PARKE BANCORP, INC.
Form 10-Q
August 14, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2017.
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 No. 000-51338

PARKE BANCORP, INC.
(Exact name of registrant as specified in its charter)

New Jersey	65-1241959
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
601 Delsea Drive, Washington Township, New Jersey	08080
(Address of principal executive offices)	(Zip Code)

856-256-2500
(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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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 [X]

As of August 14, 2017, there were issued and outstanding 7,672,003 shares of the registrant's common stock.

PARKE BANCORP, INC.

FORM 10-Q

FOR THE QUARTER ENDED June 30, 2017

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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Financial Statements

Parke Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets
(unaudited)
(in thousands except share and per share data)

	June 30, 2017	December 31, 2016
Assets		
Cash and due from financial institutions	$4,733	$4,399
Federal funds sold and cash equivalents	14,767	66,321
Total cash and cash equivalents	19,500	70,720
Investment securities available for sale, at fair value	41,851	44,854
Investment securities held to maturity (fair value of $2,462 at June 30, 2017 and $2,411 at December 31, 2016)	2,246	2,224
Total investment securities	44,097	47,078
Loans held for sale	1,882	—
Loans, net of unearned income	928,590	851,953
Less: Allowance for loan losses	(16,559)	(15,580)
Net loans	912,031	836,373
Accrued interest receivable	3,326	3,117
Premises and equipment, net	6,899	5,197
Other real estate owned (OREO)	8,722	10,528
Restricted stock, at cost	5,693	4,658
Bank owned life insurance (BOLI)	24,867	24,544
Deferred tax asset	10,566	10,746
Other assets	5,324	3,224
Total Assets	$1,042,907	$1,016,185
Liabilities and Equity		
Liabilities		
Deposits		
Noninterest-bearing deposits	$80,356	$92,535
Interest-bearing deposits	710,172	696,159
Total deposits	790,528	788,694
FHLBNY borrowings	99,650	79,650
Subordinated debentures	13,403	13,403
Accrued interest payable	627	655
Other liabilities	6,467	6,693
Total liabilities	910,675	889,095
Equity		
Preferred stock, 1,000,000 shares authorized, $1,000 liquidation value Series B - non-cumulative convertible; 19,828 shares outstanding June 30, 2017 and 20,000 shares outstanding December 31, 2016	19,828	20,000
Common stock, $0.10 par value; authorized 15,000,000 shares; Issued: 7,861,832 shares at June 30, 2017 and 7,147,952 at December 31, 2016	717	715
Additional paid-in capital	62,581	62,300
Retained earnings	52,447	47,483

Accumulated other comprehensive loss	(211)	(349)
Treasury stock, 284,522 shares at June 30, 2017 and 284,522 shares at December 31, 2016, at cost	(3,015)	(3,015)
Total shareholders' equity	132,347	127,134
Noncontrolling interest in consolidated subsidiaries	(115)	(44)
Total equity	132,232	127,090
Total liabilities and equity	$ 1,042,907	$ 1,016,185

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	(in thousands except share data)			
Interest income:				
Interest and fees on loans	$11,356	$10,100	$22,006	$20,062
Interest and dividends on investments	351	316	725	672
Interest on federal funds sold and cash equivalents	63	55	135	78
Total interest income	11,770	10,471	22,866	20,812
Interest expense:				
Interest on deposits	1,547	1,375	3,012	2,630
Interest on borrowings	420	339	795	673
Total interest expense	1,967	1,714	3,807	3,303
Net interest income	9,803	8,757	19,059	17,509
Provision for loan losses	1,000	(638)	1,500	62
Net interest income after provision for loan losses	8,803	9,395	17,559	17,447
Noninterest income:				
Gain on sale of SBA loans	84	372	84	1,803
Loan fees	175	159	241	506
Gain on Bank Owned Life Insurance	163	182	323	359
Service fees on deposit accounts	99	69	187	143
Loss on sale and write-down of real estate owned	(389)	(75)	(395)	(1,042)
Gain on sale of SBA loan portfolio	—	7,611	—	7,611
Other	459	152	547	263
Total noninterest income	591	8,470	987	9,643
Noninterest expense:				
Compensation and benefits	1,692	1,781	3,593	3,865
Professional services	382	369	747	825
Occupancy and equipment	326	311	669	643
Data processing	186	131	368	263
FDIC insurance	71	174	142	349
OREO expense	146	270	303	598
Other operating expense	758	956	1,428	2,138
Total noninterest expense	3,561	3,992	7,250	8,681
Income before income tax expense	5,833	13,873	11,296	18,409
Income tax expense	2,151	5,154	4,155	6,700
Net income attributable to Company and noncontrolling interest	3,682	8,719	7,141	11,709
Net income (loss) attributable to noncontrolling interest	17	(71)	18	(452)
Net income attributable to Company	3,699	8,648	7,159	11,257
Preferred stock dividend and discount accretion	297	300	596	600
Net income available to common shareholders	$3,402	$8,348	$6,563	$10,657
Earnings per common share:				
Basic	$0.45	$1.11	$0.87	$1.42
Diluted	$0.37	$0.88	$0.72	$1.15

Weighted average shares outstanding:				
Basic	7,577,310	7,495,234	7,570,994	7,480,204
Diluted	9,921,116	9,807,643	9,910,877	9,787,589

All share information has been adjusted for the 10% stock dividend paid May 19, 2017.

