CENTRAL VALLEY COMMUNITY BANCORP
Form 10-Q
May 09, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED March 31, 2018

o 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—31977

CENTRAL VALLEY COMMUNITY BANCORP
(Exact name of registrant as specified in its charter)

California	77-0539125
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7100 N. Financial Dr., Suite 101, Fresno, California	93720
(Address of principal executive offices)	(Zip code)

Registrant's telephone number (559) 298-1775

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 past 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 ý No o

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 ý No o

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," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer ý

Non-accelerated filer o (Do not check if a smaller reporting company)

Small reporting company o
Emerging growth company o

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 o

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý
As of May 4, 2018 there were 13,757,937 shares of the registrant's common stock outstanding.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY

2018 QUARTERLY REPORT ON FORM 10-Q

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PART 1: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except share amounts)	March 31, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$26,092	$ 38,286
Interest-earning deposits in other banks	16,016	62,080
Federal funds sold	115	17
Total cash and cash equivalents	42,223	100,383
Available-for-sale debt securities	537,389	535,281
Equity securities	7,296	7,423
Loans, less allowance for credit losses of $8,788 at March 31, 2018 and $8,778 at December 31, 2017	908,701	891,901
Bank premises and equipment, net	9,429	9,398
Bank-owned life insurance	27,978	27,807
Federal Home Loan Bank stock	6,843	6,843
Goodwill	53,777	53,777
Core deposit intangibles	2,934	3,027
Accrued interest receivable and other assets	26,427	25,815
Total assets	$1,622,997	$ 1,661,655
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$561,490	$ 585,039
Interest bearing	829,420	840,648
Total deposits	1,390,910	1,425,687
Junior subordinated deferrable interest debentures	5,155	5,155
Accrued interest payable and other liabilities	18,989	21,254
Total liabilities	1,415,054	1,452,096
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, no par value, $1,000 per share liquidation preference; 10,000,000 shares authorized, none issued and outstanding	—	—
Common stock, no par value; 80,000,000 shares authorized; issued and outstanding: 13,752,037 at March 31, 2018 and 13,696,722 at December 31, 2017	103,980	103,314
Retained earnings	107,544	103,419
Accumulated other comprehensive income (loss), net of tax	(3,581)	2,826
Total shareholders' equity	207,943	209,559
Total liabilities and shareholders' equity	$1,622,997	$ 1,661,655

See notes to unaudited consolidated financial statements.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Quarter Ended March 31,	
(In thousands, except share and per share amounts)	2018	2017
INTEREST INCOME:		
Interest and fees on loans	$12,006	$10,090
Interest on deposits in other banks	98	75
Interest and dividends on investment securities:		
Taxable	2,559	1,303
Exempt from Federal income taxes	1,067	2,122
Total interest income	15,730	13,590
INTEREST EXPENSE:		
Interest on deposits	238	245
Interest on junior subordinated deferrable interest debentures	43	33
Other	23	4
Total interest expense	304	282
Net interest income before provision for credit losses	15,426	13,308
PROVISION FOR (REVERSAL OF) CREDIT LOSSES	—	(100)
Net interest income after provision for credit losses	15,426	13,408
NON-INTEREST INCOME:		
Service charges	755	747
Appreciation in cash surrender value of bank-owned life insurance	171	148
Interchange fees	345	324
Net realized gains on sales of investment securities	815	482
Federal Home Loan Bank dividends	121	128
Loan placement fees	166	91
Other income	398	326
Total non-interest income	2,771	2,246
NON-INTEREST EXPENSES:		
Salaries and employee benefits	6,416	5,855
Occupancy and equipment	1,537	1,179
Professional services	438	420
Data processing	480	424
Regulatory assessments	162	175
ATM/Debit card expenses	201	166
License and maintenance contracts	212	146
Directors' expenses	90	229
Advertising	189	170
Internet banking expense	195	169
Acquisition and integration	217	—
Amortization of core deposit intangibles	94	47
Other	1,137	1,133
Total non-interest expenses	11,368	10,113
Income before provision for income taxes	6,829	5,541
Provision for income taxes	1,538	1,291

