GLEN BURNIE BANCORP
Form 10-Q
August 14, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-24047

GLEN BURNIE BANCORP

(Exact name of registrant as specified in its charter)

Maryland	52-1782444
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Crain Highway, S.E.	
Glen Burnie, Maryland	21061
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (410) 766-3300

Inapplicable

(Former name, former address and former fiscal year if changed from 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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer		Accelerated filer
Non-Accelerated Filer	(Do not check if a smaller reporting company)	Smaller Reporting Company
		Emerging growth company

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

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

The number of shares of the registrant's common stock outstanding as of August 3, 2018 was 2,810,961.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	June 30, 2018 (unaudited)	December 31, 2017 (audited)
ASSETS		
Cash and due from banks	$ 2,584	$ 2,610
Interest-bearing deposits in other financial institutions	5,498	9,995
Cash and Cash Equivalents	8,082	12,605
Investment securities available for sale, at fair value	87,314	89,349
Restricted equity securities, at cost	1,443	1,232
Loans, net of deferred fees and costs	289,408	271,612
Less: Allowance for loan losses	(2,284)	(2,589)
Loans, net	287,124	269,023
Real estate acquired through foreclosure	114	114
Premises and equipment, net	3,195	3,371
Bank owned life insurance	7,780	8,713
Deferred tax assets, net	2,713	2,429
Accrued interest receivable	1,142	1,133
Accrued taxes receivable	—	465
Prepaid expenses	471	433
Other assets	2,093	583
Total Assets	$ 401,471	$ 389,450
LIABILITIES		
Noninterest-bearing deposits	$ 108,414	$ 104,017
Interest-bearing deposits	233,393	230,221
Total Deposits	341,807	334,238
Short-term borrowings	25,000	20,000
Defined pension liability	317	335
Accrued Taxes Payable	28	—
Accrued expenses and other liabilities	775	835
Total Liabilities	367,927	355,408
STOCKHOLDERS' EQUITY		
	2,808	2,801

Common stock, par value $1, authorized 15,000,000 shares, issued and outstanding 2,807,819 and 2,801,149 shares as of June 30, 2018 and December 31, 2017 , respectively.		
Additional paid-in capital	10,335	10,267
Retained earnings	21,778	21,605
Accumulated other comprehensive loss	(1,377)	(631)
Total Stockholders' Equity	33,544	34,042
Total Liabilities and Stockholders' Equity	$ 401,471	$ 389,450

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
INTEREST INCOME				
Interest and fees on loans	$ 2,958	$ 2,842	$ 5,830	$ 5,616
Interest and dividends on securities	535	507	1,059	1,025
Interest on deposits with banks and federal funds sold	50	31	98	62
Total Interest Income	3,543	3,380	6,987	6,703
INTEREST EXPENSE				
Interest on deposits	325	327	634	659
Interest on short-term borrowings	165	84	308	167
Interest on long-term borrowings	—	76	—	152
Total Interest Expense	490	487	942	978
Net Interest Income	3,053	2,893	6,045	5,725
Provision for loan losses	(5)	(30)	355	165
Net interest income after provision for loan losses	3,058	2,923	5,690	5,560
NONINTEREST INCOME				
Service charges on deposit accounts	61	68	128	136
Other fees and commissions	179	168	347	328
Gains on redemption of BOLI policies	101	—	308	—
Income on life insurance	45	51	89	100
Other income	—	1	—	3
Total Noninterest Income	386	288	872	567
NONINTEREST EXPENSE				
Salary and benefits	1,649	1,615	3,371	3,036
Occupancy and equipment expenses	274	286	579	584
Legal, accounting and other professional fees	277	197	509	403
Data processing and item processing services	154	143	286	312
FDIC insurance costs	65	63	122	123
Advertising and marketing related expenses	32	42	49	73
Loan collection costs	80	29	121	47

Telephone costs	67	59	124	114
Other expenses	413	376	685	689
Total Noninterest Expenses	3,011	2,810	5,846	5,381
Income before income taxes	433	401	716	746
Income tax (benefit) expense	(45)	63	(17)	92
NET INCOME	$ 478	$ 338	$ 733	$ 654
Basic and diluted net income per share of common stock	$ 0.17	$ 0.12	$ 0.26	$ 0.23

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$ 478	$ 338	$ 733	$ 654
Other comprehensive income (loss):				
Net unrealized gain (loss) on securities available for sale:				
Net unrealized gain (loss) on securities during the period	15	507	(1,576)	549
Income tax (expense) benefit relating to item above	(6)	—	434	—
Reclassification adjustment for gain on sales of securities included in net income	—	(1)	—	(1)
Net effect on other comprehensive income (loss)	9	506	(1,142)	548
Net unrealized gain on interest rate swap:				
Net unrealized gain on interest rate swap during the period	107	—	546	—
Income tax expense relating to item above	(41)	—	(150)	—
Net effect on other comprehensive income	66	—	396	—
Other comprehensive income (loss)	75	506	(746)	548
Comprehensive income	$ 553	$ 844	$ (13)	$ 1,202