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the three months ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(in thousands)		(in thousands)	
Net income attributable to Company	$3,699	$8,648	$7,159	$11,257
Unrealized gains on securities:				
Non-credit related unrealized gains on securities with OTTI	8	9	18	9
Unrealized gains on securities without OTTI	144	203	211	826
Tax impact	(61)	(85)	(91)	(333)
Total unrealized gains on securities	91	127	138	502
Total comprehensive income	$3,790	$8,775	$7,297	$11,759

See accompanying notes to consolidated financial statements

Parke Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF EQUITY
(unaudited)

	Preferred Stock $1,000 par	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total Shareholders Equity	Non-Controlling Interest	Total Equity
	(in thousands except share data)									
Balance, December 31, 2016	$20,000	7,147,952	$715	$62,300	$47,483	$(349)	$(3,015)	$127,134	$(44)	$127,090
Capital withdrawal by minority (noncontrolling) interest								—	(53)	(53)
Common stock options exercised		7,260		232				232		232
Preferred stock shares conversion	(172)	17,774	2	13				(157)		(157)
Net income					7,159			7,159	(18)	7,141
Other comprehensive income						138		138		138
Stock compensation				36				36		36
Stock dividend 10%		688,846								
Dividend on preferred stock					(596)			(596)		(596)
Dividend on common stock (0.10 per share)					(1,599)			(1,599)		(1,599)
Balance, June 30, 2017	$19,828	7,861,832	$717	$62,581	$52,447	$(211)	$(3,015)	$132,347	$(115)	$132,232

All share information has been adjusted for the 10% stock dividend paid May 19, 2017.
See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the six months ended June 30,	
	2017	2016
	(amounts in thousands)	
Cash Flows from Operating Activities:		
Net income	$7,141	$11,709
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	144	154
Provision for loan losses	1,500	62
Gain on bank owned life insurance	(323)	(359)
Originations of loans held for sale	(2,546)	—
Gain on sale of SBA related assets	—	(7,611)
Gain on sale of SBA loans	(84)	(1,803)
SBA loans originated for sale	—	(14,041)
Proceeds from sale of SBA loans originated for sale	748	18,039
Loss on sale & write down of OREO	395	1,042
Net accretion of purchase premiums and discounts on securities	33	36
Deferred income tax benefit	179	334
Changes in operating assets and liabilities:		
(Increase) decrease in accrued interest receivable and other assets	(2,794)	3,518
Decrease in accrued interest payable and other accrued liabilities	(254)	(3,181)
Net cash provided by operating activities	4,139	7,899
Cash Flows from Investing Activities:		
(Purchases) redemptions of restricted stock	(1,035)	581
Proceeds from maturities and principal payments on mortgage-backed securities	3,178	3,205
Donated OREO property	(30)	—
Proceeds from sale of SBA related assets	—	50,348
Proceeds from sale of OREO	1,668	3,398
Capital improvements on OREO	(168)	(37)
Net increase in loans	(77,217)	(70,246)
Purchases of bank premises and equipment	(1,846)	(392)
Net cash used in investing activities	(75,450)	(13,143)
Cash Flows from Financing Activities:		
Payment of dividend on common & preferred stock	(1,973)	(1,539)
Purchase of treasury stock	—	(4)
Minority interest capital withdrawal, net	(53)	(624)
Proceeds from exercise of stock options	247	—
Stock compensation	36	30
Net increase (decrease) in FHLBNY and short term borrowings	20,000	(15,000)
Net decrease in noninterest-bearing deposits	(12,179)	(5,472)
Net increase in interest-bearing deposits	14,013	53,057
Net cash provided by financing activities	20,091	30,448

Net decrease in cash and cash equivalents	(51,220)	25,204
Cash and Cash Equivalents, January 1,	70,720	27,429
Cash and Cash Equivalents, June 30,	$19,500	$52,633
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		
Interest on deposits and borrowed funds	$3,835	$3,201
Income taxes	$5,654	$4,321
Supplemental Schedule of Noncash Activities:		
Real estate acquired in settlement of loans	$59	$589
Dividends accrued during the period	$2,195	$847

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

Parke Bancorp, Inc. ("Parke Bancorp" or the "Company") is a bank holding company incorporated under the laws of the State of New Jersey in January 2005 for the sole purpose of becoming the holding company of Parke Bank (the "Bank").

