EMCLAIRE FINANCIAL CORP
Form 10-Q
August 12, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2016**

or

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

For the transition period from _____________ to _____________

Commission File Number: **001-34527**

EMCLAIRE FINANCIAL CORP
(Exact name of registrant as specified in its charter)

Pennsylvania	25-1606091
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

612 Main Street, Emlenton, Pennsylvania 16373
(Address of principal executive offices) (Zip Code)

(844) 767-2311
(Registrant's telephone number)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company as defined in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

The number of shares outstanding of the Registrant's common stock was 2,146,308 at August 12, 2016.

EMCLAIRE FINANCIAL CORP

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PART I - FINANCIAL INFORMATION

Item 1. Interim Financial Statements

Emclaire Financial Corp

Consolidated Balance Sheets (Unaudited)

As of June 30, 2016 and December 31, 2015

(Dollar amounts in thousands, except share and per share data)

	June 30, 2016	December 31, 2015
Assets		
Cash and due from banks	$3,015	$ 2,359
Interest earning deposits with banks	35,546	9,187
Cash and cash equivalents	38,561	11,546
Securities available for sale	106,145	112,981
Loans receivable, net of allowance for loan losses of $5,431 and $5,205	498,724	429,891
Federal bank stocks, at cost	3,764	4,240
Bank-owned life insurance	11,221	11,056
Accrued interest receivable	1,837	1,501
Premises and equipment, net	17,125	16,114
Goodwill	10,291	3,664
Core deposit intangible, net	681	554
Prepaid expenses and other assets	9,276	9,048
Total Assets	$697,625	$ 600,595
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing	$122,793	$ 119,790
Interest bearing	474,093	370,097
Total deposits	596,886	489,887
Short-term borrowed funds	2,500	14,250
Long-term borrowed funds	35,000	35,000

Accrued interest payable	254	179
Accrued expenses and other liabilities	8,134	8,440
Total Liabilities	642,774	547,756
Commitments and Contingent Liabilities	-	-
Stockholders' Equity:		
Common stock, $1.25 par value, 12,000,000 shares authorized; 2,248,325 and 2,246,825 shares issued; 2,146,308 and 2,144,808 shares outstanding, respectively	2,810	2,808
Additional paid-in capital	27,809	27,701
Treasury stock, at cost; 102,017 shares	(2,114)	(2,114)
Retained earnings	28,822	28,206
Accumulated other comprehensive loss	(2,476)	(3,762)
Total Stockholders' Equity	54,851	52,839
Total Liabilities and Stockholders' Equity	$697,625	$ 600,595

See accompanying notes to consolidated financial statements.

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Emclaire Financial Corp

Consolidated Statements of Net Income (Unaudited)

For the three and six months ended June 30, 2016 and 2015

(Dollar amounts in thousands, except share and per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Interest and dividend income:				
Loans receivable, including fees	$ 5,185	$ 4,470	$ 9,887	$ 8,670
Securities:				
Taxable	441	520	874	1,045
Exempt from federal income tax	156	214	316	435
Federal bank stocks	52	29	87	102
Interest earning deposits with banks	43	19	62	34
Total interest and dividend income	5,877	5,252	11,226	10,286
Interest expense:				
Deposits	721	535	1,309	1,082
Borrowed funds	296	177	540	359
Total interest expense	1,017	712	1,849	1,441
Net interest income	4,860	4,540	9,377	8,845
Provision for loan losses	121	203	302	371
Net interest income after provision for loan losses	4,739	4,337	9,075	8,474
Noninterest income:				
Fees and service charges	386	378	731	726
Commissions on financial services	-	5	1	10
Title premiums	8	6	19	17
Net gain on sales of available for sale securities	81	34	83	34
Earnings on bank-owned life insurance	100	97	198	194
Other	367	328	690	646
Total noninterest income	942	848	1,722	1,627
Noninterest expense:				
Compensation and employee benefits	2,177	2,050	4,225	4,118
Premises and equipment	692	655	1,378	1,324
Intangible asset amortization	56	49	105	98
Professional fees	190	178	373	380