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)

(unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2016	$ 2,787	$ 10,130	$ 21,708	$ (810)	$ 33,815
Net income	—	—	654	—	654
Cash dividends, $0.20 per share	—	—	(559)	—	(559)
Dividends reinvested under dividend reinvestment plan	7	69	—	—	76
Other comprehensive income	—	—	—	548	548
Balance, June 30, 2017	2,794	10,199	21,803	(262)	34,534

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2017	$ 2,801	$ 10,267	$ 21,605	$ (631)	$ 34,042
Net income	—	—	733	—	733
Cash dividends, $0.20 per share	—	—	(560)	—	(560)
Dividends reinvested under dividend reinvestment plan	7	68	—	—	75
Other comprehensive loss	—	—	—	(746)	(746)
Balance, June 30, 2018	$ 2,808	$ 10,335	$ 21,778	$ (1,377)	$ 33,544

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income	$ 733	$ 654
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and accretion of premises and equipment	579	518
Provision for loan losses	355	165
Gain on life insurance	(308)	—
Gain on disposals of assets, net	—	(1)
Decrease (increase) in cash surrender value of bank owned life insurance	935	(100)
Decrease in ground rents	3	7
(Increase) decrease in accrued interest receivable	(9)	42
Net (increase) decrease in other assets	(232)	730
Net decrease in accrued expenses and other liabilities	(51)	(269)
Net cash provided by operating activities	2,005	1,746
Cash flows from investing activities:		
Redemptions and maturities of investment securities available for sale	5,557	9,209
Purchases of investment securities available for sale	(5,440)	(4,659)
Net purchase of Federal Home Loan Bank stock	(211)	(210)
Net increase in loans	(18,457)	(6,012)
Purchases of premises and equipment	(61)	(119)
Net cash used in investing activities	(18,612)	(1,791)
Cash flows from financing activities:		
Net increase in deposits	7,569	2,244
Increase in short term borrowings	5,000	15,000
Decrease in long term borrowings	—	(10,000)
Cash dividends paid	(560)	(559)
Common stock dividends reinvested	75	76
Net cash provided by financing activities	12,084	6,761
Net (decrease) increase in cash and cash equivalents	(4,523)	6,716
Cash and cash equivalents at beginning of year	12,605	10,622

Cash and cash equivalents at end of year	$ 8,082	$ 17,338
Supplemental Disclosures of Cash Flow Information:		
Interest paid on deposits and borrowings	$ 908	$ 1,122
Net income taxes (refunded) paid	(573)	49
Net (increase) decrease in unrealized depreciation on available for sale securities	(1,576)	905
Net (increase) decrease in unrealized depreciation on Swaps	546	—

See accompanying notes to unaudited consolidated financial statements.

GLEN BURNIE BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATIONAL

Nature of Business

Glen Burnie Bancorp (the “Company”) is a bank holding company organized in 1990 under the laws of the State of Maryland. The Company owns all the outstanding shares of capital stock of The Bank of Glen Burnie (the “Bank”), a commercial bank organized in 1949 under the laws of the State of Maryland (the “State”). The Bank provides financial services to individuals and corporate customers located in Anne Arundel County and surrounding areas of Central Maryland, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

NOTE 2 – BASIS OF PRESENTATION

In management’s opinion, the accompanying unaudited consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim period reporting, reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial position at June 30, 2018 and December 31, 2017, the results of operations for the three- and six-month periods ended June 30, 2018 and 2017, and the statements of cash flows for the three- and six-month periods ended June 30, 2018 and 2017. The operating results for the three- and six-month period ended June 30, 2018 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2018 or any future interim period. The consolidated balance sheet at December 31, 2017 has been derived from the audited financial statements included in the Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (the “SEC”) on April 2, 2018. The unaudited consolidated financial statements for June 30, 2018 and 2017, the consolidated balance sheet at December 31, 2017, and accompanying notes should be read in conjunction with the Company’s audited consolidated financial statements and the accompanying notes thereto that are included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, The Bank of Glen Burnie and GBB Properties. Consolidation resulted in the elimination of all intercompany accounts and transactions.

Cash Flow Presentation

In the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, Federal Home Loan Bank of Atlanta (“FHLB Atlanta”) overnight deposits, and federal funds sold. Generally, federal funds are sold for one-day periods.

Reclassifications

Certain items in the 2017 consolidated financial statements have been reclassified to conform to the 2018 classifications. The reclassifications had no effect on previously reported results of operations or retained earnings.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses (the “allowance”); the fair value of financial instruments,

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such as loans and investment securities; benefit plan obligations and expenses; and the valuation of deferred tax assets and liabilities.