Net income	$5,291	$4,250
Earnings per common share:		
Basic earnings per share	$0.39	$0.35
Weighted average common shares used in basic computation	13,669,976	12,167,810
Diluted earnings per share	$0.38	$0.35
Weighted average common shares used in diluted computation	13,804,480	12,317,579
Cash dividend per common share	$0.07	$0.06

See notes to unaudited consolidated financial statements.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	For the Quarter Ended March 31,	
(In thousands)	2018	2017
Net income	$5,291	$4,250
Other Comprehensive Income:		
Unrealized gains (losses) on securities:		
Unrealized holding (losses) gains arising during the period	(8,571)	3,935
Less: reclassification of net gains included in net income	815	482
Other comprehensive (loss) income, before tax	(9,386)	3,453
Tax benefit (expense) related to items of other comprehensive income	2,775	(1,452)
Total other comprehensive (loss) income	(6,611)	2,001
Comprehensive (loss) income	$(1,320)	$6,251

See notes to unaudited consolidated financial statements.

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CENTRAL VALLEY COMMUNITY BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Quarter Ended March 31,	
(In thousands)	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$5,291	$4,250
Adjustments to reconcile net income to net cash provided by operating activities:		
Net (increase) decrease in deferred loan costs	(80)	267
Depreciation	426	332
Accretion	(218)	(218)
Amortization	1,972	2,201
Stock-based compensation	74	203
(Reversal of) provision for credit losses	—	(100)
Net realized gains on sales of available-for-sale investment securities	(815)	(482)
Increase in bank-owned life insurance, net of expenses	(171)	(148)
Net decrease in accrued interest receivable and other assets	1,489	2,192
Net decrease in accrued interest payable and other liabilities	(2,266)	(821)
Benefit for deferred income taxes	646	298
Net cash provided by operating activities	6,348	7,974
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investment securities	(92,189)	(14,947)
Proceeds from sales or calls of available-for-sale investment securities	69,315	24,922
Proceeds from maturity and principal repayments of available-for-sale investment securities	10,688	10,561
Net increase in loans	(16,720)	(8,041)
Purchases of premises and equipment	(457)	(87)
Net cash provided by (used in) investing activities	(29,363)	12,408
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in demand, interest bearing and savings deposits	(27,615)	23,260
Net decrease in time deposits	(7,161)	(11,923)
Repayments of borrowings from other financial institutions	—	(400)
Proceeds from stock issued under employee stock purchase plan	43	—
Proceeds from exercise of stock options	549	371
Cash dividend payments on common stock	(961)	(730)
Net cash (used in) provided by financing activities	(35,145)	10,578
Decrease in cash and cash equivalents	(58,160)	30,960
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	100,383	38,568
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$42,223	$69,528

	For the Quarter Ended March 31,	
(In thousands)	2018	2017
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash paid during the period for:		
Interest	$297	$290
Income taxes	$180	$70

See notes to unaudited consolidated financial statements.

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Note 1. Basis of Presentation

The interim unaudited condensed consolidated financial statements of Central Valley Community Bancorp and subsidiary have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). These interim condensed consolidated financial statements include the accounts of Central Valley Community Bancorp and its wholly owned subsidiary Central Valley Community Bank (the Bank) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted. The Company believes that the disclosures are adequate to make the information presented not misleading. These interim unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company’s 2017 Annual Report to Shareholders on Form 10-K. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company’s financial position at March 31, 2018, and the results of its operations and its cash flows for the three month interim periods ended March 31, 2018 and 2017 have been included. The results of operations for interim periods are not necessarily indicative of results for the full year.

