MVB FINANCIAL CORP
Form 10-Q
May 01, 2019
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Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

or

¨ **TRANSITION REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________.

Commission File Number: 000-50567

MVB Financial Corp.

(Exact name of registrant as specified in its charter)

West Virginia	**20-0034461**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
301 Virginia Avenue, Fairmont,	**26554**

WV

(Address of principal executive offices)	(Zip Code)

(304) 363-4800

Registrant's telephone number, including area code

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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, 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	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of April 30, 2019, the Registrant had 11,640,843 shares of common stock outstanding with a par value of $1.00 per share.

Table of Contents

TABLE OF CONTENTS

		Page
PART I	FINANCIAL INFORMATION	3
Item 1	Financial Statements	3
	Consolidated Balance Sheets	3
	Consolidated Statements of Income	4
	Consolidated Statements of Comprehensive Income	5
	Consolidated Statements of Changes in Stockholders' Equity	6
	Consolidated Statements of Cash Flows	7
	Notes to the Consolidated Financial Statements	8
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	37
Item 3	Quantitative and Qualitative Disclosures About Market Risk	52
Item 4	Controls and Procedures	53
PART II	OTHER INFORMATION	54
Item 1	Legal Proceedings	54

Item 1A	Risk Factors	54
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	54
Item 3	Defaults Upon Senior Securities	54
Item 4	Mine Safety Disclosures	54
Item 5	Other Information	54
Item 6	Exhibits	54
	SIGNATURES	54

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

MVB Financial Corp. and Subsidiaries

Consolidated Balance Sheets

(Unaudited) (Dollars in thousands except per share data)

	March 31, 2019 (Unaudited)		December 31, 2018 (Note 1)	
ASSETS				
Cash and cash equivalents:				
Cash and due from banks	$	15,185	$	14,747
Interest bearing balances with banks	2,773		7,474	
Total cash and cash equivalents	17,958		22,221	
Certificates of deposit with other banks	14,778		14,778	
Investment Securities:				
Securities available-for-sale, at fair value	224,741		221,614	
Equity securities	9,841		9,599	
Loans held for sale	65,955		75,807	
Loans:	1,341,218		1,304,366	
Less: Allowance for loan losses	(11,242)		(10,939)	
Net Loans	1,329,976		1,293,427	
Premises and equipment	25,922		26,545	
Bank owned life insurance	34,128		34,291	
Accrued interest receivable and other assets	48,129		34,207	
Goodwill	18,480		18,480	
TOTAL ASSETS	$	1,789,908	$	1,750,969
LIABILITIES AND STOCKHOLDERS' EQUITY				
Deposits:				
Noninterest bearing	$	236,086	$	213,597
Interest bearing	1,194,573		1,095,557	
Total deposits	1,430,659		1,309,154	
Accrued interest payable and other liabilities	33,416		17,706	
Repurchase agreements	12,553		14,925	
FHLB and other borrowings	114,884		214,887	

Subordinated debt	17,524		17,524	
Total liabilities	1,609,036		1,574,196	
STOCKHOLDERS' EQUITY				
Preferred stock, par value $1,000; 20,000 authorized; 783 issued in 2019 and 2018, respectively (See Footnote 7)	7,834		7,834	
Common stock, par value $1; 20,000,000 shares authorized; 11,665,870 shares issued and 11,614,793 shares outstanding in 2019 and 11,658,370 shares issued and 11,607,293 shares outstanding in 2018	11,666		11,658	
Additional paid-in capital	117,408		116,897	
Retained earnings	50,937		48,274	
Accumulated other comprehensive loss	(5,889)		(6,806)	
Treasury stock, 51,077 shares, at cost	(1,084)		(1,084)	
Total stockholders' equity	180,872		176,773	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	1,789,908	$	1,750,969

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries

Consolidated Statements of Income

(Unaudited) (Dollars in thousands except per share data)

	Three Months Ended March 31	
	2019	2018
INTEREST INCOME		
Interest and fees on loans	$ 17,662	$ 13,291
Interest on deposits with other banks	122	90
Interest on investment securities - taxable	879	895
Interest on tax exempt loans and securities	960	778
Total interest income	19,623	15,054
INTEREST EXPENSE		
Interest on deposits	4,123	2,298
Interest on repurchase agreements	14	19
Interest on FHLB and other borrowings	1,229	714
Interest on subordinated debt	285	558
Total interest expense	5,651	3,589
NET INTEREST INCOME	13,972	11,465
Provision for loan losses	300	474
Net interest income after provision for loan losses	13,672	10,991
NONINTEREST INCOME		
Service charges on deposit accounts	315	185
Income on bank owned life insurance	525	218
Interchange and debit card transaction fees	141	150
Mortgage fee income	6,670	6,563
Gain on sale of portfolio loans	55	212

Insurance and investment services income	156	164
(Loss) gain on sale of available-for-sale securities, net	(118)	326
Gain on derivatives, net	450	584
Commercial swap fee income	80	413
Holding gain (loss) on equity securities	180	(30)
Other operating income	311	254
Total noninterest income	8,765	9,039
NONINTEREST EXPENSES		
Salary and employee benefits	11,734	10,473
Occupancy expense	1,185	1,049
Equipment depreciation and maintenance	854	784
Data processing and communications	988	835
Mortgage processing	809	892
Marketing, contributions, and sponsorships	214	347
Professional fees	828	745
Printing, postage, and supplies	135	165
Insurance, tax, and assessment expense	505	390
Travel, entertainment, dues, and subscriptions	690	648
Other operating expenses	506	411
Total noninterest expense	18,448	16,739
Income before income taxes	3,989	3,291
Income tax expense	797	697
Net income	$ 3,192	$ 2,594
Preferred dividends	121	121
Net income available to common shareholders	$ 3,071	$ 2,473

Earnings per share - basic	$	0.26	$	0.24
Earnings per share - diluted	$	0.26	$	0.23
Cash dividends declared	$	0.035	$	0.025
Weighted average shares outstanding - basic	11,607,543		10,474,138	
Weighted average shares outstanding - diluted	13,177,281		12,714,353	

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited) (Dollars in thousands)

	Three Months Ended March 31	
	2019	**2018**
Net Income	$ 3,192	$ 2,594
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available-for-sale	1,859	(4,448)
Income tax effect	(502)	1,201
Reclassification adjustment for loss (gain) recognized in income	118	(326)
Income tax effect	(32)	88
Change in defined benefit pension plan	(263)	—
Income tax effect	71	—
Carrying Value Adjustment - Investment hedge	(458)	—
Income tax effect	124	—
Total other comprehensive income (loss)	917	(3,485)
Comprehensive income (loss)	$ 4,109	$ (891)