The Bank is a commercial bank which commenced operations on January 28, 1999. The Bank is chartered by the New Jersey Department of Banking and Insurance (the "Department") and its deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). Parke Bancorp and the Bank maintain their principal offices at 601 Delsea Drive, Washington Township, New Jersey. The Bank also conducts business through branches in Galloway Township, Northfield, Washington Township, and Collingswood, New Jersey and Philadelphia, Pennsylvania.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Company and the Bank are subject to the regulations of certain state and federal agencies, and accordingly, the Company and the Bank are periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank's business is particularly susceptible to future state and federal legislation and regulations.

In December of 2013, the Company completed a private placement of newly designated 6.00% Non-Cumulative Perpetual Convertible Preferred Stock, Series B, with a liquidation preference of $1,000 per share. The Company sold 20,000 shares in the placement for gross proceeds of $20.0 million. Each share of Series B Preferred Stock is convertible, at the option of the holder into 113.679 shares of Common Stock.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation: The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and predominant practices within the banking industry.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary the Bank. Also included are the accounts of 44 Business Capital LLC, a joint venture formed in 2009 to originate and service SBA loans. The assets of 44 Business Capital were sold on April 28, 2016. The Bank had a 51% ownership interest in the joint venture. Parke Capital Trust I, Parke Capital Trust II and Parke Capital Trust III are wholly-owned subsidiaries but are not consolidated because they do not meet the requirements for consolidation under applicable accounting guidance. All significant inter-company balances and transactions have been eliminated.

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the six months ended June 30, 2017 and 2016 are unaudited. The balance sheet as of December 31, 2016, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the six months ended June 30, 2017 are not necessarily indicative of the results for the full

year. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings or shareholders' equity.

Use of Estimates: The preparation of financial statements in conformity with 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 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 include the allowance for loan losses, other than temporary impairment losses on investment securities, the valuation of deferred income taxes, servicing assets and carrying value of OREO.

Recently Issued Accounting Pronouncements:
During August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-15, which is new guidance related to the Statement of Cash Flows. The new guidance clarifies the classification within the statement of cash flows for certain transactions, including debt extinguishment costs, zero-coupon debt, and contingent consideration related

to business combinations, insurance proceeds, equity method distributions and beneficial interests in securitizations. The guidance also clarifies that cash flows with aspects of multiple classes of cash flows or that cannot be separated by source or use should be classified based on the activity that is likely to be the predominant source or use of cash flows for the item. This guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The adoption of this guidance is not expected to be material to the consolidated financial statements.

During June 2016, the FASB issued Accounting Standards Update ASU 2016-13, Financial Instruments Credit Losses. ASU 2016-13 (Topic 326), replaces the incurred loss impairment methodology in current GAAP with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit impaired loans will receive an allowance account at the acquisition date that represents a component of the purchase price allocation. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses, with such allowance limited to the amount by which fair value is below amortized cost. This guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

On January 5, 2016, the FASB issued Accounting Standards Update 2016-01, Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (the ASU). The ASU's changes to the current GAAP model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. ASU 2016-01 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of these amendments.

On February 25, 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842). ASU No. 2016-02 includes a lessee accounting model that recognizes two types of leases - finance leases and operating leases. The standard requires that a lessee recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Leases with terms of less than 12 months are exempt from the new standard. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as finance or operating lease. New disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases are also required. These disclosures include qualitative and quantitative requirements, providing information about the amounts recorded in the financial statements. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; that is, for a calendar year-end public entity, the changes take effect beginning January 1, 2019. The Company has taken a close look at the accounting standard and finds that the change to ASU No. 2016-02 should not have a large impact on the Bank's financial statements.

During March 2016, the FASB issued Accounting Standards Update No. 2016-09, Stock Compensation. ASU No. 2016-09 (Topic 718) eliminates the concept of additional paid-in capital pools for stock-based awards and requires that the related excess tax benefits and tax deficiencies be classified as an operating activity in the statement of cash flows. The new guidance also allows entities to make a one-time policy election to account for forfeitures when they occur, instead of accruing compensation cost based on the number of awards expected to vest. Additionally, the new guidance changes the requirement for an award to qualify for equity classification by permitting tax withholding up to the maximum statutory tax rate instead of the minimum statutory tax rate. Cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity in the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. The adoption of this guidance has had no impact to the consolidated financial statements.