Federal deposit insurance	89	98	182	195
Acquisition costs	92	-	401	-
Other	1,168	981	1,818	1,861
Total noninterest expense	4,464	4,011	8,482	7,976
Income before provision for income taxes	1,217	1,174	2,315	2,125
Provision for income taxes	287	247	583	417
Net income	930	927	1,732	1,708
Preferred stock dividends	-	25	-	50
Net income available to common stockholders	$ 930	$ 902	$ 1,732	$ 1,658
Basic earnings per common share	$ 0.43	$ 0.48	$ 0.81	$ 0.91
Diluted earnings per common share	0.43	0.48	0.80	0.90
Average common shares outstanding - basic	2,146,160	1,864,298	2,145,484	1,823,086
Average common shares outstanding - diluted	2,156,378	1,876,260	2,154,708	1,834,387

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp

Consolidated Statements of Comprehensive Income (Unaudited)

For the three and six months ended June 30, 2016 and 2015

(Dollar amounts in thousands)

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Net income	$ 930	$ 927	$ 1,732	$ 1,708
Other comprehensive income (loss)				
Unrealized gains/(losses) on securities:				
Unrealized holding gain/(loss) arising during the period	699	(1,256)	2,030	(218)
Reclassification adjustment for gains included in net income	(81)	(34)	(83)	(34)
	618	(1,290)	1,947	(252)
Tax effect	(210)	439	(662)	86
Net of tax	408	(851)	1,285	(166)
Comprehensive income	$ 1,338	$ 76	$ 3,017	$ 1,542

See accompanying notes to consolidated financial statements.

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Emclaire Financial Corp

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the six months ended June 30, 2016 and 2015

(Dollar amounts in thousands)

	For the six months ended June 30, 2016			2015		
Cash flows from operating activities						
Net income	$	1,732		$	1,708	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization		550			500	
Provision for loan losses		302			371	
Amortization of premiums, net		176			166	
Amortization of intangible assets and mortgage servicing rights		115			98	
Realized gains on sales of available for sale securities, net		(83	)		(34	)
Net gains on foreclosed real estate		(10	)		(18	)
Write-down of foreclosed real estate		-			6	
Stock compensation expense		111			108	
Increase in bank-owned life insurance, net		(165	)		(162	)
Increase in accrued interest receivable		(102	)		(5	)
		75			(2,997	)

(Increase) decrease in prepaid expenses and other assets		
Increase (decrease) in accrued interest payable	46	(12)
Decrease in accrued expenses and other liabilities	(702)	(237)
Net cash provided by (used in) operating activities	2,045	(508)
Cash flows from investing activities		
Loan originations and principal collections, net	3,604	864
Purchase of residential mortgage loans	(6,911)	(14,647)
Settlement of syndicated national credits	-	(7,039)
Available for sale securities:		
Sales	6,118	1,791
Maturities, repayments and calls	11,060	12,701
Purchases	(8,258)	(11,555)
Net cash paid for acquisition	(3,309)	-
Redemption (purchase) of federal bank stocks	1,454	(106)
Proceeds from the sale of foreclosed real estate	171	102
Purchases of premises and equipment	(392)	(404)
Net cash provided by (used in) investing activities	3,537	(18,293)
Cash flows from financing activities		
Net increase in deposits	34,299	10,593
Repayments on Federal Home Loan Bank advances	(5,000)	-

Proceeds from other long-term debt		5,000			-	
Net change in short-term borrowings		(11,750	)		1,000	
Proceeds from exercise of stock options, including tax benefit		-			4	
Dividends paid		(1,116	)		(905	)
Proceeds from the issuance of common stock		-			8,162	
Net cash provided by financing activities		21,433			18,854	
Increase in cash and cash equivalents		27,015			53	
Cash and cash equivalents at beginning of period		11,546			11,856	
Cash and cash equivalents at end of period	$	38,561		$	11,909	
Supplemental information:						
Interest paid	$	942		$	1,453	
Income taxes paid		-			525	
Supplemental noncash disclosure:						
Transfers from loans to foreclosed real estate		147			263	

See accompanying notes to consolidated financial statements.