NOTE 3 – EARNINGS PER SHARE

Basic earnings per common share ("EPS") is computed by dividing net income available to common shareholders by the weighted average common shares outstanding during the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average common shares outstanding, plus the effect of common stock equivalents (for example, stock options computed using the treasury stock method).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic and diluted earnings per share:				
Net income	$ 477,685	$ 337,927	$ 733,154	$ 653,713
Weighted average common shares outstanding	2,806,599	2,792,656	2,804,565	2,791,824
Basic and dilutive net income per share	$ 0.17	$ 0.12	$ 0.26	$ 0.23

Diluted earnings per share calculations were not required for the three- and six-month periods ended June 30, 2018 and 2017, as there were no stock options outstanding.

NOTE 4 – INVESTMENT SECURITIES

Investment securities are accounted for according to their purpose and holding period. Trading securities are those that are bought and held principally for the purpose of selling them in the near term. The Company held no trading securities at June 30, 2018 or December 31, 2017. Available-for-sale investment securities, comprised of debt and mortgage-backed securities, are those that may be sold before maturity due to changes in the Company's interest rate risk profile or funding needs, and are reported at fair value with unrealized gains and losses, net of taxes, reported as a component of other comprehensive income. Held-to-maturity investment securities are those that management has the positive intent and ability to hold to maturity and are reported at amortized cost. The Company held no held-to-maturity securities at June 30, 2018 or December 31, 2017.

Realized gains and losses are recorded in noninterest income and are determined on a trade date basis using the specific identification method. Interest and dividends on investment securities are recognized in interest income on an accrual basis. Premiums and discounts are amortized or accreted into interest income using the interest method over the expected lives of the individual securities.

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The following table summarizes the amortized cost and estimated fair value of the Company's investment securities portfolio at June 30, 2018 and December 31, 2017:

	At June 30, 2018			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Collateralized mortgage obligations	$ 22,923	$ 13	$ (918)	$ 22,018
Agency mortgage-backed securities	28,055	4	(1,056)	27,003
Municipal securities	35,330	75	(533)	34,872
U.S. Government agency securities	1,999	—	(64)	1,935
U.S. Treasury securities	1,501	—	(15)	1,486
Total securities available for sale	$ 89,808	$ 92	$ (2,586)	$ 87,314

	At December 31, 2017			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Collateralized mortgage obligations	$ 24,063	$ 20	$ (569)	$ 23,514
Agency mortgage-backed securities	25,725	4	(500)	25,229
Municipal securities	35,453	339	(159)	35,633
U.S. Government agency securities	3,526	—	(46)	3,480
U.S. Treasury securities	1,501	—	(8)	1,493
Total securities available for sale	$ 90,268	$ 363	$ (1,282)	$ 89,349

The gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2018 and December 31, 2017 are as follows:

June 30, 2018	Less than 12 months		12 months or more		Total	
Securities available for sale:	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in thousands)					
Collateralized mortgage obligations	$ 6,053	$ (169)	$ 14,783	$ (749)	$ 20,836	$ (918)

Agency mortgage-backed securities	8,799	(273)	18,019	(783)	26,818	(1,056)
Municipal securities	17,130	(310)	6,099	(223)	23,229	(533)
U.S. Government agency securities	1,935	(64)	—	—	1,935	(64)
U.S. Treasury securities	1,485	(15)	—	—	1,485	(15)
	$ 35,402	$ (831)	$ 38,901	$ (1,755)	$ 74,303	$ (2,586)

December 31, 2017	Less than 12 months		12 months or more		Total	
Securities available for sale:	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in thousands)					
Collateralized mortgage obligations	$ 6,531	$ (62)	$ 15,678	$ (507)	$ 22,209	$ (569)
Agency mortgage-backed securities	6,802	(80)	18,218	(420)	25,020	(500)
Municipal securities	2,396	(11)	6,230	(148)	8,626	(159)
U.S. Government agency securities	2,965	(37)	515	(9)	3,480	(46)
U.S. Treasury securities	1,494	(8)	—	—	1,494	(8)
	$ 20,188	$ (198)	$ 40,641	$ (1,084)	$ 60,829	$ (1,282)

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Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary-impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At June 30, 2018, the Company recorded unrealized losses in its portfolio of debt securities totaling $2.6 million related to 148 securities, which resulted from increases in market interest rates, spread volatility, and other factors that management deems to be temporary. Management does not believe the securities are impaired due to reasons of credit quality. Since management believes that it is more likely than not that the Company will not be required to sell these securities prior to maturity or a full recovery of the amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

At December 31, 2017, the Company recorded unrealized losses in its portfolio of debt securities totaling $1.3 million related to 114 securities, which resulted from increases in market interest rates, spread volatility, and other factors that management deems to be temporary. Management does not believe the securities are impaired due to reasons of credit quality. Since management believes that it is more likely than not that the Company will not be required to sell these securities prior to maturity or a full recovery of the amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

Contractual maturities of debt securities at June 30, 2018 are shown below. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	At June 30, 2018		
(dollars in thousands)	Amortized Cost	Fair Value	Yield (1), (2)
Available for sale securities maturing:			
Within one year	$ 1,198	$ 1,204	3.72 %
Over one to five years	1,815	1,791	1.50 %
Over five to ten years	19,145	18,603	2.12 %
Over ten years	67,650	65,716	2.79 %
Total debt securities	$ 89,808	$ 87,314	

(1) Yields are stated as book yields which are adjusted for amortization and accretion of purchase premiums and discounts, respectively.