During May 2014, the FASB issued Accounting Standards No. 2014-09, Revenue from Contracts with Customers. ASU No.2014-09 (Topic 606) supersedes the revenue recognition requirements in Accounting Standards Codification Topic 606, Revenue Recognition, and most industry-specific guidance throughout the Accounting Standards Codification. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. During August 2015, the FASB provided a one-year deferral of the effective date; therefore, the guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The FASB has also issued clarification guidance as it relates to principal versus agent considerations for revenue recognition purposes and clarification guidance on other various considerations related to the new revenue recognition guidance. Additionally, during April 2016, the FASB issued further clarification guidance related to identifying performance obligations and licensing. The guidance has specifically excluded revenue derived from financial instruments, the source of the majority of the Company’s revenue, and the impact of the guidance will not be material.

NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of June 30, 2017 and December 31, 2016:

As of June 30, 2017	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in AOCI	Fair value
	(amounts in thousands)				
Available for sale:					
Corporate debt obligations	$1,000	$ 32	$ —	$ —	$1,032
Residential mortgage-backed securities	40,366	275	373	—	40,268
Collateralized mortgage obligations	126	4	—	—	130
Collateralized debt obligations	712	—	—	291	421
Total available for sale	$42,204	$ 311	$ 373	$ 291	$41,851
Held to maturity:					
States and political subdivisions	$2,246	$ 216	$ —	$ —	$2,462

As of December 31, 2016	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in AOCI	Fair value
	(amounts in thousands)				
Available for sale:					
Corporate debt obligations	$1,000	$ 11	$ —	$ —	$1,011
Residential mortgage-backed securities	43,530	218	508	—	43,240
Collateralized mortgage obligations	160	6	—	—	166
Collateralized debt obligations	746	—	—	309	437
Total available for sale	$45,436	$ 235	$ 508	$ 309	$44,854
Held to maturity:					
States and political subdivisions	$2,224	$ 187	$ —	$ —	$2,411

The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of June 30, 2017 are as follows:

	Amortized Cost	Fair Value
	(amounts in thousands)	
Available for sale:		
Due within one year	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	500	500
Due after ten years	1,212	953
Residential mortgage-backed securities and collateralized mortgage obligations	40,492	40,398
Total available for sale	$42,204	$41,851
Held to maturity:		
Due within one year	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	2,246	2,462
Due after ten years	—	—
Total held to maturity	$2,246	$2,462

Expected maturities will differ from contractual maturities for mortgage related securities because the issuers of certain debt securities do have the right to call or prepay their obligations without any penalty.

Securities with a carrying value of $25.8 million and $23.1 million were pledged to secure public deposits at June 30, 2017 and December 31, 2016, respectively.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired (“OTTI”), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2017 and December 31, 2016:

As of June 30, 2017	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(amounts in thousands)					
Available for sale:						
Residential mortgage-backed securities	$15,802	$ 348	$911	$ 25	$16,713	$ 373
Total available for sale	$15,802	$ 348	$911	$ 25	$16,713	$ 373

As of December 31, 2016	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(amounts in thousands)					
Available for sale:						
Residential mortgage-backed securities	$17,519	$ 484	$1,077	$ 24	$18,596	$ 508

Total available for sale	$17,519	$ 484	$1,077	$ 24	$18,596	$ 508

The unrealized losses on the Company's investment in mortgage-backed securities relate to nine securities at June 30, 2017 versus 10 securities at December 31, 2016. The losses were caused by movement in interest rates. The securities were issued by FNMA, a government sponsored entity. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investment in these securities to be OTTI at June 30, 2017.

Other Than Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered OTTI and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructuring or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an OTTI exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity.

The credit loss component of credit-impaired debt securities was $171,000. This impairment was taken in a prior year and no OTTI was realized in the current year.

The Company did not sell any securities during the six months ended June 30, 2017.

NOTE 4. LOANS

The portfolio of loans outstanding consists of the following:

	June 30, 2017			December 31, 2016		
	Amount	Percentage of Total Loans		Amount	Percentage of Total Loans	
	(amounts in thousands)					
Commercial and Industrial	$27,097	2.9	%	$26,774	3.1	%
Real Estate Construction:						
Residential	18,862	2.0		8,825	1.0	
Commercial	59,113	6.4		58,469	6.9	

Real Estate Mortgage:						
Commercial – Owner Occupied	122,054	13.2		123,898	14.5	
Commercial – Non-owner Occupied	283,396	30.5		268,123	31.5	
Residential – 1 to 4 Family	350,445	37.7		309,340	36.3	
Residential – Multifamily	51,461	5.6		39,804	4.7	
Consumer	16,162	1.7		16,720	2.0	
Total Loans	$928,590	100.0	%	$851,953	100.0	%

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Loan Origination/Risk Management: In the normal course of business the Company is exposed to a variety of operational, reputational, legal, regulatory, and credit risks that could adversely affect our financial performance. Most of our asset risk is primarily tied to credit (lending) risk. The Company has lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Board of Directors reviews and approves these policies, guidelines and procedures. When we originate a loan we make certain subjective judgments about the borrower’s ability to meet the loan’s terms and conditions. We also make objective and subjective value assessments on the assets we finance. The borrower’s ability to repay can be adversely affected by economic changes. Likewise, changes in market conditions and other external factors can affect asset valuations. The Company actively monitors the quality of its loan portfolio. A reporting system supplements the credit review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit risk, loan delinquencies, troubled debt restructures, nonperforming and potential problem loans. Diversification in the loan portfolio is another means of managing risk associated with fluctuations in economic conditions.