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

(Unaudited) (Dollars in thousands except per share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Treasury Stock	Total Stockholders' Equity
January 1, 2018	$ 7,834	$ 10,496	$ 98,698	$ 37,236	$ (2,988)	$ (1,084)	$ 150,192
Net Income	—	—	—	2,594	—	—	2,594
Other comprehensive loss	—	—	—	—	(3,485)	—	(3,485)
Cash dividends paid ($0.025 per common share)	—	—	—	(263)	—	—	(263)
Dividends on preferred stock	—	—	—	(121)	—	—	(121)
Stock based compensation	—	—	244	—	—	—	244
Common stock options exercised	—	94	1,166	—	—	—	1,260
Stranded AOCI (See Note 2)	—	—	—	646	(646)	—	—
Mark to Market on equity positions held at December 31, 2017 (See Note 2)	—	—	—	98	(98)	—	—
Balance March 31, 2018	$ 7,834	$ 10,590	$ 100,108	$ 40,190	$ (7,217)	$ (1,084)	$ 150,421
January 1, 2019	$ 7,834	$ 11,658	$ 116,897	$ 48,274	$ (6,806)	$ (1,084)	$ 176,773
Net Income	—	—	—	3,192	—	—	3,192
Other comprehensive income	—	—	—	—	917	—	917
Cash dividends paid ($0.035 per common share)	—	—	—	(408)	—	—	(408)
Dividends on preferred	—	—	—	(121)	—	—	(121)

stock							
Stock based compensation	—	—	425	—	—	—	425
Common stock options exercised	—	8	86	—	—	—	94
Balance March 31, 2019	$ 7,834	$ 11,666	$ 117,408	$ 50,937	$ (5,889)	$ (1,084)	$ 180,872

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

MVB Financial Corp. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited) (Dollars in thousands)

	,Three Months Ended March 31	
	2019	**2018**
OPERATING ACTIVITIES		
Net Income	$ 3,192	$ 2,594
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization and accretion of investments	280	361
Net amortization of deferred loan costs	72	16
Provision for loan losses	300	474
Depreciation and amortization	759	741
Stock based compensation	425	244
Loans originated for sale	(239,160)	(238,935)
Proceeds of loans sold	255,682	261,012
Mortgage fee income	(6,670)	(6,563)
Gain on sale of securities	(33)	(326)
Loss on sale of securities	151	—
Gain on sale of portfolio loans	(55)	(212)
Income on bank owned life insurance	(525)	(218)
Deferred taxes	21	(51)
Amortization of operating lease right-of-use asset	20	—
Other, net	(1,534)	(3,924)
Net cash provided by operating activities	12,925	15,213
INVESTING ACTIVITIES		
Purchases of investment securities available-for-sale	(20,400)	(14,859)
Maturities/paydowns of investment securities available-for-sale	5,236	7,364
Sales of investment securities	13,694	680

available-for-sale				
Purchases of premises and equipment	(115)		(506)	
Net increase in loans	(36,866)		(51,321)	
Purchases of restricted bank stock	(6,119)		(5,901)	
Redemptions of restricted bank stock	8,352		3,797	
Proceeds from sale of other real estate owned	97		181	
Proceeds from death benefit of bank owned life insurance policies	688		—	
Purchase of equity securities	(450)		—	
Net cash used in investing activities	(35,883)		(60,565)	
FINANCING ACTIVITIES				
Net increase in deposits	121,505		(5,673)	
Net decrease in repurchase agreements	(2,372)		(1,727)	
Net change in short-term FHLB & other borrowings	(99,982)		67,421	
Principal payments on FHLB & other borrowings	(21)		(12,220)	
Common stock options exercised	94		1,260	
Cash dividends paid on common stock	(408)		(263)	
Cash dividends paid on preferred stock	(121)		(121)	
Net cash provided by financing activities	18,695		48,677	
(Decrease) increase in cash and cash equivalents	(4,263)		3,325	
Cash and cash equivalents at beginning of period	22,221		20,305	
Cash and cash equivalents at end of period	$	17,958	$	23,630
Supplemental disclosure of cash flow information:				
Loans transferred to other real estate owned	$	63	$	720

Initial recognition of operating lease right-of-use assets	12,935	—
Initial recognition of operating lease liabilities	15,659	—
Cash payments for:		
Interest on deposits, repurchase agreements and borrowings	$ 6,136	$ 3,635
Income taxes	—	87

See accompanying notes to unaudited consolidated financial statements.

Table of Contents
Notes to the Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

Nature of Operations

MVB Financial Corp. ("the Company") is a financial holding company and was organized in 2003. MVB operates principally through its wholly-owned subsidiary, MVB Bank, Inc. ("MVB Bank"). MVB Bank's operating subsidiaries include Potomac Mortgage Group ("PMG" which began doing business under the registered trade name "MVB Mortgage"), MVB Insurance, LLC ("MVB Insurance"), and MVB Community Development Corporation ("CDC").

Principles of Consolidation and Basis of Presentation

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by GAAP for annual year-end financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. The consolidated balance sheet as of December 31, 2018 has been derived from audited financial statements included in the Company's 2018 filing on Form 10-K. Operating results for the three months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States and practices in the banking industry. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates, such as the allowance for loan losses, are based upon known facts and circumstances. Estimates are revised by management in the period such facts and circumstances change. Actual results could differ from those estimates. All significant inter-company accounts and transactions have been eliminated in consolidation.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the company's December 31, 2018, Form 10-K filed with the Securities and Exchange Commission (the "SEC").

In certain instances, amounts reported in prior periods' consolidated financial statements have been reclassified to conform to the current presentation.

Information is presented in these notes with dollars expressed in thousands, unless otherwise noted or specified.

Accounting Changes

On January 1, 2019, the Company adopted ASU 2016-02, *Leases (Topic 842)*. This pronouncement requires that lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption with the option to elect certain practical expedients. The Company has elected to apply ASU 2016-02 as of the beginning of the period (January 1, 2019) and has not restated comparative periods. Of the optional practical expedients available under ASU 2016-02, all have been adopted. Upon adoption, the Company recognized right-of-use assets and related lease liabilities totaling $12.9 million and $15.7 million, respectively.

Certain of the Company's leases contain options to renew the lease; however, some of these renewal options are not included in the calculation of the lease liabilities as they are not reasonably expected to be exercised. The Company's leases do not contain residual value guarantees or material variable lease payments, and the Company does not have any material restrictions or covenants imposed by leases that would impact the Company's ability to pay dividends or cause the Company to incur additional financial obligations.

The Company has made an accounting policy election to not apply the recognition requirements in Topic 842 to short-term leases. The Company has also elected to use the practical expedient to make an accounting policy election for property leases to include both lease and non-lease components as a single component and account for as a lease.

Table of Contents

The Company's leases are not complex; therefore, there were no significant assumptions or judgments made in applying the requirements of Topic 842, including the determination of whether the contracts contained a lease, the allocation of consideration in the contracts between lease and non-lease components, and the determination of the discount rates for the leases.

Note 2 – Recent Accounting Pronouncements

In February 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This update requires a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate in the Tax Reform Act, which was enacted on December 22, 2017. The Tax Reform Act included a reduction to the corporate income tax rate from 34 percent to 21 percent effective January 1, 2018. The amendments in the ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company elected to early adopt ASU 2018-02 during the first quarter of 2018 and elected to reclassify the income tax effects of the Tax Reform Act from AOCI to retained earnings. The amount of the reclassification is the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate, which amounted to $646 thousand.