(2) Yields on tax-exempt obligations have been computed on a tax-equivalent basis.

NOTE 5 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The fundamental lending business of the Company is based on understanding, measuring, and controlling the credit risk inherent in the loan portfolio. The Company's loan portfolio is subject to varying degrees of credit risk. These risks entail both general risks, which are inherent in the lending process, and risks specific to individual borrowers. The Company's credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry or collateral type.

The Company currently manages its credit products and the respective exposure to loan losses by the following specific portfolio segments, which are levels at which the Company develops and documents its systematic methodology to determine the allowance for loan losses. The Company considers each loan type to be a portfolio segment having unique risk characteristics.

	June 30, 2018		December 31, 2017	
(dollars in thousands)	Amount	%	Amount	%
Consumer	$ 14,453	5	$ 16,112	6
Residential real estate	82,144	29	81,926	30
Indirect	101,181	35	85,186	32
Commercial	12,028	4	11,257	4
Construction	3,472	1	3,536	1
Commercial real estate	76,130	26	73,595	27
Loans, net of deferred fees and costs	289,408	100	271,612	100
Less: Allowance for loan losses	(2,284)		(2,589)	
Loans, net	$ 287,124		$ 269,023	

The Bank's net loans totaled $287.1 million at June 30, 2018, compared to $269.0 million at December 31, 2017, an increase of $18.1 million, or 6.73%. Consumer loans decreased from $16.1 million at December 31, 2017 to $14.5 million, a decrease of $1.6 million, or 10.30%. Residential real estate loans increased by $0.2 million, or 0.27%, from $81.9 at December 31, 2017 to $82.1 at June 30, 2018. Indirect loans increased from $85.2 million to $101.2 million, an increase of $16.0 million, or 18.78%. Commercial loans increased $0.7 million, or 6.86%, to $12.0 million at June 30, 2018 compared to $11.3 million at December 31, 2017. Commercial real estate loans increased from $73.6 million to $76.1 million, an increase of $2.5 million or 3.44%.

Credit Risk and Allowance for Loan Losses. Credit risk is the risk of loss arising from the inability of a borrower to meet his or her obligations and entails both general risks, which are inherent in the process of lending, and risks specific to individual borrowers. Credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry, or collateral type. Residential mortgage and home equity loans and lines generally have the lowest credit loss experience. Loans secured by personal property, such as auto loans, generally experience medium credit losses. Unsecured loan products, such as personal revolving credit, have the highest credit loss experience and for that reason, the Bank has chosen not to engage in a significant amount of this type of lending. Credit risk in commercial lending can vary significantly, as losses as a percentage of outstanding loans can shift widely during economic cycles and are particularly sensitive to changing economic conditions. Generally, improving economic conditions result in improved operating results on the part of commercial customers, enhancing their ability to meet their particular debt service requirements. Improvements, if any, in operating cash flows can be offset by the impact of rising interest rates that may occur during improved economic times. Inconsistent economic conditions may have an adverse effect on the operating results of commercial customers, reducing their ability to meet debt service obligations.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance, based on evaluations of the collectability of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible. The evaluations are performed for each class of loans and take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, value of collateral securing the loans and current economic conditions and trends that may affect the borrowers' ability to pay. For example, delinquencies in unsecured loans and indirect automobile installment loans will be reserved for at significantly higher ratios than loans secured by real estate. Based on that analysis, the Bank deems its allowance for loan losses in proportion to the total nonaccrual loans and past due loans to be sufficient.

For purposes of determining the allowance for loan losses, the Bank segments the loan portfolio into the following classifications:

· Consumer
· Residential Real Estate

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- Indirect
- Commercial
- Construction
- Commercial Real Estate

Each of these segments are reviewed and analyzed quarterly using the average historical charge-offs over a four year period for their respective segments as well as the following qualitative factors:

- Changes in asset quality metrics including past due (30-89 days) loans, nonaccrual loans, classified assets, watch list loans all in relation to total loans. Also policy exceptions in relationship to loan volume.
- Changes in the rate and direction of the loan volume by portfolio segment.
- Concentration of credit including the concentration percentages, changes in concentration and concentrations relative to goals.
- Changes in macro-economic factors including the rates and direction of unemployment, median income and population.
- Changes in internal factors including external loan review required reserve changes, internal review penetration, internal required reserve changes, and weighted required reserve trends.
- Changes in rate and direction of charge offs and recoveries.