Commercial and Industrial Loans: The Company originates secured loans for business purposes. Loans are made to provide working capital to businesses in the form of lines of credit, which may be secured by accounts receivable, inventory, equipment or other assets. The financial condition and cash flow of commercial borrowers are closely monitored by means of corporate financial statements, personal financial statements and income tax returns. The frequency of submissions of required financial information depends on the size and complexity of the credit and the collateral that secures the loan. The Company’s general policy is to obtain personal guarantees from the principals of the commercial loan borrowers. Such loans are made to businesses located in the Company’s market area.

Construction Loans: With respect to construction loans to developers and builders that are secured by non-owner occupied properties, loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are also generally underwritten based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, or sales of developed property until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risk than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial Real Estate: Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. Commercial real estate loans may be riskier than loans for one-to-four family residences and are typically larger in dollar size. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is generally largely dependent on the successful operation and management of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company’s commercial real estate portfolio are diverse in terms of type and geographic location within our market area. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. The Company also monitors economic conditions and trends affecting the market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Residential Mortgage: The Company originates adjustable and fixed-rate residential mortgage loans. Such mortgage loans are generally originated under terms, conditions and documentation acceptable to the secondary mortgage market. Repayment is typically dependent upon the borrower’s financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. Although the Company has placed all of these loans into its

portfolio, a substantial majority of such loans can be sold in the secondary market or pledged for potential borrowings.

Consumer Loans: Consumer loans may carry a higher degree of repayment risk than residential mortgage loans. Repayment is typically dependent upon the borrower's financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. To monitor and manage consumer loan risk, policies and procedures have been developed and modified as needed. This activity, coupled with the relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Historically the Company's losses on consumer loans have been negligible.

The Company maintains an outsourced independent loan review program that reviews and validates the credit risk assessment program on a periodic basis. Results of these external independent reviews are presented to management. The external independent

loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit risk management personnel.

Non-accrual and Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when a loan is 90 days past due, unless the loan is well secured and in the process of collection, as required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An age analysis of past due loans by class at June 30, 2017 and December 31, 2016 follows:

June 30, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(amounts in thousands)					
Commercial and Industrial	$—	$—	$ 19	$19	$27,078	$27,097
Real Estate Construction:						
Residential	—	—	—	—	18,862	18,862
Commercial	—	—	2,515	2,515	56,598	59,113
Real Estate Mortgage:						
Commercial – Owner Occupied	—	2,749	159	2,908	119,146	122,054
Commercial – Non-owner Occupied	—	—	2,488	2,488	280,908	283,396
Residential – 1 to 4 Family	356	337	3,178	3,871	346,574	350,445
Residential – Multifamily	—	—	50	50	51,411	51,461
Consumer	—	—	90	90	16,072	16,162
Total Loans	$356	$3,086	$ 8,499	$11,941	$916,649	$928,590

December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(amounts in thousands)					
Commercial and Industrial	$—	$—	$ 159	$159	$26,615	$26,774
Real Estate Construction:						
Residential	—	—	—	—	8,825	8,825
Commercial	—	—	3,241	3,241	55,228	58,469
Real Estate Mortgage:						
Commercial – Owner Occupied	—	165	430	595	123,303	123,898
Commercial – Non-owner Occupied	—	—	3,958	3,958	264,165	268,123
Residential – 1 to 4 Family	715	361	3,095	4,171	305,169	309,340
Residential – Multifamily	—	—	308	308	39,496	39,804
Consumer	31	42	107	180	16,540	16,720

Total Loans	$746	$568	$11,298	$12,612	$839,341	$851,953

Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

All impaired loans are assessed for recoverability based on an independent third-party full appraisal to determine the net realizable value ("NRV") based on the fair value of the underlying collateral, less cost to sell and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are generally updated every 12 months or sooner if we have identified possible further deterioration in value. Prior to receiving the updated appraisal, we will establish a specific reserve for any estimated deterioration, based upon our assessment of market conditions, adjusted for estimated costs to sell and other identified costs. If the NRV is greater than the loan amount, then no impairment loss exists. If the NRV is less than the loan amount, the shortfall is recognized by a specific reserve. If the borrower fails to pledge additional collateral in the ninety day period, a charge-off equal to the difference between the loan's carrying value and NRV will occur. In certain circumstances, however, a direct charge-off may be taken at the time that the NRV calculation reveals a shortfall. All impaired loans are evaluated based on the criteria stated above on a quarterly basis and any change in the reserve requirements are recorded in the period identified. All partially charged-off loans remain on non-accrual status until they are brought current as to both principal and interest and have at least nine months of payment history and future collectability of principal and interest is assured.

