MACATAWA BANK CORP
Form 10-Q
July 28, 2016

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

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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: 000-25927

MACATAWA BANK CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-3391345
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10753 Macatawa Drive, Holland, Michigan 49424
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (616) 820-1444

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 33,922,289 shares of the Company's Common Stock (no par value) were outstanding as of July 28, 2016.

Forward-Looking Statements

This report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Macatawa Bank Corporation. Forward-looking statements are identifiable by words or phrases such as “outlook”, “plan” or “strategy”; that an event or trend “may”, “should”, “will”, “is likely”, or is “probable” to occur or “continue”, has “begun” or “is scheduled” or or that the Company or its management “anticipates”, “believes”, “estimates”, “plans”, “forecasts”, “intends”, “predicts”, “proj “expects” a particular result, or is “committed”, “confident”, “encouraged”, “optimistic” or has an “opinion” that an event will occur, or other words or phrases such as “ongoing”, “future”, “signs”, “efforts”, “tend”, “exploring”, “appearing”, “until”, “nea “going forward”, “focus”, “starting”, “initiative,” “trend” and variations of such words and similar expressions. Such statement are based upon current beliefs and expectations and involve substantial risks and uncertainties which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These statements include, among others, future levels of earning assets, statements related to stabilization of our loan portfolio, trends in credit quality metrics, future capital levels and capital needs, including the impact of Basel III, real estate valuation, future levels of repossessed and foreclosed properties and nonperforming assets, future levels of losses and costs associated with the administration and disposition of repossessed and foreclosed properties and nonperforming assets, future levels of loan charge-offs, future levels of other real estate owned, future levels of provisions for loan losses and reserve recoveries, the rate of asset dispositions, future dividends, future growth and funding sources, future cost of funds, future liquidity levels, future profitability levels, future FDIC assessment levels, future net interest margin levels, building and improving our investment portfolio, diversifying our credit risk, the effects on earnings of changes in interest rates, future economic conditions, future effects of new or changed accounting standards, future loss recoveries, future balances of short-term investments, future loan demand and loan growth, future levels of mortgage banking revenue and the future level of other revenue sources. Management's determination of the provision and allowance for loan losses, the appropriate carrying value of intangible assets (including deferred tax assets) and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other-than-temporary and the amount of any impairment) involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. Our ability to sell other real estate owned at its carrying value or at all, successfully implement new programs and initiatives, increase efficiencies, maintain our current levels of deposits and other sources of funding, maintain liquidity, respond to declines in collateral values and credit quality, increase loan volume, originate high quality loans, maintain or improve mortgage banking income, realize the benefit of our deferred tax assets, continue payment of dividends and improve profitability is not entirely within our control and is not assured. The future effect of changes in the real estate, financial and credit markets and the national and regional economy on the banking industry, generally, and Macatawa Bank Corporation, specifically, are also inherently uncertain. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions (“risk factors”) that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Macatawa Bank Corporation does not undertake to update forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

Risk factors include, but are not limited to, the risk factors described in "Item 1A - Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2015. These and other factors are representative of the risk factors that may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

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Part I Financial Information
Item 1.
MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
As of June 30, 2016 (unaudited) and December 31, 2015
(Dollars in thousands, except per share data)

	June 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$30,045	$ 29,104
Federal funds sold and other short-term investments	94,888	152,372
Cash and cash equivalents	124,933	181,476
Interest-bearing time deposits in other financial institutions	---	20,000
Securities available for sale, at fair value	173,580	166,815
Securities held to maturity (fair value 2016 - $50,803 and 2015 - $52,837)	49,373	51,856
Federal Home Loan Bank (FHLB) stock	11,558	11,558
Loans held for sale, at fair value	1,138	2,776
Total loans	1,211,844	1,197,932
Allowance for loan losses	(16,959)	(17,081)
Net loans	1,194,885	1,180,851
Premises and equipment – net	50,639	51,456
Accrued interest receivable	3,657	3,622
Bank-owned life insurance	28,942	28,858
Other real estate owned - net	14,066	17,572
Net deferred tax asset	8,422	8,819
Other assets	5,354	3,984
Total assets	$1,666,547	$ 1,729,643
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$451,644	$ 477,032
Interest-bearing	903,434	958,480
Total deposits	1,355,078	1,435,512
Other borrowed funds	104,840	96,169
Long-term debt	41,238	41,238
Accrued expenses and other liabilities	6,929	4,747
Total liabilities	1,508,085	1,577,666
Commitments and contingent liabilities	---	---
Shareholders' equity		
Common stock, no par value, 200,000,000 shares authorized; 33,922,289 and 33,925,113 shares issued and outstanding at June 30, 2016 and December 31, 2015	216,799	216,540
Retained deficit	(59,695)	(64,910)
Accumulated other comprehensive income	1,358	347
Total shareholders' equity	158,462	151,977
Total liabilities and shareholders' equity	$1,666,547	$ 1,729,643