The preparation of these interim unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Management has determined that since all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment, and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Impact of New Financial Accounting Standards:

FASB Accounting Standards Update (ASU) 2014-09 - Revenue from Contracts with Customers (Topic 606): Revenue from Contracts with Customers was issued in May 2014. This ASU is the result of a joint project initiated by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue, and to develop common revenue standards and disclosure requirements that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosures; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This ASU is effective for annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. The Company adopted ASU 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Since the guidance does not apply to revenue associated with financial instruments such as loans and investments, which are accounted for under other provisions of GAAP, there was no impact to interest income, our largest component of income. The Company adopted this ASU effective January 1, 2018 and it did not have a material impact on the Company's consolidated financial position, cash flows or results of operations. No cumulative adjustment was required upon adoption.

The Company performed an overall assessment of revenue streams potentially affected by the ASU, including certain deposit related fees and interchange fees, to determine the potential impact of this guidance on our consolidated financial statements. Approximately 91% of our revenue, including all of our net interest income and a portion of our noninterest income, is out of scope of the guidance. The contracts that are in scope of the guidance are primarily related to service charges and fees on deposit accounts, debit card fees, ATM processing fees, and other service charges, commissions and fees. We have completed analyzing the individual contracts in scope and determined our revenue recognition practices within the scope of the ASU as described below did not change in any material regard upon adoption of the ASU.

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Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Merchant and Debit Card Fees: The Company earns interchange fees from cardholder transactions conducted through the payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

FASB Accounting Standards Update (ASU) 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, was issued January 2016. The main provisions of the update are to eliminate the available-for-sale classification of accounting for equity securities and to adjust the fair value disclosures for financial instruments carried at amortized costs such that the disclosed fair values represent an exit price as opposed to an entry price. The provisions of this update will require that equity securities be carried at fair market value on the balance sheet and any periodic changes in value will be adjustments to the income statement. A practical expedient is provided for equity securities without a readily determinable fair value, such that these securities can be carried at cost less any impairment. ASU No. 2016-01 was effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The impact of adoption of this ASU by the Company was not material, but did result in a reclassification of an equity investment from securities available-for-sale to equity securities. The Company was required to adopt the ASU provisions on January 1, 2018, and for those equity securities with readily determinable fair values, the Company elected the modified retrospective transition approach with a cumulative effect adjustment to the balance sheet. The impact of the adoption of this accounting standard on the Company's consolidated financial statements will be subject to the price volatility of the equity investments. As a result of the adoption, $204,000 of after-tax unrealized losses on equity securities was reclassified on January 1, 2018, from accumulated other comprehensive income to retained earnings. In addition, the fair value disclosures for financial instruments in Note 3 are computed using an exit price notion as required by the ASU.

FASB Accounting Standards Update (ASU) 2016-02 - Leases - Overall (Subtopic 845), was issued February 2016. The update requires all leases, with the exception of short-term leases that have contractual terms of no greater than one year, to be recorded on the balance sheet. Under the provisions of the update, leases classified as operating will be reflected on the balance sheet with the recognition of both a right-of-use asset and a lease liability. Under the update, a distinction will exist between finance and operating type leases and the rules for determining which classification a lease will fall into are similar to existing rules. For public business entities, the amendments of this update are effective for interim and annual periods beginning after December 15, 2018. The update requires a modified retrospective transition under which comparative balance sheets from the earliest historical period presented will be revised to reflect what the financials would have looked like were the provisions of the update applied consistently in all prior periods. The Company is currently evaluating the provisions of ASU No. 2016-02 and has determined that the provisions of ASU No. 2016-02 will result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities; however, the Company does not expect this to have a material impact on the Company's results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2016-13 - Measurement of Credit Losses on Financial Instruments (Subtopic 326): Financial Instruments - Credit Losses, commonly referred to as "CECL," was issued June 2016. The provisions of the update eliminate the probable initial recognition threshold under current GAAP which requires reserves to be based on an incurred loss methodology. Under CECL, reserves required for financial assets measured at amortized cost will reflect an organization's estimate of all expected credit losses over the contractual term of the financial asset and thereby require the use of reasonable and supportable forecasts to estimate future credit losses. Because CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization's reasonable and supportable estimate of expected credit losses extends to held to maturity ("HTM") debt securities. Under the provisions of the update, credit losses recognized on available for sale ("AFS") debt securities will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans, with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Under current GAAP a purchased loan's contractual balance is adjusted to fair value through a credit discount and no reserve is recorded on the purchased loan upon acquisition. Since under CECL reserves will be established for purchased loans at the time of acquisition, the accounting for purchased loans is made more comparable to the accounting for originated loans. Finally, increased disclosure requirements under CECL require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. The FASB expects that the evaluation of underwriting standards and credit quality trends by financial statement users will be enhanced with the additional vintage disclosures. For public business entities that are SEC filers, the amendments of the update will become effective beginning January 1, 2020. While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating its current IT systems. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the one-time adjustment or the overall impact of the new guidance on the Company's financial position, results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2017-04 - Intangibles Goodwill and Other (Subtopic 350): Simplifying the Test for Goodwill Impairment, was issued January 2017. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net leftover amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit's goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit's goodwill. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2019.

