | $ — | $ 276,315 |
| | | | | |
| Liabilities: | | | | |
| Derivative liability - interest rate swaps on loans | $ — | $ 1,261 | $ — | $ 1,261 |

| | | | | |
|---|---|---|---|---|
| Total liabilities | $ — | $ 1,261 | $ — | $ 1,261 |

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Corporation may be required, from time to time, to measure and recognize certain assets at fair value on a nonrecurring basis in accordance with U. S. GAAP. The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a nonrecurring basis in the financial statements.

Impaired loans. The Corporation does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is considered impaired and an allowance for loan losses is established. The Corporation measures impairment either based on the fair value of the loan using the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent, or using the present value of expected future cash flows discounted at the loan's effective interest rate, which is not a fair value measurement. The Corporation maintains a valuation allowance to the extent that this measure of the impaired loan is less than the recorded investment in the loan. When an impaired loan

Table of Contents

is measured at fair value based solely on observable market prices or a current appraisal without further adjustment for unobservable inputs, the Corporation records the impaired loan as a nonrecurring fair value measurement classified as Level 2. However, if based on management's review, additional discounts to observed market prices or appraisals are required or if observable inputs are not available, the Corporation records the impaired loan as a nonrecurring fair value measurement classified as Level 3.

Impaired loans that are measured based on expected future cash flows discounted at the loan's effective interest rate rather than the market rate of interest, are not recorded at fair value and are therefore excluded from fair value disclosure requirements.

OREO. Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure. Initial fair value is based upon appraisals the Corporation obtains from independent licensed appraisers. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intent with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations indicate a further deterioration in market conditions. As such, the Corporation records OREO as a nonrecurring fair value measurement classified as Level 3.

The following table presents the balances of assets measured at fair value on a nonrecurring basis.

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets at Fair |
| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Value |
| Impaired loans, net | $ — | $ — | $ 648 | $ 648 |
| Other real estate owned, net | — | — | 188 | 188 |
| Total | $ — | $ — | $ 836 | $ 836 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets at Fair |
| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Value |
| Impaired loans, net | $ — | $ — | $ 3,438 | $ 3,438 |

| | | | | |
|---|---|---|---|---|
| Other real estate owned, net | — | — | 168 | 168 |
| Total | $ — | $ — | $ 3,606 | $ 3,606 |

The following table presents quantitative information about Level 3 fair value measurements for financial assets measured at fair value on a nonrecurring basis:

| | Fair Value Measurements at September 30, 2018 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Fair Value | Valuation Technique(s) | Unobservable Inputs | Range of Inputs |
| Impaired loans, net | $ 648 | Appraisals | Discount to reflect current market conditions and estimated selling costs | 18% - 38% |
| Other real estate owned, net | 188 | Appraisals | Discount to reflect current market conditions and estimated selling costs | 28%-69% |
| Total | $ 836 | | | |

Fair Value of Financial Instruments

FASB ASC 825, Financial Instruments, requires disclosure about fair value of financial instruments, including those financial assets and financial liabilities that are not required to be measured and reported at fair value on a recurring or nonrecurring basis. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure

Table of Contents

requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation. Additionally, in accordance with ASU 2016-01, which the Corporation adopted on January 1, 2018 on a prospective basis, the Corporation uses the exit price notion, rather than the entry price notion, in calculating the fair values of financial instruments not measured at fair value on a recurring basis.

The following tables reflect the carrying amounts and estimated fair values of the Corporation's financial instruments whether or not recognized on the Consolidated Balance Sheets at fair value.

| | Carrying | Fair Value Measurements at September 30, 2018 Using | | | Total Fair |
|---|---|---|---|---|---|
| (Dollars in thousands) | Value | Level 1 | Level 2 | Level 3 | Value |
| Financial assets: | | | | | |
| Cash and short-term investments | $ 109,149 | $ 109,149 | $ — | $ — | $ 109,149 |
| Securities available for sale | 217,114 | — | 217,114 | — | 217,114 |
| Loans, net | 1,002,423 | — | — | 985,257 | 985,257 |
| Loans held for sale | 45,979 | — | 45,979 | — | 45,979 |
| Derivative asset - IRLC | 939 | — | 939 | — | 939 |
| Derivative asset - interest rate swaps on loans | 2,633 | — | 2,633 | — | 2,633 |
| Derivative asset - cash flow hedges | 412 | — | 412 | — | 412 |
| Bank-owned life insurance | 15,869 | — | 15,869 | — | 15,869 |
| Accrued interest receivable | 7,354 | 7,354 | — | — | 7,354 |
| Financial liabilities: | | | | | |
| Demand deposits | $ 812,213 | $ 812,213 | $ — | $ — | $ 812,213 |
| Time deposits | 346,242 | — | 344,065 | — | 344,065 |
| Borrowings | 159,796 | — | 151,334 | — | 151,334 |
| Derivative liability - interest rate swaps on loans | 2,633 | — | 2,633 | — | 2,633 |
| Accrued interest payable | 916 | 916 | — | — | 916 |

| | Carrying | Fair Value Measurements at December 31, 2017 Using | | | Total Fair |
|---|---|---|---|---|---|
| (Dollars in thousands) | Value | Level 1 | Level 2 | Level 3 | Value |
| Financial assets: | | | | | |
| Cash and short-term investments | $ 119,423 | $ 119,423 | $ — | $ — | $ 119,423 |
| Securities available for sale | 218,976 | — | 218,976 | — | 218,976 |