In August 2017, the FASB issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*, which amends the existing hedge accounting model and expands an entity's ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest-rate risk. The ASU eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The ASU also changes certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. This ASU is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company adopted this ASU in accordance with paragraph ASC 815-20-65-3 subpart C. The adoption of this ASU did not have a significant impact on the Company's financial condition, results of operations and consolidated financial statements. The Company can now employ additional hedging strategies as described above, including the ability to apply fair value hedge accounting to a specified pool of assets by excluding the portion of the hedged items related to prepayments, defaults and other events. This allows the Company to better align its accounting and the financial reporting of its hedging activities with their economic objectives thereby reducing the earnings volatility resulting from these hedging activities.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. This ASU amends guidance on the amortization period of premiums on certain purchased callable debt securities. Specifically, the amendments shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date. The amendments affect all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). For public companies, this update is effective for fiscal years beginning after December 15, 2018, including all interim periods within those fiscal years. The adoption of this guidance was not material to the consolidated financial statements, as it is our current policy to amortize premiums of investment securities to the earliest call date.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. Topic 350, Intangibles – Goodwill and Other (Topic 350), currently requires an entity that has not elected the private company alternative for goodwill to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An

impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit to address concerns over the cost and complexity of the two-step goodwill impairment test. The amendments in this Update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. For public companies, this update will be effective for fiscal years beginning after December 15, 2019, including all interim periods within those fiscal years. The adoption of this guidance will not have a material impact on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The new guidance replaces the incurred loss impairment methodology in current GAAP with an

Table of Contents

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. The guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The Company has formed an implementation team led by the CFO, that also includes other lines of business and functions within the Company. The Company has also engaged a third party to assist with a data gap analysis and will utilize the data to determine the impact of the pronouncement. Additionally, the Company has researched and acquired software to assist in the development of models that can meet the requirements of the new guidance. While this standard may potentially have a material impact on the Company’s consolidated financial statements, we are still in the process of completing our evaluation.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:(1) A lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. ASU 2016-02 initially required transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842) - Targeted Improvements*, which, among other things, provides an additional transition method that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB also issued ASU 2018-20, *Leases (Topic 842) - Narrow Scope Improvements*, for Lessors which provides certain policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs. Upon the adoption of ASU 2016-02, ASU 2018-11, and ASU 2018-20 on January 1, 2019, the Company recognized right-of-use assets and related lease liabilities totaling $12.9 million and $15.7 million, respectively. The initial balance sheet gross up upon adoption was primarily related to operating leases of certain real estate properties and financing leases of certain office equipment. The Company has no material subleases or leasing arrangements for which it is the lessor of property or equipment. The Company applied certain practical expedients provided under ASU 2016-02 whereby the Company did reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases, and (iii) initial direct costs for any existing leases. The Company did not apply the recognition requirements of ASU 2016-02 to any short-term leases (as defined by related accounting guidance). The Company accounted for lease and non-lease components separately because such amounts are readily determinable under our lease contracts and because this election resulted in a lower impact on our balance sheet. The Company utilized the modified-retrospective transition approach prescribed by ASU 2018-11. See Note 5, “Premises and Equipment” of the Notes to the Consolidated Financial Statements, included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.`

In January 2016, the FASB issued ASU 2016-01, *Accounting for Financial Instruments - Overall: Classification and Measurement (Subtopic 825-10)*. Amendments within ASU 2016-01 that relate to non-public entities have been excluded from this presentation. The amendments in this ASU 2016-01 address the following: 1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a

similar investment of the same issuer; 2) simplify the impairment assessment of equity investments without readily-determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; 3) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; 4) require entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 5) require separate presentation in other comprehensive income for the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; 6) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and 7) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company

Table of Contents

adopted this guidance in the first quarter of 2018. The adoption of ASU 2016-01 on January 1, 2018 did not have a material impact on the Company's Consolidated Financial Statements. In accordance with 4) above, the Company discloses the fair value of its loan portfolio on a quarterly basis using an exit price notion. See Note 7, "Fair Value of Financial Instruments" of the Notes to the Consolidated Financial Statements, included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The new revenue pronouncement creates a single source of revenue guidance for all companies in all industries and is more principles-based than current revenue guidance. The pronouncement provides a five-step model for a company to recognize revenue when it transfers control of goods or services to customers at an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. The five steps are: (1) identify the contract with the customer, (2) identify the separate performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations and (5) recognize revenue when each performance obligation is satisfied. The Company evaluated the impact of this standard on individual customer contracts, while management evaluated the impact of this standard on the broad categories of its customer contracts and revenue streams. The Company determined that this standard did not have a material impact on its consolidated financial statements because revenue related to financial instruments, including loans and investment securities are not in scope of these updates. Loan interest income, investment interest income, insurance services revenue and BOLI are accounted for under other U.S. GAAP standards and out of scope of ASC 606 revenue standard. The Company also completed an evaluation of certain costs related to customer contracts and revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross versus net). Based on the evaluation, the Company determined that the classification of certain debit and credit card related costs should change (i.e., costs previously recorded as expense are now recorded as contra-revenue). This classification change resulted in immaterial changes to both revenue and expense. The Company adopted the revenue recognition standard and its related amendments as of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts for the debit and credit card related cost reclassifications noted above.

Note 3 – Investment Securities

There were no held-to-maturity securities at March 31, 2019 or December 31, 2018.

Amortized cost and fair values of investment securities available-for-sale at March 31, 2019 are summarized as follows:

(Dollars in thousands)	Amortized Cost		Unrealized Gain		Unrealized Loss		Fair Value	
U. S. Agency securities	$	67,631	$	—	$	(1,043)	$	66,588
U.S. Sponsored Mortgage-backed securities	49,223		1		(1,453)		47,771	
Municipal securities	100,253		241		(487)		100,007	
Total debt securities	217,107		242		(2,983)		214,366	
Other securities	10,294		98		(17)		10,375	
Total investment securities available-for-sale	$	227,401	$	340	$	(3,000)	$	224,741

Amortized cost and fair values of investment securities available-for-sale at December 31, 2018 are summarized as follows:

(Dollars in thousands)	Amortized Cost		Unrealized Gain		Unrealized Loss		Fair Value	
U. S. Agency securities	$	79,041	$	14	$	(1,625)	$	77,430
U.S. Sponsored Mortgage-backed securities	52,154		—		(2,039)		50,115	
Municipal securities	84,747		206		(1,192)		83,761	
Total debt securities	215,942		220		(4,856)		211,306	
Other securities	10,308		68		(68)		10,308	
Total investment securities available-for-sale	$	226,250	$	288	$	(4,924)	$	221,614

Table of Contents

The following table summarizes amortized cost and fair values of debt securities by maturity:

	March 31, 2019	
	Available for sale	
(Dollars in thousands)	**Amortized Cost**	**Fair Value**
Within one year	$ 11,085	$ 11,280
After one year, but within five	31,156	30,716
After five years, but within ten	23,163	22,725
After ten years	151,703	149,645
Total	$ 217,107	$ 214,366

Investment securities with a carrying value of $58.3 million at March 31, 2019, were pledged to secure public funds, repurchase agreements, and potential borrowings at the Federal Reserve discount window.