FASB Accounting Standards Update (ASU) 2017-08 - Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities, was issued March 2017. The provisions of the update require premiums recognized upon the purchase of callable debt securities to be amortized to the earliest call date in order to avoid losses recognized upon call. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2018. Management does not expect the requirements of this update to have a material impact on the Company's financial position, results of operations or cash flows.

FASB Accounting Standards Update (ASU) 2017-09 - Compensation - Stock Compensation (Subtopic 718): Scope of Modification Accounting, was issued May 2017. The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effects of a modification unless all of the following conditions are met: the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. The amendments in this Update are effective for annual periods, and interim periods within those annual periods, beginning after December 31, 2017. The Company adopted this ASU effective January 1, 2018 and it did not have a material impact on the Company's Consolidated Financial Statements.

Note 2. ACQUISITIONS

On October 1, 2017, the Company completed the acquisition of Folsom Lake Bank ("FLB") for an aggregate transaction value of $28,475,000. FLB was merged into the Bank, and the Company issued 1,276,888 shares of common stock to the former shareholders of FLB. The Company also assumed the outstanding FLB stock options. With the FLB acquisition, the Company added two full service branches, located in Folsom, and Rancho Cordova, California. The FLB Roseville branch was consolidated with the Company's Roseville branch in October 2017. FLB's assets as of October 1, 2017 totaled approximately $196,148,000.
In accordance with GAAP guidance for business combinations, the Company recorded $13,466,000 of goodwill and $1,879,000 of other intangible assets on the acquisition date. The other intangible assets are primarily related to core

deposits and are being amortized using a straight-line method over a period of ten years with no significant residual value. For tax purposes, purchase accounting adjustments including goodwill are all non-taxable and/or non-deductible. Acquisition related costs of $217,000 are included in the income statement for the quarter ended March 31, 2018.

The acquisition was consistent with the Company's strategy to build a regional presence in Central California. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region. Goodwill arising from the acquisition consisted largely of synergies and the expected cost savings resulting from the combined operations.

Pro Forma Results of Operations

The following table presents pro forma results of operations information for the periods presented as if the acquisition had occurred on January 1, 2017 after giving effect to certain adjustments. The unaudited pro forma results of operations for the three months ended March 31, 2017 include the historical accounts of the Company and FLB and pro forma adjustments as

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may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. The pro forma information is intended for informational purposes only and is not necessarily indicative of the Company's future operating results or operating results that would have occurred had the acquisition been completed at the beginning of 2017. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions. (In thousands, except per-share amounts):

Pro Forma Results of Operations	For the Quarter Ended March 31,	
(In thousands, except per share amounts)	2017	
Net interest income	$	14,907
(Reversal of) Provision for credit losses	(100	)
Non-interest income	2,298	
Non-interest expense	11,303	
Income before provision for income taxes	6,002	
Provision for income taxes	1,481	
Net income	$	4,521
Basic earnings per common share	$	0.37
Diluted earnings per common share	$	0.37

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Note 3. Fair Value Measurements

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In accordance with applicable guidance, the Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 — Quoted market prices (unadjusted) for identical instruments traded in active exchange markets that the Company has the ability to access as of the measurement date.