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Emclaire Financial Corp

Consolidated Statements of Changes in Stockholders’ Equity (Unaudited)

For the three and six months ended June 30, 2016 and 2015

(Dollar amounts in thousands, except per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Balance at beginning of period	$ 54,007	$ 49,061	$ 52,839	$ 47,990
Net income	930	927	1,732	1,708
Other comprehensive income (loss)	408	(851)	1,285	(166)
Stock compensation expense	64	55	111	108
Dividends declared on preferred stock	-	(25)	-	(50)
Dividends declared on common stock	(558)	(428)	(1,116)	(855)
Exercise of stock options, including tax benefit	-	-	-	4
Issuance of common stock (350,000 shares)	-	8,162	-	8,162
Balance at end of period	$ 54,851	$ 56,901	$ 54,851	$ 56,901
Cash dividend per common share	$ 0.26	$ 0.24	$ 0.52	$ 0.48

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp

Notes to Consolidated Financial Statements (Unaudited)

1. Nature of Operations and Basis of Presentation

Emclaire Financial Corp (the Corporation) is a Pennsylvania corporation and the holding company of The Farmers National Bank of Emlenton (the Bank) and Emclaire Settlement Services, LLC (the Title Company). The Corporation provides a variety of financial services to individuals and businesses through its offices in Western Pennsylvania. Its primary deposit products are checking, savings and term certificate accounts and its primary lending products are residential and commercial mortgages, commercial business loans and consumer loans.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries, the Bank and the Title Company. All significant intercompany transactions and balances have been eliminated in preparing the consolidated financial statements.

The accompanying unaudited consolidated financial statements for the interim periods include all adjustments, consisting of normal recurring accruals, which are necessary, in the opinion of management, to fairly reflect the Corporation’s consolidated financial position and results of operations. Additionally, these consolidated financial statements for the interim periods have been prepared in accordance with instructions for the Securities and Exchange Commission’s (SEC’s) Form 10-Q and Article 10 of Regulation S-X and therefore do not include all information or footnotes necessary for a complete presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (GAAP). For further information, refer to the audited consolidated financial statements and footnotes thereto for the year ended December 31, 2015, as contained in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC.

The balance sheet at December 31, 2015 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements.

The preparation of financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim quarterly or year-to-date periods are not necessarily indicative of the results that may be expected for the entire year or any other period. Certain amounts previously reported may have been reclassified to conform to the current year’s financial statement presentation.

2. Mergers and Acquisitions

On April 30, 2016, the Corporation completed its acquisition of United American Savings Bank (United American) in accordance with the terms of the Agreement and Plan of Merger, dated as of December 30, 2015, by and among the Corporation, the Bank and United American (the Merger Agreement). Pursuant to the Merger Agreement, the Corporation acquired United American through a reverse merger of a newly created, wholly-owned subsidiary of the Bank into United American. Immediately after the merger, United American merged with and into The Farmers National Bank of Emlenton, with The Farmers National Bank of Emlenton being the surviving bank. At December 31, 2015, United American had reported assets of $89.3 million. The Corporation acquired all of the outstanding shares of common stock of United American for cash consideration of $13.2 million ($42.67 per share).

The acquisition expanded the Corporation's franchise into contiguous markets and increased the Corporation's consolidated total assets, loans and deposits.

The assets and liabilities of United American were recorded on the Corporation's consolidated balance sheet at their estimated fair value as of April 30, 2016, and their results of operations have been included in the consolidated income statement since such date.

2. Mergers and Acquisitions (continued)

Included in the purchase price was goodwill and a core deposit intangible of $6.6 million and $232,000, respectively. Goodwill is the excess of the purchase price over the fair value of the net assets acquired and is the result of expected operational synergies and other factors. This goodwill is not expected to be deductible for tax purposes. The goodwill will not be amortized, but will be measured annually for impairment or more frequently if circumstances require. The core deposit intangible will be amortized over a weighted average estimated life of ten years using the double declining balance method. Core deposit intangible expense projected for the succeeding five years beginning 2016 is estimated to be $31,000, $40,000, $32,000, $26,000 and $20,000 per year, respectively, and $83,000 in total for years after 2020.