Transactions in the allowance for loan losses for the six months ended June 30, 2018 and the year ended December 31, 2017 were as follows:

June 30, 2018 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Unallocated	Total
Balance, beginning of year	$ 214	$ 1,061	$ 774	$ 237	$ 12	$ 291	$ —	$ 2,589
Charge-offs	(92)	(514)	(163)	—	—	—	—	(769)
Recoveries	12	2	95	—	—	—	—	109
Provision for loan losses	43	112	93	9	(1)	99	—	355
Balance, end of year	$ 177	$ 661	$ 799	$ 246	$ 11	$ 390	$ —	$ 2,284
Individually evaluated for impairment:								
Balance in allowance	$ 27	$ —	$ —	$ 211	$ —	$ —	$ —	$ 238
	96	2,006	—	211	—	3,016	—	5,329

Related loan balance								
Collectively evaluated for impairment:								
Balance in allowance	$ 150	$ 661	$ 799	$ 35	$ 11	$ 390	$ —	$ 2,046
Related loan balance	14,357	80,138	101,181	11,817	3,472	73,114	—	284,079

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December 31, 2017 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Unallocated	Total
Balance, beginning of year	$ 182	$ 1,042	$ 693	$ 284	$ 10	$ 259	$ 14	$ 2,484
Charge-offs	(96)	(3)	(458)	(9)	—	—	—	(566)
Recoveries	8	27	286	—	—	14	—	335
Provision for loan losses	120	(5)	253	(38)	2	18	(14)	336
Balance, end of year	$ 214	$ 1,061	$ 774	$ 237	$ 12	$ 291	$ —	$ 2,589
Individually evaluated for impairment:								
Balance in allowance	$ 52	$ 513	$ —	$ 217	$ —	$ —	$ —	$ 782
Related loan balance	160	2,345	—	217	—	1,176	—	3,898
Collectively evaluated for impairment:								
Balance in allowance	$ 162	$ 548	$ 774	$ 20	$ 12	$ 291	$ —	$ 1,807
Related loan balance	15,952	79,580	85,186	11,040	3,536	72,420	—	267,714

Management believes the allowance for credit losses is at an appropriate level to absorb inherent probable losses in the portfolio.

(dollars in thousands)	June 30, 2018	June 30, 2017
Average loans	$ 281,104	$ 269,533
Net charge offs to average loans (annualized)	0.48 %	0.04 %

During the six-month period ending June 30, 2018, loans to 25 borrowers and related entities totaling approximately $769,000 were determined to be uncollectible and were charged off. During the six-month period ending June 30, 2017, loans to 38 borrowers and related entities totaling approximately $254,000 were determined to be uncollectible and were charged off.

Reserve for Unfunded Commitments. Loan commitments and unused lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The Bank generally requires collateral to support financial instruments with credit risk on the same basis as it does for on-balance sheet instruments. The collateral requirement is based on management's credit evaluation of the counter party. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

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As of June 30, 2018 and 2017, the Bank had outstanding commitments totaling $33.8 million and $24.0 million, respectively. These outstanding commitments consisted of letters of credit, undrawn lines of credit, and other loan commitments. The following table shows the Bank's reserve for unfunded commitments arising from these transactions:

	Six Months Ended June 30,	
(dollars in thousands)	2018	2017
Beginning balance	$ 24	$ 25
Reduction of unfunded reserve	(18)	(20)
Provisions charged to operations	37	17
Ending balance	$ 43	$ 22

Contractual Obligations and Commitments. No material changes, outside the normal course of business, have been made during 2018.

Asset Quality. The following tables set forth the amount of the Bank's current, past due, and non-accrual loans by categories of loans and restructured loans, at the dates indicated.

At June 30, 2018 (dollars in thousands)	Current	30-89 Days Past Due	90 Days or More and Still Accruing	Nonaccrual	Total
Consumer	$ 14,094	$ 237	$ —	$ 122	$ 14,453
Residential Real Estate	80,232	159	—	1,753	82,144
Indirect	100,453	599	—	129	101,181
Commercial	12,023	—	5	—	12,028
Construction	3,133	—	29	310	3,472
Commercial Real Estate	73,759	—	—	2,371	76,130
	$ 283,694	$ 995	$ 34	$ 4,685	$ 289,408

At December 31, 2017 (dollars in thousands)	Current	30-89 Days Past Due	90 Days or More and Still Accruing	Nonaccrual	Total

Consumer	$ 15,823	$ 80	$ 24	$ 185	$ 16,112
Residential Real Estate	79,205	597	—	2,124	81,926
Indirect	83,932	1,166	—	88	85,186
Commercial	11,203	—	6	48	11,257
Construction	3,188	—	30	318	3,536
Commercial Real Estate	73,088	—	—	507	73,595
	$ 266,439	$ 1,843	$ 60	$ 3,270	$ 271,612

The balances in the above charts have not been reduced by the allowance for loan loss. For the period ending June 30, 2018, the allowance for loan loss is $2.3 million. For the period ending December 31, 2017, the allowance for loan loss is $2.6 million.