Level 2 — Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 — Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company’s estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, we report the transfer at the beginning of the reporting period. The estimated carrying and fair values of the Company’s financial instruments are as follows (in thousands):

	March 31, 2018				
	Carrying	Fair Value			
(In thousands)	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$26,092	$26,092	$ —	$ —	$ 26,092
Interest-earning deposits in other banks	16,016	16,016	—	—	16,016
Federal funds sold	115	115	—	—	115
Available-for-sale debt securities	537,389	—	537,389	—	537,389
Equity securities	7,296	7,296	—	—	7,296
Loans, net	908,701	—	—	900,986	900,986
Federal Home Loan Bank stock	6,843	N/A	N/A	N/A	N/A
Accrued interest receivable	6,159	22	2,939	3,198	6,159
Financial liabilities:					
Deposits	1,390,910	1,268,148	120,978	—	1,389,126
Junior subordinated deferrable interest debentures	5,155	—	—	3,950	3,950
Accrued interest payable	110	—	72	38	110

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	December 31, 2017				
	Carrying	Fair Value			
(In thousands)	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$38,286	$38,286	$ —	$ —	$ 38,286
Interest-earning deposits in other banks	62,080	62,080	—	—	62,080
Federal funds sold	17	17	—	—	17
Available-for-sale debt securities	535,281	—	535,281	—	535,281
Equity securities	7,423	7,423	—	—	7,423
Loans, net	891,901	—	—	899,191	899,191
Federal Home Loan Bank stock	6,843	N/A	N/A	N/A	N/A
Accrued interest receivable	7,168	57	3,256	3,855	7,168
Financial liabilities:					
Deposits	1,425,687	1,296,048	127,966	—	1,424,014
Junior subordinated deferrable interest debentures	5,155	—	—	3,550	3,550
Accrued interest payable	110	—	72	38	110

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.
The methods and assumptions used to estimate fair values are described as follows:

(a) Cash and Cash Equivalents — The carrying amounts of cash and due from banks, interest-earning deposits in other banks, and Federal funds sold approximate fair values and are classified as Level 1.

(b) Investment Securities — Investment securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for investment securities classified in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

(c) Loans — Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Purchased credit impaired (PCI) loans are measured at estimated fair value on the date of acquisition. Carrying value is calculated as the present value of expected cash flows and approximates fair value and included in Level 3. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are initially valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The estimated fair values of financial instruments disclosed above as of March 31, 2018 follow the guidance in ASU 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity, and marketability factors. The fair values shown as of December 31, 2017 and prior use an "entry price" approach.

(d) FHLB Stock — It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

(e) Deposits — Fair value of demand deposit, savings, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. Fair value for fixed and variable rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for certificates with similar remaining maturities resulting in a Level 2 classification.

(f) Other Borrowings — The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

(g) Accrued Interest Receivable/Payable — The fair value of accrued interest receivable and payable is based on the fair value hierarchy of the related asset or liability.

(h) Off-Balance Sheet Instruments — Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not considered significant for financial reporting purposes.

Assets Recorded at Fair Value

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of March 31, 2018:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of March 31, 2018 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale debt securities:				
U.S. Treasury securities	$32,607	$—	$32,607	$ —
U.S. Government agencies	69,852	—	69,852	—
Obligations of states and political subdivisions	140,626	—	140,626	—
U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations	203,717	—	203,717	—
Private label mortgage and asset backed securities	90,587	—	90,587	—
Equity securities	7,296	7,296	—	—
Total assets measured at fair value on a recurring basis	$544,685	$7,296	$537,389	$ —

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale debt securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the three months ended March 31, 2018, no transfers between levels occurred.