Impaired loans at June 30, 2017 and December 31, 2016 are set forth in the following tables:

June 30, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$19	$22	$ —
Real Estate Construction:			
Residential	—	—	—
Commercial	435	435	—
Real Estate Mortgage:			
Commercial – Owner Occupied	159	159	—
Commercial – Non-owner Occupied	2,560	2,805	—
Residential – 1 to 4 Family	2,542	2,598	—
Residential – Multifamily	—	—	—
Consumer	90	90	—
	5,805	6,109	—
With an allowance recorded:			
Commercial and Industrial	—	—	—
Real Estate Construction:			
Residential	—	—	—
Commercial	6,747	10,647	810
Real Estate Mortgage:			
Commercial – Owner Occupied	3,812	3,841	57
Commercial – Non-owner Occupied	14,720	16,315	906
Residential – 1 to 4 Family	1,582	1,582	212
Residential – Multifamily	50	95	50
Consumer	—	—	—
	26,911	32,480	2,035
Total:			
Commercial and Industrial	19	22	—
Real Estate Construction:			
Residential	—	—	—
Commercial	7,182	11,082	810
Real Estate Mortgage:			
Commercial – Owner Occupied	3,971	4,000	57
Commercial – Non-owner Occupied	17,280	19,120	906
Residential – 1 to 4 Family	4,124	4,180	212
Residential – Multifamily	50	95	50
Consumer	90	90	—
	$32,716	$38,589	$ 2,035

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$21	$23	$ —
Real Estate Construction:			
Residential	—	—	—
Commercial	1,161	1,161	—
Real Estate Mortgage:			
Commercial – Owner Occupied	—	—	—
Commercial – Non-owner Occupied	3,494	3,739	—
Residential – 1 to 4 Family	2,384	2,434	—
Residential – Multifamily	308	354	—
Consumer	107	107	—
	7,475	7,818	—
With an allowance recorded:			
Commercial and Industrial	138	1,392	138
Real Estate Construction:			
Residential	—	—	—
Commercial	7,225	11,125	155
Real Estate Mortgage:			
Commercial – Owner Occupied	4,380	4,409	498
Commercial – Non-owner Occupied	15,506	17,100	226
Residential – 1 to 4 Family	1,681	1,697	234
Residential – Multifamily	—	—	—
Consumer	—	—	—
	28,930	35,723	1,251
Total:			
Commercial and Industrial	159	1,415	138
Real Estate Construction:			
Residential	—	—	—
Commercial	8,386	12,286	155
Real Estate Mortgage:			
Commercial – Owner Occupied	4,380	4,409	498
Commercial – Non-owner Occupied	19,000	20,839	226
Residential – 1 to 4 Family	4,065	4,131	234
Residential – Multifamily	308	354	—
Consumer	107	107	—
	$36,405	$43,541	$ 1,251

The following table presents by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,			
	2017		2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(amounts in thousands)			
Commercial and Industrial	$23	$ —	$1,691	$ —
Real Estate Construction:				
Residential	—	—	—	—
Commercial	9,158	51	13,302	59
Real Estate Mortgage:				
Commercial – Owner Occupied	4,024	40	5,152	44
Commercial – Non-owner Occupied	18,483	155	21,078	191
Residential – 1 to 4 Family	4,179	22	3,645	32
Residential – Multifamily	180	—	354	4
Consumer	90	1	31	—
Total	$36,137	$ 269	$45,253	$ 330

	Six Months Ended June 30,			
	2017		2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(amounts in thousands)			
Commercial and Industrial	$23	$ 1	$1,740	$ —
Real Estate Construction:				
Residential	—	—	—	—
Commercial	8,535	102	13,328	118
Real Estate Mortgage:				
Commercial – Owner Occupied	4,054	97	6,036	89
Commercial – Non-owner Occupied	18,248	328	21,140	373
Residential – 1 to 4 Family	4,185	42	3,688	65
Residential – Multifamily	223	—	355	8
Consumer	90	2	31	1
Total	$35,358	$ 572	$46,318	$ 654