At June 30, 2018, there was $1.0 million in loans outstanding, that were in an accrual status, but known information about possible credit problems of borrowers caused management to have doubts as to the ability of such borrowers to comply with present loan repayment terms. Such loans consist of loans which were not 90 days or more past due but where the borrower is in bankruptcy or has a history of delinquency, or the loan to value ratio is considered excessive due to deterioration of the collateral or other factors. The three loans outstanding, totaling $1.0 million are as

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follows: $646,000 Commercial Real Estate loan where the guarantor is in bankruptcy and the loan has an accelerated payoff since we have an assignment of rents from the property which has a very long-term national tenant; $159,000 Home Equity Line of Credit which is paying as agreed, however the borrower has defaulted on other commercial loans which have been satisfied; and a $211,000 Commercial loan with a loan to value ratio which has deteriorated, which has a complete specific reserve of $211,000. All three of these loans are classified with a risk rating of Substandard.

Non-accrual loans with specific reserves at June 30, 2018 are comprised of:

Consumer loans – Two loans to two borrowers in the amount of $96,109 with specific reserves of $26,827 established for the loans.

Below is a summary of the recorded investment amount and related allowance for losses of the Bank's impaired loans at June 30, 2018 and December 31, 2017.

June 30, 2018 (dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Interest Income Recognized	Specific Reserve	Average Recorded Investment
Impaired loans with specific reserves:					
Consumer	$ 96	$ 96	$ 1	$ 27	$ 137
Commercial	211	211	6	211	214
Total impaired loans with specific reserves	307	307	7	238	351
Impaired loans with no specific reserve:					
Residential Real Estate	$ 1,735	$ 2,161	$ 4	$ —	$ 2,871
Indirect	129	129	—	—	—
Construction	228	228	—	—	236
Commercial Real Estate	3,099	3,409	95	—	4,758
Total impaired loans with no specific reserve	$ 5,191	$ 5,927	$ 99	—	$ 7,865

December 31, 2017 (dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Interest Income Recognized	Specific Reserve	Average Recorded Investment
Impaired loans with specific reserves:					
Consumer	$ 160	$ 160	$ 5	$ 52	$ 205
Residential Real Estate	1,294	1,322	—	513	1,312
Commercial	217	217	—	217	223
Total impaired loans with specific reserves	1,671	1,699	5	782	1,740

Impaired loans with no specific reserve:					
Consumer	$ 49	$ 49	$ —	—	$ —
Residential Real Estate	992	1,760	11	—	1,572
Indirect	88	88	—	—	—
Commercial	2	2	—	—	2
Construction	318	318	—	—	322
Commercial Real Estate	1,194	1,194	39	—	1,632
Total impaired loans with no specific reserve	$ 2,643	$ 3,411	$ 50	—	$ 3,528

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(dollars in thousands)	June 30, 2018	December 31, 2017
Troubled debt restructured loans	$ 256	$ 263
Non-accrual and 90+ days past due and still accruing loans to average loans	1.48 %	1.32 %
Allowance for loan losses to nonaccrual & 90+ days past due and still accruing loans	58.6 %	77.7 %

At June 30, 2018, there were two troubled debt restructured loans consisting of a commercial loan of $211,000 and a consumer loan of $45,000. The consumer loan is in a nonaccrual status.

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The following table shows the activity for non-accrual loans for the quarters ended June 30, 2017 and 2018.

(dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Totals
December 31, 2016	403	2,508	193	—	—	647	3,751
Transfers into nonaccrual	4	40	349	—	84	132	609
Loans paid down/payoffs	(67)	(82)	(96)	—	(84)	(6)	(335)
Loans returned to accrual status	—	(132)	(112)	—	—	—	(244)
Loans charged off	(4)	(3)	(247)	—	—	—	(254)
June 30, 2017	336	2,331	87	—	—	773	3,527
December 31, 2017	185	2,124	88	48	318	507	3,270
Transfers into nonaccrual	44	183	305	—	—	2,000	2,532
Loans paid down/payoffs	(15)	(41)	(51)	(48)	(8)	(136)	(299)
Loans returned to accrual status	—	—	(50)	—	—	—	(50)
Loans charged off	(92)	(513)	(163)	—	—	—	(768)
June 30, 2018	122	1,753	129	—	310	2,371	4,685

Other Real Estate Owned. At June 30, 2018, the Company had $114,000 in real estate acquired in partial or total satisfaction of debt, unchanged from $114,000 at December 31, 2017. All such properties are initially recorded at the lower of cost or fair value (net realizable value) at the date acquired and carried on the balance sheet as other real estate owned. Losses arising at the date of acquisition are charged against the allowance for credit losses. Subsequent write-downs that may be required and expense of operation are included in noninterest expense. Gains and losses realized from the sale of other real estate owned are included in noninterest expense.