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There were no Level 3 assets measured at fair value on a recurring basis at or during the three months ended March 31, 2018. Also there were no liabilities measured at fair value on a recurring basis at March 31, 2018.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at March 31, 2018.
At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow methods as prescribed by ASC Topic 310 is not a fair value measurement since the discount rate utilized is the loan’s effective interest rate which is not a market rate. There were no changes in valuation techniques used during the three months month period ended March 31, 2018.
Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.
Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $165,000 with a valuation allowance of $165,000 at March 31, 2018, resulting in fair value of $0. The valuation allowance represent specific allocation for the allowance for credit losses for impaired loans. There were no charge-offs related to loans carried at fair value during the three months ended March 31, 2018 and 2017. Activity related to changes in the allowance for loan losses related to impaired loans for the three months ended March 31, 2018 and 2017 was not considered significant for disclosure purposes. There were no liabilities measured at fair value on a non-recurring basis at March 31, 2018.
The following tables present information about the Company’s assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2017:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as of December 31, 2017 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale debt securities:				
U.S. Government agencies	$ 66,587	$ —	$ 66,587	$ —
Obligations of states and political subdivisions	143,105	—	143,105	—
	234,908	—	234,908	—

U.S. Government sponsored entities and agencies collateralized by residential mortgage obligations				
Private label mortgage and asset backed securities	90,681	—	90,681	—
Equity securities	7,423	7,423	—	—
Total assets measured at fair value on a recurring basis	$ 542,704	$ 7,423	$ 535,281	$ —

Securities in Level 1 are mutual funds and fair values are based on quoted market prices for identical instruments traded in active markets. Fair values for available-for-sale debt securities in Level 2 are based on quoted market prices for similar securities in active markets. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators.

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Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings. During the year ended December 31, 2017, no transfers between levels occurred.
There were no Level 3 assets measured at fair value on a recurring basis at or during the year ended December 31, 2017. Also there were no liabilities measured at fair value on a recurring basis at December 31, 2017.

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets and liabilities that are measured at the lower of cost or fair value that were recognized at fair value which was below cost at December 31, 2017 (in thousands).

Description	Fair Value	Level 1	Level 2	Level 3
Other repossessed assets	70	—	—	70
Total assets measured at fair value on a non-recurring basis	$ 70	$ —	$ —	$ 70

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method as prescribed by ASC Topic 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the year ended December 31, 2017.
Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.
As of December 31, 2017, there were no loans measured using the fair value of the collateral for collateral dependent loans.
During the year ended December 31, 2017 specific allocation for the allowance for credit losses related to loans carried at fair value was $0. During the year ended December 31, 2017, there was no net charge-offs related to loans carried at fair value.
There were no liabilities measured at fair value on a non-recurring basis at December 31, 2017.
Note 4. Investments

The investment portfolio consists primarily of U.S. Government sponsored entity and agency securities collateralized by residential mortgage obligations, private label residential mortgage backed securities (PLRMBS), and obligations of states and political subdivisions securities. As of March 31, 2018, $87,955,000 of these securities were held as collateral for borrowing arrangements, public funds, and for other purposes. The Company adopted ASU 2016-01 on

January 1, 2018, and applied it prospectively without prior period amounts restated. Upon adoption, equity securities included in the available-for-sale portfolio were reclassified to equity securities. The December 31, 2017 cost and fair value of the equity securities transferred were $7,500,000 and $7,423,000, respectively.

The fair value of the available-for-sale investment portfolio reflected a net unrealized loss of $5,171,000 at March 31, 2018 compared to an unrealized gain of $4,089,000 at December 31, 2017. The unrealized gain/(loss) recorded is net of $(1,590,000) and $1,186,000 in tax (benefits) liabilities as accumulated other comprehensive income within shareholders' equity at March 31, 2018 and December 31, 2017, respectively.

The following table sets forth the carrying values and estimated fair values of our investment securities portfolio at the dates indicated (in thousands):

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Available-for-Sale Securities	March 31, 2018 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				