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Three and Six Month Periods Ended June 30, 2016 and 2015
(unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Interest income				
Loans, including fees	$ 11,634	$ 11,152	$ 23,390	$ 22,115
Securities				
Taxable	565	501	1,115	1,002
Tax-exempt	441	376	874	720
FHLB Stock	122	111	246	228
Federal funds sold and other short-term investments	111	98	256	184
Total interest income	12,873	12,238	25,881	24,249
Interest expense				
Deposits	439	610	902	1,229
Other borrowings	458	452	900	867
Long-term debt	368	331	733	656
Total interest expense	1,265	1,393	2,535	2,752
Net interest income	11,608	10,845	23,346	21,497
Provision for loan losses	(750)	(500)	(850)	(1,500)
Net interest income after provision for loan losses	12,358	11,345	24,196	22,997
Noninterest income				
Service charges and fees	1,112	1,097	2,159	2,098
Net gains on mortgage loans	572	821	1,060	1,544
Trust fees	788	723	1,496	1,457
ATM and debit card fees	1,257	1,219	2,443	2,329
Gain on sale of securities	10	---	99	83
Bank owned life insurance ("BOLI") income	158	171	602	333
Other	639	481	1,285	963
Total noninterest income	4,536	4,512	9,144	8,807
Noninterest expense				
Salaries and benefits	6,168	6,134	12,355	12,316
Occupancy of premises	901	903	1,883	1,875
Furniture and equipment	839	813	1,704	1,596
Legal and professional	188	191	347	431
Marketing and promotion	275	263	550	568
Data processing	688	648	1,347	1,226
FDIC assessment	220	289	472	571
Interchange and other card expense	308	285	594	560
Bond and D&O Insurance	131	146	263	292
Net losses (gains) on repossessed and foreclosed properties	258	(31)	294	420
Administration and disposition of problem assets	202	284	577	660
Other	1,292	1,297	2,635	2,569

Total noninterest expenses	11,470	11,222	23,021	23,084
Income before income tax	5,424	4,635	10,319	8,720
Income tax expense	1,679	1,420	3,079	2,665
Net income	$ 3,745	$ 3,215	$ 7,240	$ 6,055
Basic earnings per common share	$ 0.11	$ 0.09	$ 0.21	$ 0.18
Diluted earnings per common share	$ 0.11	$ 0.09	$ 0.21	$ 0.18
Cash dividends per common share	$ 0.03	$ 0.03	$ 0.06	$ 0.05

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Three and Six Month Periods Ended June 30, 2016 and 2015
(unaudited)
(Dollars in thousands)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net income	$ 3,745	$ 3,215	$ 7,240	$ 6,055
Other comprehensive income:				
Unrealized gains (losses):				
Net change in unrealized gains (losses) on securities available for sale	590	(1,214)	1,654	67
Tax effect	(206)	425	(579)	(24)
Net change in unrealized gains (losses) on securities available for sale, net of tax	384	(789)	1,075	43
Less: reclassification adjustments:				
Reclassification for gains included in net income	10	---	99	83
Tax effect	(3)	---	(35)	(29)
Reclassification for gains included in net income, net of tax	7	---	64	54
Other comprehensive income (loss), net of tax	377	(789)	1,011	(11)
Comprehensive income	$ 4,122	$ 2,426	$ 8,251	$ 6,044

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Six Month Periods Ended June 30, 2016 and 2015

(unaudited)

(Dollars in thousands, except per share data)

	Common Stock	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2015	$216,460	$(74,002)	$ 61	$ 142,519
Net income for the six months ended June 30, 2015	---	6,055	---	6,055
Cash dividends at $.05 per share	---	(1,682)	---	(1,682)
Net change in unrealized gain on securities available for sale, net of tax	---	---	(11)	(11)
Tax effect of expired common stock warrants	(280)	---	---	(280)
Stock compensation expense	242	---	---	242
Balance, June 30, 2015	$216,422	$(69,629)	$ 50	$ 146,843
Balance, January 1, 2016	$216,540	$(64,910)	$ 347	$ 151,977
Net income for the six months ended June 30, 2016	---	7,240	---	7,240
Cash dividends at $.06 per share	---	(2,025)	---	(2,025)
Repurchase of 2,824 shares for taxes withheld on vested restricted stock	(19)	---	---	(19)
Net change in unrealized gain on securities available for sale, net of tax	---	---	1,011	1,011
Stock compensation expense	278	---	---	278
Balance, June 30, 2016	$216,799	$(59,695)	$ 1,358	$ 158,462