While the Corporation believes that the accounting for the acquisition is complete, accounting guidance allows for adjustments to goodwill for a period of up to one year after the acquisition date for information that becomes available that reflects circumstances at the acquisition date. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed:

(Dollar amounts in thousands)	
Assets acquired:	
Cash and cash equivalents	$9,899
Securities available for sale	60
Loans receivable	66,145
Federal bank stocks	978
Accrued interest receivable	234
Premises and equipment	1,169
Goodwill	6,626
Core deposit intangible	232
Prepaid expenses and other assets	989
Total assets acquired	86,332
Liabilities assumed:	
Deposits	72,700
Accrued interest payable	29
Accrued expenses and other liabilities	395
Total liabilities assumed	73,124
Consideration paid	$13,208

The fair value of loans was determined using discounted cash flows. The book balance of the loans at the time of the acquisition was $66.1 million before considering United American's allowance for loan losses, which was not carried over. The fair value disclosed above reflects a credit-related adjustment of $(927,000) and an adjustment for other factors of $982,000. Loans evidencing credit deterioration since origination (purchased credit impaired loans) included in loans receivable were immaterial.

Costs related to the acquisition totaled $92,000 for the three months ended June 30, 2016. These costs included legal fees, system conversion costs and other professional fees of $50,000, $32,000 and $10,000, respectively. For the six months ended June 30, 2016, costs related to the acquisition totaled $401,000 including legal fees, system conversion costs and other costs of $194,000, $132,000 and $75,000, respectively.

3. Issuance of Common Stock

On June 10, 2015, the Corporation sold 350,000 shares of common stock, par value of $1.25 per share, in a private offering to accredited individual and institutional investors at $23.50 per share. The Corporation realized $8.2 million in proceeds from the offering, net of $63,000 of direct costs relating to the offering.

4. Participation in the Small Business Lending Fund (SBLF) of the U.S. Treasury Department (U.S. Treasury)

On August 18, 2011, the Corporation entered into a Securities Purchase Agreement (the Agreement) with the U.S. Treasury Department, pursuant to which the Corporation issued and sold to the U.S. Treasury 10,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), having a liquidation preference of $1,000 per share, for aggregate proceeds of $10.0 million, pursuant to the U.S. Treasury's SBLF program. On September 17, 2013, with the approval of the Corporation's primary federal banking regulator, the Corporation redeemed 5,000 shares, or 50%, of its Series B Preferred Stock held by the U.S. Treasury at an aggregate redemption price of $5.0 million, plus accrued but unpaid dividends. On September 30, 2015, the Corporation redeemed the remaining 5,000 shares of its Series B Preferred Stock held by the U.S. Treasury at an aggregate redemption price of $5.0 million, plus accrued but unpaid dividends. Following this redemption, the Corporation does not have any Series B Preferred Stock outstanding.

5. Earnings per Common Share

Basic earnings per common share (EPS) excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS includes the dilutive effect of additional potential common shares for assumed issuance of restricted stock and shares issued under stock options.

The factors used in the Corporation's earnings per common share computation follow:

	For the three months ended		For the six months ended	
(Dollar amounts in thousands, except for per share amounts)	June 30,		June 30,	
	2016	2015	2016	2015
Earnings per common share - basic				
Net income	$930	$927	$1,732	$1,708
Less: Preferred stock dividends	-	25	-	50
Net income available to common stockholders	$930	$902	$1,732	$1,658
Average common shares outstanding	2,146,160	1,864,298	2,145,484	1,823,086
Basic earnings per common share	$0.43	$0.48	$0.81	$0.91
Earnings per common share - diluted				
Net income available to common stockholders	$930	$902	$1,732	$1,658
Average common shares outstanding	2,146,160	1,864,298	2,145,484	1,823,086
	10,218	11,962	9,224	11,301