Troubled debt restructuring: Periodically management evaluates our loans in order to determine the appropriate risk rating, interest accrual status and potential classification as a troubled debt restructuring ("TDR"), some of which are performing and accruing interest. A TDR is a loan on which we have granted a concession due to a borrower’s financial difficulty. These are concessions that would not otherwise be considered. The terms of these modified loans may include extension of maturity, renewals, changes in interest rate, additional collateral requirements or infusion of additional capital into the project by the borrower to reduce debt or to support future debt service. On construction and land development loans we may modify the loan as a result of delays or other project issues such as slower than anticipated sell-outs, insufficient leasing activity and/or a decline in the value of the underlying collateral securing the loan. Management believes that working with a borrower to restructure a loan provides us with a better likelihood of collecting our loan. It is our policy not to renegotiate the terms of a commercial loan simply because of a delinquency

status. However, we will use our Troubled Debt Restructuring Program to work with delinquent borrowers when the delinquency is temporary. The Bank considers all TDRs to be impaired.

At the time a loan is modified in a TDR, we consider the following factors to determine whether the loan should accrue interest:

- Whether there is a period of current payment history under the current terms, typically 6 months;
- Whether the loan is current at the time of restructuring; and
- Whether we expect the loan to continue to perform under the restructured terms with a debt coverage ratio that complies with the Bank's credit underwriting policy of 1.25 times debt service.

We also review the financial performance of the borrower over the past year to be reasonably assured of repayment and performance according to the modified terms. This review consists of an analysis of the borrower's historical results; the borrower's projected results over the next four quarters; and current financial information of the borrower and any guarantors. The projected repayment source needs to be reliable, verifiable, quantifiable and sustainable. In addition, all TDRs are reviewed quarterly to determine the amount of any impairment. At the time of restructuring, the amount of the loan principal for which we are not reasonably assured of repayment is charged-off, but not forgiven.

A borrower with a restructured loan must make a minimum of six consecutive monthly payments at the restructured level and be current as to both interest and principal to be returned to accrual status.

Performing TDRs (not reported as non-accrual loans) totaled $24.2 million and $24.8 million with related allowances of $831,000 and $409,000 as of June 30, 2017 and December 31, 2016, respectively. Nonperforming TDRs were 749,000 with $50,000 related allowances as of June 30, 2017 and no related allowance as of December 31, 2016, respectively. All TDRs are classified as impaired loans and are included in the impaired loan disclosures above. There were no new loans modified as a TDR during the six month periods ended June 30, 2017 and 2016. Also, there were no loans that were modified and deemed a TDR that subsequently defaulted during the six month periods ended June 30, 2017 and 2016.

Some loans classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall allowance for loan losses estimate. The level of any re-defaults will likely be affected by future economic conditions. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is repaid in full, foreclosed, sold or it meets the criteria to be removed from TDR status.

Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grades of loans, the level of classified loans, net charge-offs, nonperforming loans (see details above) and the general economic conditions in the region.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 7. Grades 1 through 4 are considered "Pass". A description of the general characteristics of the seven risk grades is as follows:

1. Good: Borrower exhibits the strongest overall financial condition and represents the most creditworthy profile.
2. Satisfactory (A): Borrower reflects a well-balanced financial condition, demonstrates a high level of creditworthiness and typically will have a strong banking relationship with the Bank.
3. Satisfactory (B): Borrower exhibits a balanced financial condition and does not expose the Bank to more than a normal or average overall amount of risk. Loans are considered fully collectable.
4. Watch List: Borrower reflects a fair financial condition, but there exists an overall greater than average risk. Risk is deemed acceptable by virtue of increased monitoring and control over borrowings. Probability of timely repayment is present.

5. Other Assets Especially Mentioned (OAEM): Financial condition is such that assets in this category have a potential weakness or pose unwarranted financial risk to the Bank even though the asset value is not currently impaired. The asset does not currently warrant adverse classification but if not corrected could weaken and could create future increased risk exposure. Includes loans which require an increased degree of monitoring or servicing as a result of internal or external changes.
6. Substandard: This classification represents more severe cases of #5 (OAEM) characteristics that require increased monitoring. Assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral. Asset has a well-defined weakness or weaknesses that impairs the ability to repay debt and jeopardizes the timely liquidation or realization of the collateral at the asset's net book value.
7. Doubtful: Assets which have all the weaknesses inherent in those assets classified #6 (Substandard) but the risks are more severe relative to financial deterioration in capital and/or asset value; accounting/evaluation techniques may be questionable and the overall possibility for collection in full is highly improbable. Borrowers in this category require constant monitoring, are considered work-out loans and present the potential for future loss to the Bank.