The Company’s investment portfolio includes securities that are in an unrealized loss position as of March 31, 2019, the details of which are included in the following table. Although these securities, if sold at March 31, 2019 would result in a pretax loss of $3.0 million, the Company has no intent to sell the applicable securities at such fair values, and maintains the Company has the ability to hold these securities until all principal has been recovered. Management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis. Declines in the fair values of these securities can be traced to general market conditions which reflect the prospect for the economy as a whole. When determining other-than-temporary impairment on securities, the Company considers such factors as adverse conditions specifically related to a certain security or to specific conditions in an industry or geographic area, the time frame securities have been in an unrealized loss position, the Company’s ability to hold the security for a period of time sufficient to allow for anticipated recovery in value, whether or not the security has been downgraded by a rating agency, and whether or not the financial condition of the security issuer has severely deteriorated. As of March 31, 2019, the Company considers all securities with unrealized loss positions to be temporarily impaired, and consequently, does not believe the Company will sustain any material realized losses as a result of the current temporary decline in fair value.

The following table discloses investments in an unrealized loss position at March 31, 2019:

(Dollars in thousands)	**Less than 12 months**			**12 months or more**
Description and number of positions	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. Agency securities (51)	$ 6,898	$ (70)	$ 59,690	$ (973)
U.S. Sponsored Mortgage-backed securities (39)	—	—	45,326	(1,453)
Municipal securities (55)	523	(7)	29,130	(480)
Other securities (2)	—	—	1,018	(17)
	$ 7,421	$ (77)	$ 135,164	$ (2,923)

The following table discloses investments in an unrealized loss position at December 31, 2018:

(Dollars in thousands)	Less than 12 months		12 months or more	
Description and number of positions	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Agency securities (54)	$ 9,762	$ (123)	$ 63,740	$ (1,502)
U.S. Sponsored Mortgage-backed securities (42)	2,360	(32)	47,755	(2,007)
Municipal securities (78)	5,936	(46)	35,955	(1,146)
Other securities (2)	2,452	(48)	1,018	(20)
	$ 20,510	$ (249)	$ 148,468	$ (4,675)

For the three-month periods ended March 31, 2019 and 2018, the Company sold investments available-for-sale of $13.7 million and $680 thousand, respectively. These sales resulted in gross gains of $33 thousand and $326 thousand and gross losses of $151 thousand and $0 thousand, respectively.

For the three months ended March 31, 2019, the Company recognized an unrealized holding gain of $180 thousand on equity securities held as of March 31, 2019, which was recorded in noninterest income in the consolidated statements of income.

Table of Contents

For the three months ended March 31, 2018, the Company recognized an unrealized holding loss of $30 thousand on equity securities held as of March 31, 2018, which was recorded in noninterest income in the consolidated statements of income.

Note 4 – Loans and Allowance for Loan Losses

The components of loans in the Consolidated Balance Sheets at March 31, 2019 and December 31, 2018, were as follows:

(Dollars in thousands)	March 31, 2019		December 31, 2018	
Commercial and Non-Residential Real Estate	$	962,064	$	941,033
Residential Real Estate	310,713		294,929	
Home Equity	58,675		59,015	
Consumer	9,469		9,605	
Total Loans	$	1,340,921	$	1,304,582
Deferred loan origination fees and costs, net	297		(216)	
Loans receivable	$	1,341,218	$	1,304,366

All loan origination fees and direct loan origination costs are deferred and recognized over the life of the loan.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank’s ALL. The Bank’s methodology allows for the analysis of certain impaired loans in homogeneous pools, rather than on an individual basis, when those loans are below specific thresholds based on outstanding principal balance. More specifically, residential mortgage loans, home equity lines of credit, and consumer loans, when considered impaired, are evaluated collectively for impairment by applying allocation rates derived from the Bank’s historical losses specific to impaired loans. Total collectively evaluated impaired loans were $1.8 million and $1.7 million, while the related reserves were $187 thousand and $218 thousand as of March 31, 2019 and December 31, 2018.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by qualified factors.

The segments described below in the impaired loans by class table, which are based on the federal call code assigned to each loan, provide the starting point for the ALL analysis. Company and bank management tracks the historical net charge-off activity at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. All pools currently utilize a rolling 12 quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Company and Bank management have identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: lending policies and procedures, nature and volume of the portfolio, experience and ability of lending management and staff, volume and severity of problem credits, conclusion of loan reviews, audits, and exams, changes in the value of underlying collateral, effect of concentrations of credit from a loan type, industry and/or geographic standpoint, changes in economic and business conditions consumer sentiment, and other external factors. The combination of historical charge-off and qualitative factors are then weighted for each risk grade. These weightings are determined internally based upon the likelihood of loss as a loan risk grading deteriorates.

Table of Contents

To estimate the liability for off-balance sheet credit exposures, Bank management analyzed the portfolios of letters of credit, non-revolving lines of credit, and revolving lines of credit, and based its calculation on the expectation of future advances of each loan category. Letters of credit were determined to be highly unlikely to advance since they are generally in place only to ensure various forms of performance of the borrowers. In the Bank's history, there have been no letters of credit drawn upon. In addition, many of the letters of credit are cash secured and do not warrant an allocation. Non-revolving lines of credit were determined to be highly likely to advance as these are typically construction lines. Meanwhile, the likelihood of revolving lines of credit advancing varies with each individual borrower. Therefore, the future usage of each line was estimated based on the average line utilization of the revolving line of credit portfolio as a whole.

Once the estimated future advances were calculated, an allocation rate, which was derived from the Bank's historical losses and qualitative environmental factors, was applied in the similar manner as those used for the allowance for loan loss calculation. The resulting estimated loss allocations were totaled to determine the liability for unfunded commitments related to these loans, which Management considers necessary to anticipate potential losses on those commitments that have a reasonable probability of funding. As of March 31, 2019 and December 31, 2018, the liability for unfunded commitments related to loans held for investment was $284 thousand.