Add: Dilutive effects of assumed issuance of restricted stock and exercise of stock options				
Average shares and dilutive potential common shares	2,156,378	1,876,260	2,154,708	1,834,387
Diluted earnings per common share	$0.43	$0.48	$0.80	$0.90
Stock options not considered in computing earnings per share because they were antidilutive	67,000	67,000	67,000	67,000

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6. Securities

The following table summarizes the Corporation's securities as of June 30, 2016 and December 31, 2015:

(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale:				
June 30, 2016:				
U.S. Treasury and federal agency	$ 1,493	$ 19	$ -	$ 1,512
U.S. government sponsored entities and agencies	8,401	7	(1)	8,407
U.S. agency mortgage-backed securities: residential	28,542	962	-	29,504
U.S. agency collateralized mortgage obligations: residential	28,321	50	(260)	28,111
State and political subdivisions	27,972	532	-	28,504
Corporate debt securities	8,014	44	-	8,058
Equity securities	1,829	238	(18)	2,049
	$ 104,572	$ 1,852	$ (279)	$ 106,145
December 31, 2015:				
U.S. Treasury and federal agency	$ 1,493	$ -	$ (27)	$ 1,466
U.S. government sponsored entities and agencies	8,998	2	(47)	8,953
U.S. agency mortgage-backed securities: residential	32,947	256	(53)	33,150
U.S. agency collateralized mortgage obligations: residential	32,289	23	(872)	31,440
State and political subdivisions	28,352	264	(25)	28,591
Corporate debt securities	7,507	1	(21)	7,487
Equity securities	1,769	188	(63)	1,894
	$ 113,355	$ 734	$ (1,108)	$ 112,981

The following table summarizes scheduled maturities of the Corporation's debt securities as of June 30, 2016. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations are not due at a single maturity and are shown separately.

	Available for sale	
(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 1,711	$ 1,716
Due after one year through five years	16,342	16,480
Due after five through ten years	27,088	27,532
Due after ten years	739	753

Mortgage-backed securities: residential	28,542	29,504
Collateralized mortgage obligations: residential	28,321	28,111
	$102,743	$104,096

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6. Securities (continued)

Information pertaining to securities with gross unrealized losses at June 30, 2016 and December 31, 2015, aggregated by investment category and length of time that individual securities have been in a continuous loss position are included in the table below:

(Dollar amounts in thousands)	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
June 30, 2016:						
U.S. government sponsored entities and agencies	$1,000	$ (1)	$-	$ -	$1,000	$ (1)
U.S. agency collateralized mortgage obligations: residential	2,218	(65)	13,241	(195)	15,459	(260)
Equity securities	232	(18)	-	-	232	(18)
	$3,450	$ (84)	$13,241	$ (195)	$16,691	$ (279)
December 31, 2015:						
U.S. Treasury and federal agency	$-	$ -	$1,466	$ (27)	$1,466	$ (27)
U.S. government sponsored entities and agencies	4,962	(36)	1,989	(11)	6,951	(47)
U.S. agency mortgage-backed securities: residential	6,710	(53)	-	-	6,710	(53)
U.S. agency collateralized mortgage obligations: residential	4,283	(41)	25,336	(831)	29,619	(872)
State and political subdivisions	1,028	(2)	1,819	(23)	2,847	(25)
Corporate debt securities	3,484	(20)	500	(1)	3,984	(21)
Equity securities	1,137	(63)	-	-	1,137	(63)
	$21,604	$ (215)	$31,110	$ (893)	$52,714	$ (1,108)

Gains on sales of available for sale securities for the three and six months ended June 30 were as follows:

(Dollar amounts in thousands)	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Proceeds	$2,439	$1,791	$6,118	$1,791
Gains	81	34	83	34
Tax provision related to gains	28	12	28	12

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other conditions warrant such evaluation. Consideration is given to: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will be required to sell the security before its anticipated recovery, the Corporation records an other-than-temporary loss in an amount equal to the entire difference between fair value and amortized cost. Otherwise, only the credit portion of the estimated loss on debt securities is recognized in earnings, with the other portion of the loss recognized in other comprehensive income. For equity securities determined to be other-than-temporarily impaired, the entire amount of impairment is recognized through earnings.