An analysis of the credit risk profile by internally assigned grades as of June 30, 2017 and December 31, 2016 is as follows:

At June 30, 2017	Pass	OAEM	Substandard	Doubtful	Total
	(amounts in thousands)				
Commercial and Industrial	$26,988	$109	$ —	$ —	$27,097
Real Estate Construction:					
Residential	18,862	—	—	—	18,862
Commercial	42,697	6,955	9,461	—	59,113
Real Estate Mortgage:					
Commercial – Owner Occupied	119,141	2,754	159	—	122,054
Commercial – Non-owner Occupied	278,017	—	5,379	—	283,396
Residential – 1 to 4 Family	345,446	1,674	3,325	—	350,445
Residential – Multifamily	51,411	—	50	—	51,461
Consumer	16,072	—	90	—	16,162
Total	$898,634	$11,492	$ 18,464	$ —	$928,590

At December 31, 2016	Pass	OAEM	Substandard	Doubtful	Total
	(amounts in thousands)				
Commercial and Industrial	$26,515	$121	$ 138	$ —	$26,774
Real Estate Construction:					
Residential	8,825	—	—	—	8,825
Commercial	35,656	12,516	10,297	—	58,469
Real Estate Mortgage:					
Commercial – Owner Occupied	120,166	3,302	430	—	123,898
Commercial – Non-owner Occupied	261,181	79	6,863	—	268,123
Residential – 1 to 4 Family	304,042	1,536	3,762	—	309,340
Residential – Multifamily	39,496	—	308	—	39,804
Consumer	16,612	—	108	—	16,720
Total	$812,493	$17,554	$ 21,906	$ —	$851,953

NOTE 5. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of, and trends related to, non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company’s control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a grade of 6 or higher, the loan is analyzed to determine whether the loan is impaired and, if impaired, whether there is a need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, any collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, high-moderate, moderate, low-moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

An analysis of the allowance for loan losses for the three and six month periods ended June 30, 2017 and 2016 is as follows:

Allowance for Loan Losses:	For the three months ended June 30, 2017				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$1,165	$ —	$ 8	$ 29	$1,202
Real Estate Construction:					
Residential	229	—	—	35	264
Commercial	1,940	—	—	54	1,994
Real Estate Mortgage:					
Commercial – Owner Occupied	1,869	—	69	(103)	1,835
Commercial – Non-owner Occupied	4,240	—	5	670	4,915
Residential – 1 to 4 Family	5,136	—	2	284	5,422
Residential – Multifamily	662	—	—	37	699
Consumer	234	—	—	(6)	228
Total	$15,475	$ —	$ 84	$ 1,000	$16,559

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Allowance for Loan Losses:	For the three months ended June 30, 2016				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$900	$ (40)	$ 1	$ 9	$870
Real Estate Construction:					
Residential	180	—	—	72	252
Commercial	2,831	(1,081)	—	762	2,512
Real Estate Mortgage:					
Commercial – Owner Occupied	3,225	—	—	(1,539)	1,686
Commercial – Non-owner Occupied	3,944	(154)	—	133	3,923
Residential – 1 to 4 Family	5,096	(698)	1	(177)	4,222
Residential – Multifamily	381	(45)	—	116	452
Consumer	262	—	—	(14)	248
Total	$16,819	$ (2,018)	$ 2	$ (638)	$14,165

Allowance for Loan Losses:	For the six months ended June 30, 2017				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$1,188	$ (134)	$ 42	$ 106	$1,202
Real Estate Construction:					
Residential	268	—	—	(4)	264
Commercial	2,496	—	—	(502)	1,994
Real Estate Mortgage:					
Commercial – Owner Occupied	2,082	(430)	69	114	1,835
Commercial – Non-owner Occupied	3,889	—	45	981	4,915
Residential – 1 to 4 Family	4,916	(118)	5	619	5,422
Residential – Multifamily	505	—	—	194	699
Consumer	236	—	—	(8)	228
Total	$15,580	$ (682)	$ 161	$ 1,500	$16,559

Allowance for Loan Losses:	For the six months ended June 30, 2016				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$952	$ (76)	$ 1	$ (7)	$870
Real Estate Construction:					
Residential	247	—	—	5	252
Commercial	2,501	(1,081)	—	1,092	2,512
Real Estate Mortgage:					
Commercial – Owner Occupied	3,267	—	—	(1,581)	1,686
Commercial – Non-owner Occupied	3,838	(154)	—	239	3,923
Residential – 1 to 4 Family	4,802	(698)	20	98	4,222
Residential – Multifamily	254	(45)	—	243	452
Consumer	275	—	—	(27)	248
Total	$16,136	$ (2,054)	$ 21	$ 62	$14,165

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Allowance for Loan Losses, at June 30, 2017	Individually evaluated for impairment	Collectively evaluated for impairment	Total
	(amounts in thousands)		
Commercial and Industrial	$ —	$ 1,202	$ 1,202
Real Estate Construction:			
Residential	—	264	264
Commercial	810	1,184	1,994
Real Estate Mortgage:			
Commercial – Owner Occupied	57	1,778	1,835