Bank management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

The ALL is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following tables summarize the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of March 31, 2019:

(Dollars in thousands)	Commercial		Residential		Home Equity		Consumer		Total	
January 1, 2019	$	8,605	$	1,405	$	684	$	245	$	10,939
Charge-offs	—		—		—		—		—	
Recoveries	—		1		1		1		3	
Provision (recovery)	259		11		19		11		300	
ALL balance at March 31, 2019	$	8,864	$	1,417	$	704	$	257	$	11,242
Individually evaluated for impairment	$	1,123	$	—	$	—	$	—	$	1,123
Collectively evaluated for impairment	$	7,741	$	1,417	$	704	$	257	$	10,119

The following table summarizes the primary segments of the Company loan portfolio as of March 31, 2019:

(Dollars in thousands)	Commercial		Residential		Home Equity		Consumer		Total	
	$	9,914	$	2,890	$	121	$	36	$	12,961

Individually evaluated for impairment					
Collectively evaluated for impairment	952,150	307,823	58,554	9,433	1,327,960
Total Loans	962,064	310,713	58,675	9,469	1,340,921

The following tables summarize the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of March 31, 2018:

(Dollars in thousands)	**Commercial**		**Residential**		**Home Equity**		**Consumer**		**Total**	
January 1, 2018	$	7,804	$	1,119	$	705	$	250	$	9,878
Charge-offs	(324)		(11)		—		(21)		(356)	
Recoveries	2		9		56		4		71	
Provision	516		60		(68)		(34)		474	
ALL balance at March 31, 2018	$	7,998	$	1,177	$	693	$	199	$	10,067
Individually evaluated for impairment	$	915	$	—	$	—	$	—	$	915
Collectively evaluated for impairment	$	7,083	$	1,177	$	693	$	199	$	9,152

Table of Contents

The following table summarizes the primary segments of the Company loan portfolio as of March 31, 2018:

(Dollars in thousands)	Commercial		Residential		Home Equity		Consumer		Total	
Individually evaluated for impairment	$	12,957	$	1,707	$	44	$	43	$	14,751
Collectively evaluated for impairment	811,668		258,806		59,482		11,866		1,141,822	
Total Loans	$	824,625	$	260,513	$	59,526	$	11,909	$	1,156,573

Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company evaluates residential mortgage loans, home equity lines of credit, and consumer loans in homogeneous pools, rather than on an individual basis, when each of those loans are below specific thresholds based on outstanding principal balance. Such loans that individually exceed these thresholds are evaluated individually for impairment. The Chief Credit Officer identifies these loans individually by monitoring the delinquency status of the Bank's portfolio. Once identified, the Bank's ongoing communications with the borrower allow Management to evaluate the significance of the payment delays and the circumstances surrounding the loan and the borrower.

Once the determination has been made that a loan is impaired, the amount of the impairment is measured using one of 3 valuation methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis.

Table of Contents

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of March 31, 2019 and December 31, 2018:

	Impaired Loans with Specific Allowance		**Impaired Loans with No Specific Allowance**	**Total Impaired Loans**	
(Dollars in thousands)	**Recorded Investment**	**Related Allowance**	**Recorded Investment**	**Recorded Investment**	**Unpaid Principal Balance**
March 31, 2019					
Commercial					
Commercial Business	$ 4,925	$ 744	$ 616	$ 5,541	$ 5,566
Commercial Real Estate	1,826	374	343	2,169	2,227
Acquisition & Development	1,787	5	417	2,204	3,583
Total Commercial	8,538	1,123	1,376	9,914	11,376
Residential	—	—	2,890	2,890	2,915
Home Equity	—	—	121	121	126
Consumer	—	—	36	36	36
Total Impaired Loans	$ 8,538	$ 1,123	$ 4,423	$ 12,961	$ 14,453
December 31, 2018					
Commercial					
Commercial Business	$ 4,885	$ 668	$ 387	$ 5,272	$ 5,292
Commercial Real Estate	1,842	375	396	2,238	2,300
Acquisition & Development	—	—	2,224	2,224	3,601
Total Commercial	6,727	1,043	3,007	9,734	11,193
Residential	—	—	2,831	2,831	2,882
Home Equity	—	—	123	123	123
Consumer	—	—	90	90	316
Total Impaired Loans	$ 6,727	$ 1,043	$ 6,051	$ 12,778	$ 14,514

Impaired loans have increased by $183 thousand, or 1.4%, during the three months ended March 31, 2019. This change is the net effect of multiple factors, including the identification of $328 thousand of impaired loans, the foreclosure of a commercial development loan which required the reclassification of $63 thousand to other real estate owned, the classification of $50 thousand to performing loans based on improved repayment performance, and normal loan amortization.

The following table presents the average recorded investment in impaired loans and related interest income recognized for the periods indicated:

Three Months Ended March 31, 2019	**Three Months Ended March 31, 2018**

(Dollars in thousands)	Average Investment in Impaired Loans	Interest Income Recognized on Accrual Basis	Interest Income Recognized on Cash Basis	Average Investment in Impaired Loans	Interest Income Recognized on Accrual Basis	Interest Income Recognized on Cash Basis
Commercial						
Commercial Business	$ 3,608	$ —	$ —	$ 4,525	$ 38	$ 53
Commercial Real Estate	4,038	40	39	7,431	21	23
Acquisition & Development	2,215	31	29	1,837	—	—
Total Commercial	9,861	71	68	13,793	59	76
Residential	2,858	3	3	1,747	5	48
Home Equity	122	1	1	65	—	—
Consumer	79	—	—	132	—	—
Total	$ 12,920	$ 75	$ 72	$ 15,737	$ 64	$ 124

As of March 31, 2019, the Bank's other real estate owned balance totaled $2.1 million. The Bank held twelve foreclosed residential real estate properties representing $877 thousand, or 42%, of the total balance of other real estate owned. These

Table of Contents

properties are held as a result of the foreclosures of primarily two commercial loan relationships, one of which included two properties for a total of $294 thousand, while the other included seven properties for a total of $174 thousand. The three remaining residential real estate properties, totaling $409 thousand, were result of the foreclosure of three unrelated borrowers. The remaining $1.2 million, or 58%, of other real estate owned is the result of the foreclosure of three unrelated commercial development loans. There are three additional consumer mortgage loans collateralized by residential real estate properties in the process of foreclosure. The total recorded investment in these loans was $270 thousand as of March 31, 2019. These loans are included in the table above and have no specific allowance allocated to them.

Bank management uses a nine-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. Any portion of a loan that has been or is expected to be charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as past due status, bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank’s Chief Credit Officer is responsible for the timely and accurate risk rating of the loans in the portfolio at origination and on an ongoing basis. The Credit Department ensures that a review of all commercial relationships of one million dollars or greater is performed annually.

Review of the appropriate risk grade is included in both the internal and external loan review process, and on an ongoing basis. The Bank has an experienced Credit Department that continually reviews and assesses loans within the portfolio. The Bank engages an external consultant to conduct independent loan reviews on at least an annual basis. Generally, the external consultant reviews larger commercial relationships or criticized relationships. The Bank’s Credit Department compiles detailed reviews, including plans for resolution, on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

Table of Contents

The following table represents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of March 31, 2019 and December 31, 2018:

(Dollars in thousands)	Pass		Special Mention		Substandard		Doubtful		Total	
March 31, 2019										
Commercial										
Commercial Business	$	463,995	$	6,238	$	6,318	$	—	$	476,551
Commercial Real Estate	382,037		4,985		2,513		—		389,535	
Acquisition & Development	92,822		177		2,854		125		95,978	
Total Commercial	938,854		11,400		11,685		125		962,064	
Residential	306,347		2,573		1,675		118		310,713	
Home Equity	57,767		870		38		—		58,675	
Consumer	9,287		164		18		—		9,469	
Total Loans	$	1,312,255	$	15,007	$	13,416	$	243	$	1,340,921
December 31, 2018										
Commercial										
Commercial Business	$	432,589	$	5,290	$	5,652	$	—	$	443,531
Commercial Real Estate	371,309		2,071		2,181		—		375,561	
Acquisition & Development	118,754		179		2,879		129		121,941	
Total Commercial	922,652		7,540		10,712		129		941,033	
Residential	290,602		2,608		1,600		119		294,929	
Home Equity	58,100		876		39		—		59,015	
Consumer	9,359		164		19		63		9,605	
Total Loans	$	1,280,713	$	11,188	$	12,370	$	311	$	1,304,582

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due.