6. Securities (continued)

There was one equity security in an unrealized loss position for less than 12 months as of June 30, 2016. Equity securities owned by the Corporation consist of common stock of various financial service providers. The investment security is in unrealized loss positions as a result of recent market volatility. The Corporation does not invest in these securities with the intent to sell them for a profit in the near term. For investments in equity securities, in addition to the general factors mentioned above for determining whether the decline in market value is other-than-temporary, the analysis of whether an equity security is other-than-temporarily impaired includes a review of the profitability, capital adequacy and other relevant information available to determine the financial position and near term prospects of each issuer. The results of analyzing the aforementioned metrics and financial fundamentals suggest recovery of amortized cost as the sector improves. Based on that evaluation, and given that the Corporation's current intention is not to sell any impaired security and it is more likely than not it will not be required to sell this security before the recovery of its amortized cost basis, the Corporation does not consider the equity security with an unrealized loss as of June 30, 2016 to be other-than-temporarily impaired.

There were 14 debt securities in an unrealized loss position as of June 30, 2016, of which 11 were in an unrealized loss position for more than 12 months. Of these 14 securities, 13 were government-backed collateralized mortgage obligations and 1 was a U.S. government sponsored entity and agency security. The unrealized losses associated with these securities were not due to the deterioration in the credit quality of the issuer that would likely result in the non-collection of contractual principal and interest, but rather have been caused by a rise in interest rates from the time the securities were purchased. Based on that evaluation and other general considerations, and given that the Corporation's current intention is not to sell any impaired securities and it is more likely than not it will not be required to sell these securities before the recovery of its amortized cost basis, the Corporation does not consider the debt securities with unrealized losses as of June 30, 2016 to be other-than-temporarily impaired.

7. Loans Receivable and Related Allowance for Loan Losses

The Corporation's loans receivable as of the respective dates are summarized as follows:

(Dollar amounts in thousands)	June 30, 2016	December 31, 2015
Mortgage loans on real estate:		
Residential first mortgages	$184,414	$ 139,305
Home equity loans and lines of credit	91,604	87,410
Commercial real estate	154,890	129,691
	430,908	356,406
Other loans:		
Commercial business	66,197	71,948

Consumer	7,050	6,742
	73,247	78,690
Total loans, gross	504,155	435,096
Less allowance for loan losses	5,431	5,205
Total loans, net	$498,724	$ 429,891

Included in total loans above are net deferred costs of $1.2 million and $835,000 at June 30, 2016 and December 31, 2015, respectively.

An allowance for loan losses (ALL) is maintained to absorb probable incurred 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 nonperforming loans.

7. Loans Receivable and Related Allowance for Loan Losses (continued)

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 following table details activity in the ALL and the recorded investment by portfolio segment based on impairment method:

(Dollar amounts in thousands)

	Residential Mortgages	Home Equity & Lines of Credit	Commercial Real Estate	Commercial Business	Consumer	Total
Three months ended June 30, 2016:						
Allowance for loan losses:						
Beginning Balance	$ 1,577	$ 636	$ 1,926	$ 1,162	$ 51	$ 5,352
Charge-offs	(8)	(33)	-	-	(6)	(47)
Recoveries	-	1	3	-	1	5
Provision	127	41	189	(242)	6	121
Ending Balance	$ 1,696	$ 645	$ 2,118	$ 920	$ 52	$ 5,431
Six months ended June 30, 2016:						
Allowance for loan losses:						
Beginning Balance	$ 1,429	$ 586	$ 2,185	$ 960	$ 45	$ 5,205
Charge-offs	(40)	(33)	-	-	(15)	(88)
Recoveries	-	1	7	-	4	12
Provision	307	91	(74)	(40)	18	302
Ending Balance	$ 1,696	$ 645	$ 2,118	$ 920	$ 52	$ 5,431
At June 30, 2016:						
Ending ALL balance attributable to loans:						
Individually evaluated for impairment	$ 19	$ -	$ -	$ -	$ -	$ 19
Collectively evaluated for impairment	1,677	645	2,118	920	52	5,412
Total	$ 1,696	$ 645	$ 2,118	$ 920	$ 52	$ 5,431
Total loans:						
Individually evaluated for impairment	$ 136	$ -	$ 823	$ 690	$ -	$ 1,649
Acquired loans	29,818	6,266	30,386	1,505	300	68,275
Collectively evaluated for impairment	154,460	85,338	123,681	64,002	6,750	434,231