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six Month Periods Ended June 30, 2016 and 2015
(unaudited)
(Dollars in thousands)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Cash flows from operating activities		
Net income	$ 7,240	$ 6,055
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,403	1,522
Stock compensation expense	278	242
Tax effect of expired common stock warrants	---	(280)
Provision for loan losses	(850)	(1,500)
Origination of loans for sale	(37,891)	(51,416)
Proceeds from sales of loans originated for sale	40,589	50,193
Net gains on mortgage loans	(1,060)	(1,544)
Gain on sales of securities	(99)	(83)
Write-down of other real estate	555	624
Net (gain) loss on sales of other real estate	(260)	(205)
Change in net deferred tax asset	(147)	1,336
Change in accrued interest receivable and other assets	(1,405)	(1,702)
Earnings in bank-owned life insurance	(602)	(333)
Change in accrued expenses and other liabilities	2,182	(703)
Net cash from operating activities	9,933	2,206
Cash flows from investing activities		
Loan originations and payments, net	(13,286)	(12,264)
Change in interest-bearing deposits in other financial institutions	20,000	---
Purchases of securities available for sale	(43,570)	(19,604)
Purchases of securities held to maturity	(1,144)	(11,826)
Purchase FHLB stock	---	(320)
Proceeds from:		
Maturities and calls of securities	30,480	8,944
Sales of securities available for sale	9,648	12,063
Principal paydowns on securities	1,873	1,952
Sales of other real estate	3,313	2,962
Death benefit from bank-owned life insurance	518	---
Additions to premises and equipment	(501)	(529)
Net cash from investing activities	7,331	(18,622)
Cash flows from financing activities		
Change in deposits	(80,434)	21,488
Repayments of other borrowed funds	(1,329)	(1,271)
Proceeds from other borrowed funds	10,000	10,000
Cash dividends paid	(2,025)	(1,682)

Repurchase of shares for taxes withheld on vested restricted stock	(19)	---
Net cash from financing activities	(73,807)	28,535
Net change in cash and cash equivalents	(56,543)	12,119
Cash and cash equivalents at beginning of period	181,476	129,455
Cash and cash equivalents at end of period	$ 124,933	$ 141,574

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Six Month Periods Ended June 30, 2016 and 2015
(unaudited)
(Dollars in thousands)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Supplemental cash flow information		
Interest paid	$ 2,536	$ 2,758
Income taxes paid	3,200	3,675
Supplemental noncash disclosures:		
Transfers from loans to other real estate	102	1,442
Security settlement	---	(330)

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Macatawa Bank Corporation ("the Company", "our", "we") and its wholly-owned subsidiary, Macatawa Bank ("the Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The Bank operates 26 full service branch offices providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan.

The Company owns all of the common stock of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are not consolidated with the Company under accounting principles generally accepted in the United States of America.

Basis of Presentation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) believed necessary for a fair presentation have been included.

Operating results for the three and six month periods ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, valuation of deferred tax assets, loss contingencies, fair value of other real estate owned and fair values of financial instruments are particularly subject to change.

Allowance for Loan Losses: The allowance for loan losses (allowance) is a valuation allowance for probable incurred credit losses inherent in our loan portfolio, increased by the provision for loan losses and recoveries, and decreased by charge-offs of loans. Management believes the allowance for loan losses balance to be adequate based on known and inherent risks in the portfolio, past loan loss experience, information about specific borrower situations and estimated collateral values, economic conditions and other relevant factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Management continues its collection efforts on previously charged-off balances and applies recoveries as additions to the allowance for loan losses.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current qualitative factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class and the loan risk grade assignment for commercial loans. At June 30, 2016, an 18 month annualized historical loss experience was used for commercial loans and a 12 month historical loss experience period was applied to residential mortgage loans and consumer loans. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative factors, including economic trends, credit quality trends, valuation trends, concentration risk, quality of loan review, changes in personnel, external factors and other considerations.