A loan that has deteriorated and requires additional collection efforts by the Bank could warrant non-accrual status. A thorough review is presented to the Chief Credit Officer and/or the MLC, as required with respect to any loan which is in a collection process and to make a determination as to whether the loan should be placed on non-accrual status. The placement of loans on non-accrual status is subject to applicable regulatory restrictions and guidelines. Generally, loans should be placed in non-accrual status when the loan reaches 90 days past due, when it becomes likely the borrower cannot or will not make scheduled principal or interest payments, when full repayment of principal and interest is not expected, or when the loan displays potential loss characteristics. Normally, all accrued interest is charged off when a loan is placed in non-accrual status, unless Management believes it is likely the accrued interest will be collected. Any payments subsequently received are applied to principal. To remove a loan from non-accrual status, all principal and interest due must be paid up to date and the Bank is reasonably sure of future satisfactory payment performance. Usually, this requires a six-month recent history of payments due. Removal of a loan from

non-accrual status will require the approval of the Chief Credit Officer and/or MLC.

Table of Contents

The following table presents the classes of the loan portfolio summarized by aging categories of performing loans and non-accrual loans as of March 31, 2019 and December 31, 2018:

(Dollars in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Total Loans	Non-Accrual	90+ Days Still Accruing
March 31, 2019								
Commercial								
Commercial Business	$ 472,847	$ 165	$ 130	$ 3,409	$ 3,704	$ 476,551	$ 3,707	$ —
Commercial Real Estate	389,336	199	—	—	199	389,535	333	—
Acquisition & Development	95,686	—	—	292	292	95,978	417	—
Total Commercial	957,869	364	130	3,701	4,195	962,064	4,457	—
Residential	307,936	2,384	50	343	2,777	310,713	2,506	—
Home Equity	58,457	193	25	—	218	58,675	83	—
Consumer	9,435	5	—	29	34	9,469	29	—
Total Loans	$ 1,333,697	$ 2,946	$ 205	$ 4,073	$ 7,224	$ 1,340,921	$ 7,075	$ —
December 31, 2018								
Commercial								
Commercial Business	$ 432,097	$ 6,380	$ 1,746	$ 3,308	$ 11,434	$ 443,531	$ 3,684	$ —
Commercial Real Estate	374,880	681	—	—	681	375,561	385	—
Acquisition & Development	121,644	—	—	297	297	121,941	426	—
Total Commercial	928,621	7,061	1,746	3,605	12,412	941,033	4,495	—
Residential	291,665	1,000	760	1,504	3,264	294,929	2,442	—
Home Equity	58,575	400	40	—	440	59,015	84	—
Consumer	9,485	28	10	82	120	9,605	82	—
Total Loans	$ 1,288,346	$ 8,489	$ 2,556	$ 5,191	$ 16,236	$ 1,304,582	$ 7,103	$ —

Troubled Debt Restructurings

The restructuring of a loan is considered a troubled debt restructuring (“TDR”) if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. At March 31, 2019 and December 31, 2018, the Bank had specific reserve allocations for TDR’s of $484 thousand and $439 thousand, respectively.

Loans considered to be troubled debt restructured loans totaled $8.2 million and $8.0 million as of March 31, 2019 and December 31, 2018, respectively. Of these totals, $4.5 million and $4.2 million, respectively, represent accruing

troubled debt restructured loans and represent 35% and 27%, respectively of total impaired loans. Meanwhile, as of March 31, 2019, $3.7 million represents three loans to two borrowers that have defaulted under the restructured terms. Two of the three loans, totaling $417 thousand, are commercial acquisition and development loans that were considered TDR's due to extended interest only periods and/or unsatisfactory repayment structures once transitioned to principal and interest payments. The third loan, to an unrelated borrower, is a $3.3 million commercial term loan which was previously considered a TDR due to multiple interest only periods being provided. This loan defaulted during the three months ended September 30, 2018. The default is due to delayed payments stemming from ongoing negotiations with respect to a third-party operator that is expected to provide a new source of reliable cash flow to service the required payments of this loan. These negotiations are expected to conclude in the second quarter of 2019. These borrowers have experienced continued financial difficulty and are considered non-performing loans as of March 31, 2019 and December 31, 2018.

A commercial loan in the amount of $128 thousand was classified as impaired and as a TDR in the first quarter of 2018. Upon the identification of financial difficulties on the part of the borrower, this loan was modified to interest-only payments for a twelve-month period with the balance due at maturity. A commercial loan in the amount of $268 thousand was classified as a TDR during the three months ended March 31, 2019. Upon the identification of financial difficulties on the part of the borrower, this loan was modified to a lower loan payment by lengthening the amortization period beyond what is typical for a commercial loan of this type. These loans have paid as agreed since they were renewed under modified terms.

Table of Contents

(Dollars in thousands)	Three Months Ended March 31, 2019			Three Months Ended March 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial						
Commercial Business	1	$ 268	$ 267	1	$ 128	$ 128
Commercial Real Estate	—	—	—	—	—	—
Acquisition & Development	—	—	—	—	—	—
Total Commercial	1	268	267	1	128	128
Residential	—	—	—	—	—	—
Home Equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	1	$ 268	$ 267	1	$ 128	$ 128

[1] The pre-modification and post-modification balances represent the balances outstanding immediately before and after modification of the loan.

Note 5 – Premises and Equipment

The Company leases certain premises and equipment under operating and finance leases. At March 31, 2019, the Company had lease liabilities totaling $15.7 million and right-of-use assets totaling $12.9 million related to these leases. Lease liabilities and right-of-use assets are reflected in other liabilities and other assets, respectively. For the three months ended March 31, 2019, the weighted average remaining lease term for finance leases was 3.4 years and the weighted average discount rate used in the measurement of finance lease liabilities was 2.86%. For the three months ended March 31, 2019, the weighted average remaining lease term for operating leases was 12.3 years and the weighted average discount rate used in the measurement of operating lease liabilities was 3.52%.

Lease costs were as follows:

(Dollars in thousands)	Three Months Ended March 31, 2019
Amortization of right-of-use assets, finance leases	$ 20
Interest on lease liabilities, finance leases	2
Operating lease cost	530
Short-term lease cost	25
Variable lease cost	10

Total lease cost	$	587

Rent expense for the three months ended March 31, 2018, prior to the adoption of ASU 2016-02, was $512 thousand.

There were no sale and leaseback transactions, leveraged leases, or lease transactions with related parties during the three months ended March 31, 2019. At March 31, 2019, the Company had leases that had not commenced, but will create approximately $2.4 million and $4.1 million of additional lease liabilities and right-of-use assets, respectively, for the Company.