Total	$ 184,414	$ 91,604	$ 154,890	$ 66,197	$ 7,050	$ 504,155
At December 31, 2015:						
Ending ALL balance attributable to loans:						
Individually evaluated for impairment	$ 29	$ -	$ 5	$ 76	$ -	$ 110
Collectively evaluated for impairment	1,400	586	2,180	884	45	5,095
Total	$ 1,429	$ 586	$ 2,185	$ 960	$ 45	$ 5,205
Total loans:						
Individually evaluated for impairment	$ 169	$ -	$ 839	$ 999	$ -	$ 2,007
Collectively evaluated for impairment	139,136	87,410	128,852	70,949	6,742	433,089
Total	$ 139,305	$ 87,410	$ 129,691	$ 71,948	$ 6,742	$ 435,096
Three months ended June 30, 2015:						
Allowance for loan losses:						
Beginning Balance	$ 1,088	$ 611	$ 2,233	$ 1,360	$ 48	$ 5,340
Charge-offs	-	(22)	-	(182)	(6)	(210)
Recoveries	-	25	6	-	6	37
Provision	170	8	(78)	104	(1)	203
Ending Balance	$ 1,258	$ 622	$ 2,161	$ 1,282	$ 47	$ 5,370
Six months ended June 30, 2015:						
Allowance for loan losses:						
Beginning Balance	$ 955	$ 543	$ 2,338	$ 1,336	$ 52	$ 5,224
Charge-offs	(4)	(85)	-	(182)	(29)	(300)
Recoveries	-	30	12	20	13	75
Provision	307	134	(189)	108	11	371
Ending Balance	$ 1,258	$ 622	$ 2,161	$ 1,282	$ 47	$ 5,370

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7. Loans Receivable and Related Allowance for Loan Losses (continued)

The allowance for loan losses is based on estimates and actual losses may 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.

At June 30, 2016, there was no allowance for loan losses allocated to loans acquired in the April 2016 merger with United American.

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 June 30, 2016:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of June 30, 2016			For the three months ended June 30, 2016		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 78	$ 78	$ 19	$ 78	$ 1	$ 1
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial business	-	-	-	315	-	-
Consumer	-	-	-	-	-	-
Total	$ 78	$ 78	$ 19	$ 393	$ 1	$ 1

For the six months ended June 30, 2016		
Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period

Residential first\ mortgages	$ 109	$ 2	$ 2
Home equity and lines of credit	-	-	-
Commercial real estate	31	-	-
Commercial business	517	-	-
Consumer	-	-	-
Total	$ 657	$ 2	$ 2

Impaired Loans with No Specific Allowance

	As of June 30, 2016		For the three months ended June 30, 2016		
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 91	$ 58	$ 58	$ -	$ -
Home equity and lines of credit	-	-	-	-	-
Commercial real estate	1,222	823	840	-	-
Commercial business	690	690	382	1	1
Consumer	-	-	-	-	-
Total	$ 2,003	$ 1,571	$ 1,280	$ 1	$ 1

	For the six months ended June 30, 2016		
	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 38	$ 2	$ 2
Home equity and lines of credit	-	-	-
Commercial real estate	809	1	1
Commercial business	280	1	1
Consumer	-	-	-
Total	$ 1,127	$ 4	$ 4