A loan is impaired when, based on current information and events, it is believed to be probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified and a concession has been made, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Commercial and commercial real estate loans with relationship balances exceeding $500,000 and an internal risk grading of 6 or worse are evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated and the loan is reported at the present value of estimated future cash flows using the loan's existing interest rate or at the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment and they are not separately identified for impairment disclosures.

Troubled debt restructurings are also considered impaired with impairment generally measured at the present value of estimated future cash flows using the loan's effective rate at inception or using the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure, primarily other real estate owned, are initially recorded at fair value less estimated costs to sell when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed unless they add value to the property.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

We recognize a tax position as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. We recognize interest and penalties related to income tax matters in income tax expense.

Derivatives: Certain of our commercial loan customers have entered into interest rate swap agreements directly with the Bank. At the same time the Bank enters into a swap agreement with its customer, the Bank enters into a corresponding interest rate swap agreement with a correspondent bank at terms mirroring the Bank's interest rate swap with its commercial loan customer. This is known as a back-to-back swap agreement. Under this arrangement the Bank has two freestanding interest rate swaps, both of which are carried at fair value. As the terms mirror each other, there is no income statement impact to the Bank. At June 30, 2016 and December 31, 2015, the total notional amount of such agreements was $48.5 million and resulted in a derivative asset with a fair value of $1.4 million and $790,000, respectively, which were included in other assets and a derivative liability of $1.4 million and $790,000, respectively, which were included in other liabilities.

Reclassifications: Some items in the prior period financial statements were reclassified to conform to the current presentation.

Adoption of New Accounting Standards: The Financial Accounting Standards Board "FASB" issued Accounting Standards Update ("ASU") 2015-03, Simplifying the Presentation of Debt Issuance Costs. This ASU requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability, consistent with the presentation of debt discounts. Further, the ASU requires the amortization of debt issuance costs to be reported as interest expense. Similarly, debt issuance costs and any discount or premium are considered in the aggregate when determining the effective interest rate on the debt. The new guidance was effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The new guidance must be applied retrospectively. The impact of adoption of this ASU by the Company was not material.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. This ASU provides guidance related to the accounting for internal-use software accessed through a hosting arrangement (e.g., cloud computing, software as a service, etc.) only if both of the following criteria are met: (1) the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty (there is no significant penalty if the customer has the ability to take delivery of the software without incurring significant cost and the ability to use the software separately without significant loss of utility or value); and (2) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software. If both of the criteria are present in a hosting arrangement, then the arrangement contains a software license and the customer should generally capitalize and subsequently amortize the cost of the license. If both of the criteria are not present, the customer should account for the arrangement as a service contract (i.e., expense fees as incurred). The new guidance was effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The impact of adoption of this ASU by the Company was not material.

Newly Issued Not Yet Effective Standards: FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The amendments in this Update create a new topic in the Codification, Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASC 606 establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 adds a new Subtopic to the Codification, ASC 340-40, Other Assets and Deferred Costs: Contracts with Customers, to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantees other than product or service warranties, and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. The impact of adoption of this ASU by the Company is not expected to be material.

FASB issued ASU 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The impact of adoption of this ASU by the Company is not expected to be material.

FASB issued ASU 2016-04, Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Cards (a consensus of the FASB Emerging Issues Task Force), which addresses the current and potential future diversity in practice related to the derecognition of a prepaid stored-value product liability. When an entity sells a prepaid stored-value card that is redeemable at a third-party merchant, it recognizes a liability for its obligation to provide the customer with the ability to purchase goods or services at that third-party merchant. When the customer redeems the prepaid stored-value card, the liability (or part of that liability) between the entity and the customer is extinguished. At the same time, the entity incurs a liability to the merchant that provided the goods or services. This liability is typically extinguished with cash through a card-settlement process. In some cases, however, a prepaid stored-value card may be unused wholly or partially for an indefinite time period. ASU No. 2016-04 provides that liabilities related to the sale of prepaid stored-value products within its scope are financial liabilities. Additionally, it provides a narrow-scope exception to Subtopic 405-20, Liabilities—Extinguishments of Liabilities, to require that breakage be accounted for consistent with the breakage guidance in Topic 606 for those liabilities with the characteristics described above. The amendments are effective for financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The impact of adoption of this ASU by the Company is not expected to be material.

FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting. This ASU simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the following: Accounting for income taxes, classification of excess tax benefits on the statement of cash flows, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities and classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. The amendments are effective for annual periods beginning after December 15, 2016, and for interim periods within those annual periods. The impact of adoption of this ASU by the Company is not expected to be material.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU provides financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The new guidance eliminates the probable initial recognition threshold and, instead, reflects an entity's current estimate of all expected credit losses. The new guidance broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually to include forecasted information, as well as past events and current conditions. There is no specified method for measuring expected credit losses, and an entity is allowed to apply methods that reasonably reflect its expectations of the credit loss estimate. Although an entity may still use its current systems and methods for recording the allowance for credit losses, under the new rules, the inputs used to record the allowance for credit losses generally will need to change to appropriately reflect an estimate of all expected credit losses and the use of reasonable and supportable forecasts. Additionally, credit losses on available-for-sale debt securities will now have to be presented as an allowance rather than as a write-down. This ASU is effective for fiscal years beginning after December 15, 2019, and for interim periods within those years. The Company is currently evaluating the impact of this new ASU on its consolidated financial statements.

NOTE 2 – SECURITIES

The amortized cost and fair value of securities at period-end were as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2016				
Available for Sale:				
U.S. Treasury and federal agency securities	$ 82,677	443	(65)	$ 83,055
U.S. Agency MBS and CMOs	12,564	101	(2)	12,663
Tax-exempt state and municipal bonds	34,114	1,082	(3)	35,193
Taxable state and municipal bonds	27,850	431	(12)	28,269
Corporate bonds and other debt securities	12,786	92	(3)	12,875
Other equity securities	1,500	25	---	1,525
	$ 171,491	$ 2,174	$ (85)	$ 173,580
Held to Maturity				
Tax-exempt state and municipal bonds	$ 49,373	$ 1,430	$ ---	$ 50,803
December 31, 2015				
Available for Sale:				
U.S. Treasury and federal agency securities	$ 74,618	48	(274)	$ 74,392
U. S. Agency MBS and CMOs	13,828	35	(108)	13,755
Tax-exempt state and municipal bonds	32,943	692	(37)	33,598
Taxable state and municipal bonds	28,554	246	(37)	28,763

Corporate bonds and other debt securities	14,838	19	(44)	14,813
Other equity securities	1,500	---	(6)	1,494
	$ 166,281	$ 1,040	$ (506)	$ 166,815
<u>Held to Maturity:</u>				
Tax-exempt state and municipal bonds	$ 51,856	$ 986	$ (5)	$ 52,837

NOTE 2 – SECURITIES (Continued)

Proceeds from the sale of securities available for sale were $230,000 in the three month period ended June 30, 2016 and $9.6 million in the six month period ended June 30, 2016 resulting in net gains on sale of $10,000 and $99,000, respectively, as reported in the Consolidated Statements of Income. This resulted in reclassifications of $10,000 ($7,000 net of tax) and $99,000 ($64,000 net of tax) from accumulated other comprehensive income to gain on sale of securities in the Consolidated Statements of Income in the three and six month periods ended June 30, 2016. There were no sales of securities in the three month period ended June 30, 2015. Proceeds from the sale of securities available for sale were $12.1 million in the six month period ended June 30, 2015 resulting in net gains on sale of $83,000, as reported in the Consolidated Statements of Income. This resulted in reclassifications of $83,000 ($54,000 net of tax) from accumulated other comprehensive income to gain on sale of securities in the Consolidated Statements of Income in the six month period ended June 30, 2015.

Contractual maturities of debt securities at June 30, 2016 were as follows (dollars in thousands):

	Held–to-Maturity Securities		Available-for-Sale Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 13,397	$ 13,421	$ 10,876	$ 10,943
Due from one to five years	9,221	9,444	94,834	95,745
Due from five to ten years	14,555	15,497	51,059	52,040
Due after ten years	12,200	12,441	13,222	13,327
	$ 49,373	$ 50,803	$ 169,991	$ 172,055

Securities with unrealized losses at June 30, 2016 and December 31, 2015, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
June 30, 2016	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$ 23,483	$ (61)	$ 3,092	$ (4)	$26,575	$ (65)
U.S. Agency MBS and CMOs	2,301	(1)	1,097	(1)	3,398	(2)
Tax-exempt state and municipal bonds	836	(3)	---	---	836	(3)
Taxable state and municipal bonds	1,488	(12)	---	---	1,488	(12)
Corporate bonds and other debt securities	1,416	(3)	---	---	1,416	(3)
Other equity securities	---	---	---	---	---	---
Total temporarily impaired	$ 29,524	$ (80)	$ 4,189	$ (5)	$33,713	$ (85)

	Less than 12 Months		12 Months or More		Total	
December 31, 2015	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and federal agency securities	$ 35,090	$ (187)	$ 7,036	$ (82)		