Credit Quality Information

In addition to monitoring the performance status of the loan portfolio, the Company utilizes a risk rating scale (1-8) to evaluate loan asset quality for all loans. Loans that are rated 1-4 are classified as pass credits. For the pass rated loans, management believes there is a low risk of loss related to these loans and, as necessary, credit may be strengthened through improved borrower performance and/or additional collateral.

The Bank's internal risk ratings are as follows:

1 Superior – minimal risk. (normally supported by pledged deposits, United States government securities, etc.)
2 Above Average - low risk. (all of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
3 Average – moderately low risk. (most of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
4 Acceptable – moderate risk. (the weighted overall risk associated with this credit based on each of the bank's creditworthiness criteria is acceptable)
5 Other Assets Especially Mentioned – moderately high risk. (possesses deficiencies which corrective action by the bank would remedy; potential watch list)

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6 Substandard – (the bank is inadequately protected and there exists the distinct possibility of sustaining some loss if not corrected)
7 Doubtful – (weaknesses make collection or liquidation in full, based on currently existing facts, improbable)
8 Loss – (of little value; not warranted as a bankable asset)

The following table provides information with respect to the Company's credit quality indicators by loan portfolio segment at June 30, 2018:

June 30, 2018 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Total
Pass	$ 14,119	$ 79,828	$ 100,143	$ 11,817	$ 3,472	$ 73,031	$ 282,410
Special mention	187	215	610	—	—	—	1,012
Substandard	146	2,101	355	211	—	3,099	5,912
Doubtful	1	—	73	—	—	—	74
Loss	—	—	—	—	—	—	—
	$ 14,453	$ 82,144	$ 101,181	$ 12,028	$ 3,472	$ 76,130	$ 289,408
Nonaccrual	122	1,753	129	—	310	2,371	4,685
Troubled debt restructures	45	—	—	211	—	—	256
Number of TDRs accounts	1	—	—	1	—	—	2
Non-performing TDRs	45	—	—	—	—	—	45
Number of non-performing TDR accounts	1	—	—	—	—	—	1

December 31, 2017 (dollars in thousands)	Consumer	Residential Real Estate	Indirect	Commercial	Construction	Commercial Real Estate	Total
Pass	$ 15,823	$ 79,060	$ 83,756	$ 11,038	$ 3,218	$ 72,074	$ 264,969
Special mention	77	384	1,027	2	—	327	1,817
Substandard	188	2,482	362	217	318	1,194	4,761
Doubtful	24	—	41	—	—	—	65
Loss	—	—	—	—	—	—	—
	$ 16,112	$ 81,926	$ 85,186	$ 11,257	$ 3,536	$ 73,595	$ 271,612
Nonaccrual	185	2,124	88	48	318	507	3,270
Troubled debt restructures	46	—	—	217	—	—	263

Number of TDRs accounts	1	—	—	1	—	—	2
Non-performing TDRs	46	—	—	—	—	—	46
Number of non-performing TDR accounts	1	—	—	—	—	—	1

NOTE 6 – FAIR VALUE

ASC Topic 820 provides a framework for measuring and disclosing fair value under GAAP. ASC 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial

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recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or a nonrecurring basis (for example, impaired loans).

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Fair Value Hierarchy

ASC 820 10 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with ASC 820 10, these inputs are summarized in the three broad levels listed below:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.
- Level 2 – Other significant observable inputs (including quoted prices in active markets for similar securities)
- Level 3 – Significant unobservable inputs (including the Company's own assumptions in determining the fair value of investments)

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Investment Securities Available-for-Sale. Investment securities available-for-sale and interest rate swap contracts 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 present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage backed securities issued by government sponsored entities, municipal bonds and corporate debt securities, and interest rate swap contracts. Securities classified as Level 3 include asset-backed securities in illiquid markets.

The Bank may be required, from time to time, to measure certain other financial and non-financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP.

Loans. At June 30, 2018, these assets include 22 loans, excluding $168,000 of residential real estate and indirect loans, classified as impaired, which include nonaccrual, past due 90 days or more and still accruing, and a homogeneous pool of indirect loans all considered to be impaired loans, which are valued under Level 3 inputs. Loans which are deemed to be impaired ($5.3 million of loans with $237,000 of specific reserves as of June 30, 2018) and foreclosed real estate assets are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Company is predominantly a cash flow lender with real estate serving as collateral on a majority of loans ($5.0 million of the total impaired loans as of June 30, 2018). On a quarterly basis, the Company determines such fair values through a variety of data points and mostly rely on appraisals from independent appraisers. We obtain an appraisal on properties when they become impaired and have new appraisals at least every year. Typically, these appraisals do not include an inside inspection of the property as our loan documents do not require the borrower to allow access to the property. Therefore the most significant unobservable inputs is the details of the amenities included within the property and the condition of the property. Further, we cannot always accurately assess the amount of time it takes to gain ownership of our collateral through the foreclosure process and the damage, as well as potential looting, of the property further decreasing our value. Thus, in determining the fair values we discount the current independent appraisals, with a range from 0% to 16%, based on individual circumstances. The remaining impaired loans ($475,000

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million with $226,000 of specific reserves as of June 30, 2018) include mobile homes, commercial, consumer, and indirect auto loans, which are valued based on the value of the underlying collateral.