Table of Contents

Future minimum payments for finance leases and operating leases with initial or remaining terms of one year or more are as follows:

	March 31, 2019	
(Dollars in thousands)	**Finance Leases**	**Operating Leases**
2019	$ 69	$ 1,851
2020	66	1,753
2021	66	1,783
2022	27	1,655
2023	—	1,425
2024 and thereafter	—	11,050
Total future minimum lease payments	$ 228	$ 19,517
Less: Amounts representing interest	(10)	(4,048)
Present value of net future minimum lease payments	$ 218	$ 15,469

Note 6 – Borrowed Funds

Short-term borrowings

Along with traditional deposits, the Bank has access to short-term borrowings from the FHLB, Federal Reserve discount window borrowings, and Fed Funds purchased from correspondent banks to fund its operations and investments. Short-term borrowings totaled $112.4 million at March 31, 2019, compared to $212.4 million at December 31, 2018.

Information related to short-term borrowings is summarized as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Balance at end of period	$ 112,412	$ 212,395
Average balance during the period	176,428	171,117
Maximum month-end balance	177,164	264,297
Weighted-average rate during the year	2.63 %	2.27 %
Weighted-average rate at end of period	2.70 %	2.62 %

Repurchase agreements

Along with traditional deposits, the Bank has access to securities sold under agreements to repurchase "repurchase agreements" with customers representing funds deposited by customers, on an overnight basis, that are collateralized by investment securities owned by the Company. Repurchase agreements with customers are included in borrowings section on the consolidated balance sheets. All repurchase agreements are subject to terms and conditions of repurchase/security agreements between the Company and the client and are accounted for as secured borrowings. The Company's repurchase agreements reflected in liabilities consist of customer accounts and securities which are pledged on an individual security basis.

The Company monitors the fair value of the underlying securities on a monthly basis. Repurchase agreements are reflected at the amount of cash received in connection with the transaction and included in Securities sold under agreements to repurchase on the consolidated balance sheets. The primary risk with the Company's repurchase agreements is market risk associated with the investments securing the transactions, as we may be required to provide additional collateral based on fair value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

All of the Company's repurchase agreements were overnight agreements at March 31, 2019 and December 31, 2018. These borrowings were collateralized with investment securities with a carrying value of $13.0 million and $15.4 million at March 31, 2019 and December 31, 2018, respectively, and were comprised of U.S. Government Agencies and Mortgage backed securities. Declines in the value of the collateral would require the Company to increase the amounts of securities pledged.

Repurchase agreements totaled $12.6 million at March 31, 2019, compared to $14.9 million at December 31, 2018.

Table of Contents

Information related to repurchase agreements is summarized as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Balance at end of period	$ 12,553	$ 14,925
Average balance during the period	14,206	18,536
Maximum month-end balance	14,655	20,903
Weighted-average rate during the year	0.38 %	0.30 %
Weighted-average rate at end of period	0.52 %	0.16 %

Long-term notes from the FHLB were as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Fixed interest rate notes, originating between October 2006 and April 2007, due between October 2021 and April 2022, interest of between 5.18% and 5.20% payable monthly	$ 1,727	$ 1,741
Amortizing fixed interest rate note, originating February 2007, due February 2022, payable in monthly installments of $5 thousand, including interest of 5.22%	745	751
	$ 2,472	$ 2,492

Subordinated Debt

Information related to subordinated debt is summarized as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Balance at end of period	$ 17,524	$ 17,524
Average balance during the period	17,524	25,774
Maximum month-end balance	17,524	33,524
Weighted-average rate during the year	6.51 %	6.81 %
Weighted-average rate at end of period	6.53 %	6.57 %

In March 2007, the Company completed the private placement of $4 million Floating Rate, Trust Preferred Securities through its MVB Financial Statutory Trust I subsidiary (the “Trust”). The Company established the Trust for the sole

purpose of issuing the Trust Preferred Securities pursuant to an Amended and Restated Declaration of Trust. The proceeds from the sale of the Trust Preferred Securities will be loaned to the Company under subordinated Debentures (the "Debentures") issued to the Trust pursuant to an Indenture. The Debentures are the only asset of the Trust. The Trust Preferred Securities have been issued to a pooling vehicle that will use the distributions on the Trust Preferred Securities to securitize note obligations. The securities issued by the Trust are includable for regulatory purposes as a component of the Company's Tier 1 capital.

The Trust Preferred Securities and the Debentures mature in 2037 and have been redeemable by the Company since 2012. Interest payments are due in March, June, September, and December and are adjusted at the interest due dates at a rate of 1.62% over the three-month LIBOR Rate. The obligations of the Company with respect to the issuance of the trust preferred securities constitute a full and unconditional guarantee by the Company of the Trust's obligations with respect to the trust preferred securities to the extent set forth in the related guarantees.

On June 30, 2014, the Company issued its Convertible Subordinated Promissory Notes Due 2024 (the "Notes") to various investors in the aggregate principal amount of $29,400,000. The Notes were issued in $100,000 increments per Note subject to a minimum investment of $1,000,000. The Notes expire 10 years after the initial issuance date of the Notes (the "Maturity Date").

Interest on the Notes accrues on the unpaid principal amount of each Note (paid quarterly in arrears on January 1, April 1, July 1, and October 1 of each year) which rate shall be dependent upon the principal invested in the Notes and the holder's ownership of common stock in the Company. For investments of less than $3,000,000 in Notes, an ownership of Company common stock representing at least 30% of the principal of the Notes acquired, the interest rate on the Notes is 7% per annum. For investments of $3,000,000 or greater in Notes and ownership of the Company's common stock representing at least 30% of the principal of the Notes acquired, the interest rate on the Notes is 7.5% per annum. For investments of $10,000,000 or greater, the interest rate on the Notes is 7% per annum, regardless of whether the holder owns or acquires MVB common stock. The principal on the Notes shall be paid in full at the Maturity Date. On the fifth anniversary of the issuance of the Notes, a holder may elect to continue to

Table of Contents
receive the stated fixed rate on the Notes or a floating rate determined by LIBOR plus 5% up to a maximum rate of 9%, adjusted quarterly.

The Notes are unsecured and subject to the terms and conditions of any senior debt and after consultation with the Board of Governors of the Federal Reserve System, the Company may, after the Notes have been outstanding for 5 years, and without premium or penalty, prepay all or a portion of the unpaid principal amount of any Note together with the unpaid interest accrued on such portion of the principal amount of such Note. All such prepayments shall be made pro rata among the holders of all outstanding Notes.

At the election of a holder, any or all of the Notes may be converted into shares of common stock during the 5-day period after the first, second, third, fourth, and fifth anniversaries of the issuance of the Notes or upon a notice to prepay by the Company. On December 28, 2017, the Company distributed notices to the holders of the Notes that provide that the Company has elected to waive the timing requirements associated with when a conversion may occur and, instead, the Company will accept notices of conversion at any time prior to July 1, 2019, which is the final conversion date for the Notes. The Notes will convert into common stock based on $16 per share of the Company's common stock. The conversion price will be subject to anti-dilution adjustments for certain events such as stock splits, reclassifications, non-cash distributions, extraordinary cash dividends, pro rata repurchases of common stock, and business combination transactions. The Company must give 20 days' notice to the holders of the Company's intent to prepay the Notes, so that holders may execute the conversion right set forth above if a holder so desires.