The changes in the assets subject to fair value measurements are summarized below by level:

(dollars in thousands)	Level 1	Level 2	Level 3	Fair Value
June 30, 2018				
Recurring:				
Securities available for sale				
Collateralized mortgage obligations	$ —	$ 22,018	$ —	$ 22,018
Agency mortgage-backed securities	—	27,003	—	27,003
Municipal securities	—	34,872	—	34,872
U.S. Government agency securities	—	1,935	—	1,935
U.S. Treasury securities	—	1,486	—	1,486
Interest rate swap	—	431	—	431
Non-recurring:				
Maryland Financial Bank stock	—	—	30	30
Impaired loans	—	—	5,260	5,260
OREO	—	114	—	114
	$ —	$ 87,859	$ 5,290	$ 93,149
December 31, 2017				
Recurring:				
Securities available for sale				
Collateralized mortgage obligations	$ —	$ 23,514	$ —	$ 23,514
Agency mortgage-backed securities	—	25,229	—	25,229
Municipal securities	—	35,633	—	35,633
U.S. Government agency securities	—	3,480	—	3,480
U.S. Treasury securities	—	1,493	—	1,493
Non-recurring:				
Maryland Financial Bank stock	—	—	30	30
Impaired loans	—	—	3,532	3,532
OREO	—	114	—	114
	$ —	$ 89,463	$ 3,562	$ 93,025

The estimated fair values of the Company’s financial instruments at June 30, 2018 and December 31, 2017 are summarized below. The fair values of a significant portion of these financial instruments are estimates derived using present value techniques and may not be indicative of the net realizable or liquidation values. Also, the calculation of

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estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

(dollars in thousands)	June 30, 2018 Carrying Amount	Fair Value	December 31, 2017 Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	$ 2,584	$ 2,584	$ 2,610	$ 2,610
Interest-bearing deposits in other financial institutions	5,498	5,498	9,846	9,846
Federal funds sold	197	197	149	149
Investment securities available for sale	87,314	87,314	89,349	89,349
Investments in restricted stock	1,443	1,443	1,232	1,232
Ground rents	150	150	153	153
Loans, less allowance for credit losses	287,124	285,394	269,023	275,819
Accrued interest receivable	1,142	1,142	1,133	1,133
Cash value of life insurance	7,780	7,780	8,713	8,713
Financial liabilities:				
Deposits	341,807	319,687	334,238	324,512
Long-term borrowings	—	—	—	—
Short-term borrowings	25,000	25,110	20,000	20,739
Accrued interest payable	136	136	101	101
Unrecognized financial instruments:				
Commitments to extend credit	33,796	33,796	19,109	19,109
Standby letters of credit	1,025	1,025	71	71

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments.

(dollars in thousands)

June 30, 2018	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial instruments - Assets					
Cash and cash equivalents	$ 8,279	$ 8,279	$ 8,279	—	$ —
Loans receivable, net	287,124	285,394	—	—	285,394
Cash value of life insurance	7,780	7,780	—	7,780	—
Financial instruments - Liabilities					
Deposits	341,807	319,687	—	319,687	—
Short-term debt	25,000	25,110	—	25,110	—

Fair values are based on quoted market prices for similar instruments or estimated using discounted cash flows. The discounts used are estimated using comparable market rates for similar types of instruments adjusted to be commensurate with the credit risk, overhead costs and optionality of such instruments.

The fair value of cash and due from banks, federal funds sold, investments in restricted stocks and accrued interest receivable are equal to the carrying amounts. The fair values of investment securities are determined using market quotations. The fair value of loans receivable is estimated using discounted cash flow analysis.

The fair value of non-interest bearing deposits, interest-bearing checking, savings, and money market deposit accounts, securities sold under agreements to repurchase, and accrued interest payable are equal to the carrying amounts. The fair value of fixed-maturity time deposits is estimated using discounted cash flow analysis.

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NOTE 7 – RECENT ACCOUNTING PRONOUNCEMENTS

The FASB has issued several exposure drafts which, if adopted, would significantly alter the Company's (and all other financial institutions') method of accounting for, and reporting, its financial assets and some liabilities from a historical cost method to a fair value method of accounting as well as the reported amount of net interest income. The Company has not determined the extent of the possible changes at this time. The exposure drafts are in different stages of review, approval and possible adoption.

ASU 2014 09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014 09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014 09 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. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014 09 was effective for the Company on January 1, 2018 and did not have a significant impact on our financial statements.