Repayment of the Notes is subordinated to the Company's outstanding senior debt including (if any) without limitation, senior secured loans. No payment will be made by the Company, directly or indirectly, on the Notes, unless and until all of the senior debt then due has been paid in full. Notwithstanding the foregoing, so long as there exists no event of default under any senior debt, the Company would make, and a holder would receive and retain for the holder's account, regularly scheduled payments of accrued interest and principal pursuant to the terms of the Notes.

The Company must obtain a consent of the holders of the Notes prior to issuing any new senior debt in excess of $15,000,000 after the date of issuance of the Notes and prior to the Maturity Date.

An event of default will occur upon the Company's bankruptcy or any failure to pay interest, principal, or other amounts owing on the Notes when due. Upon the occurrence and during the continuance of an event of default (but subject to the subordination provisions of the Notes) the holders of a majority of the outstanding principal amount of the Notes may declare all or any portion of the outstanding principal amount of the Notes due and payable and demand immediate payment of such amount.

The Notes are redeemable, in whole or in part, at a redemption price equal to 100% of the principal amount of the Notes to be redeemed on any interest payment date after a date five years from the original issue date.

The Company reflects subordinated debt in the amount of $17.5 million as of March 31, 2019 and December 31, 2018 and interest expense of $285 thousand and $558 thousand for the three months ended March 31, 2019 and 2018. In 2018, $16.0 million of subordinated debt was converted into common stock, which resulted in the issuance of 1,000,000 new shares and provided an annual interest expense savings of $1.1 million.

A summary of maturities of borrowings and subordinated debt over the next five years is as follows (dollars in thousands):

Year	Amount	
2019	$	112,477
2020	90	
2021	886	

2022	1,431	
2023	—	
Thereafter	17,524	
	$	132,408

23

Table of Contents

Note 7 – Fair Value of Financial Instruments

Accounting standards require that the Company adopt fair value measurement for financial assets and financial liabilities. This enhanced guidance for using fair value to measure assets and liabilities applies whenever other standards require or permit assets or liabilities to be measured at fair value. This guidance does not expand the use of fair value in any new circumstances.

Accounting standards establish a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by these standards are as follows:

Level I:	Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
Level II:	Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
Level III:	Assets and liabilities that

have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The methods of determining the fair value of assets and liabilities presented in this footnote are consistent with our methodologies disclosed in Note 17, "Fair Value of Financial Instruments" and Note 18, "Fair Value Measurement" of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of the Company's 2018 Annual Report on Form 10-K, except for the valuation of loans held for investment which was impacted by the adoption of ASU 2016-01. In accordance with ASU 2016-01, the fair value of loans held for investment is estimated using a discounted cash flow analysis. The discount rates used to determine fair value use interest rate spreads that reflect factors such as liquidity, credit, and nonperformance risk of the loans. Loans are considered a Level III classification.

Assets Measured on a Recurring Basis

As required by accounting standards, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company classified investments in government securities as Level II instruments and valued them using the market approach. The following measurements are made on a recurring basis.

• **Available-for-sale investment and equity securities –** Available-for-sale investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level I securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level II securities include mortgage-backed securities issued by government sponsored entities and private label entities, municipal bonds, and corporate debt securities. There have been no changes in valuation techniques for the three months ended March 31, 2019. Valuation techniques are consistent with techniques used in prior periods. Certain local municipal securities related to tax increment financing ("TIF") are independently valued and classified as Level III instruments.

- **Loans held for sale –** The fair value of mortgage loans held for sale is determined, when possible, using quoted secondary-market prices or investor commitments. If no such quoted price exists, the fair value of a loan is determined using quoted prices for a similar asset or assets, adjusted for the specific attributes of that loan, which would be used by other market participants.

- **Interest rate lock commitment –** The Company estimates the fair value of interest rate lock commitments based on the value of the underlying mortgage loan, quoted mortgage-backed security prices, and estimates of the fair value of the mortgage servicing rights and the probability that the mortgage loan will fund within the terms of the interest rate lock commitments.

- **Mortgage-backed security hedges –** MBS hedges are considered derivatives and are recorded at fair value based on observable market data of the individual mortgage-backed security.

Table of Contents

•**Interest rate cap –** The fair value of the interest rate cap is determined at the end of each quarter by using Bloomberg Finance which values the interest rate cap using observable inputs from forward and futures yield curves as well as standard market volatility.

•**Interest rate swap –** Interest rate swaps are recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data.

•**Fair value hedge –** Treated like an interest rate swap, fair value hedges are recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data.

Table of Contents

The following tables present the assets reported on the consolidated statements of financial condition at their fair value on a recurring basis as of March 31, 2019 and December 31, 2018 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	March 31, 2019			
(Dollars in thousands)	**Level I**	**Level II**	**Level III**	**Total**
Assets:				
U.S. Government Agency securities	$ —	$ 66,588	$ —	$ 66,588
U.S. Sponsored Mortgage backed securities	—	47,771	—	47,771
Municipal securities	—	63,206	36,801	100,007
Other securities	—	10,375	—	10,375
Equity securities	5,819	3,272	750	9,841
Loans held for sale	—	65,955	—	65,955
Interest rate lock commitment	—	—	2,256	2,256
Interest rate swap	—	2,666	—	2,666
Interest rate cap	—	—	—	—
Fair value hedge	—	630	—	630
Liabilities:				
Interest rate swap	—	2,666	—	2,666
Fair value hedge	—	630	—	630
Mortgage-backed security hedges	—	687	—	687

	December 31, 2018			
(Dollars in thousands)	**Level I**	**Level II**	**Level III**	**Total**
Assets:				
U.S. Government Agency securities	$ —	$ 77,430	$ —	$ 77,430
U.S. Sponsored Mortgage backed securities	—	50,115	—	50,115
Municipal securities	—	50,639	33,122	83,761
Other securities	—	10,308	—	10,308
Equity securities	6,027	3,272	300	9,599
Loans held for sale	—	75,807	—	75,807
Interest rate lock commitment	—	—	1,750	1,750
Interest rate swap	—	1,375	—	1,375
Interest rate cap	—	8	—	8
Fair value hedge	—	343	—	343
Liabilities:				
Interest rate swap	—	1,375	—	1,375

Fair value hedge	—	343	—	343
Mortgage-backed security hedges	—	853	—	853

Table of Contents

The following table represents recurring level III assets:

(Dollars in thousands)	Interest Rate Lock Commitments		Municipal Securities		Equity Securities		Total	
Balance at January 1, 2019	$	1,750	$	33,122	$	300	$	35,172
Realized and unrealized gains included in earnings	506		—		—		506	
Purchase of securities	—		—		450		450	
Unrealized gain included in other comprehensive income (loss)	—		5,012		—		5,012	
Unrealized loss included in other comprehensive income (loss)	—		(1,333)		—		(1,333)	
Balance at Balance at March 31, 2019	$	2,256	$	36,801	$	750	$	