7. Loans Receivable and Related Allowance for Loan Losses (continued)

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 December 31, 2015:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of December 31, 2015			For the year ended December 31, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 169	$ 169	$ 29	$ 170	$ 6	$ 6
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	93	93	5	1,613	12	9
Commercial business	923	923	76	1,641	112	99
Consumer	-	-	-	-	-	-
Total	$ 1,185	$ 1,185	$ 110	$ 3,424	$ 130	$ 114

	Impaired Loans with No Specific Allowance				
	As of December 31, 2015		For the year ended December 31, 2015		
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ -	$ -	$ 45	$ 7	$ 7
Home equity and lines of credit	-	-	-	-	-
Commercial real estate	1,145	746	1,069	49	40
Commercial business	76	76	66	3	3
Consumer	-	-	-	-	-
Total	$ 1,221	$ 822	$ 1,180	$ 59	$ 50

7. Loans Receivable and Related Allowance for Loan Losses (continued)

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 June 30, 2016:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of June 30, 2015			For the three months ended June 30, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$169	$ 169	$ 27	$170	$ 2	$ 2
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	3,538	2,597	216	2,603	49	41
Commercial business	1,159	1,159	342	1,859	118	106
Consumer	-	-	-	-	-	-
Total	$4,866	$ 3,925	$ 585	$4,632	$ 169	$ 149

	For the six months ended June 30, 2015		
	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$170	$ 4	$ 4
Home equity and lines of credit	-	-	-
Commercial real estate	2,627	49	41
Commercial business	2,113	118	106
Consumer	-	-	-
Total	$4,910	$ 171	$ 151

Impaired Loans with No Specific Allowance

	As of June 30, 2015	For the three months ended June 30, 2015

	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ -	$ -	$ 55	$ 7	$ 7
Home equity and lines of credit	-	-	-	-	-
Commercial real estate	805	406	608	1	1
Commercial business	73	73	62	-	-
Consumer	-	-	-	-	-
Total	$ 878	$ 479	$ 725	$ 8	$ 8

	For the six months ended June 30, 2015		
	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 75	$ 7	$ 7
Home equity and lines of credit	-	-	-
Commercial real estate	690	6	6
Commercial business	58	2	2
Consumer	-	-	-
Total	$ 823	$ 15	$ 15

Unpaid principal balance includes any loans that have been partially charged off but not forgiven. Accrued interest is not included in the recorded investment in loans presented above or in the tables that follow based on the amounts not being material.

7. Loans Receivable and Related Allowance for Loan Losses (continued)

Troubled debt restructurings (TDR). The Corporation has certain loans that have been modified in order to maximize collection of loan balances. If, for economic or legal reasons related to the customer's financial difficulties, management grants a concession compared to the original terms and conditions of the loan that it would not have otherwise considered, the modified loan is classified as a TDR. Concessions related to TDRs generally do not include forgiveness of principal balances. The Corporation generally does not extend additional credit to borrowers with loans classified as TDRs.

At June 30, 2016 and December 31, 2015, the Corporation had $406,000 and $835,000, respectively, of loans classified as TDRs, which are included in impaired loans above. The Corporation had allocated $19,000 and $63,000 of specific allowance for these loans at June 30, 2016 and December 31, 2015, respectively.

During the three and six month periods ended June 30, 2016, the Corporation modified one home equity loan with a recorded investment of $10,000 due to a bankruptcy order. At June 30, 2016, the Corporation did not have any allowance for loan losses allocated to this specific loan. The modification did not have a material impact on the Corporation's income statement during the periods. During the three and six month periods ended June 30, 2015, the Corporation did not modify any loans as TDRs.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms. During the three and six month periods ended June 30, 2016, the Corporation did not have any loans which were modified as TDRs for which there was a payment default within twelve months following the modification. During the three and six month periods ended June 30, 2015, there was a default on one $90,000 residential mortgage loan within 12 months following modification. The default did not have a material impact on the Corporation's income statement during the periods.

Credit Quality Indicators. Management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors.

Commercial real estate and commercial business loans not identified as impaired are evaluated as risk rated pools of loans utilizing a risk rating practice that is supported by a quarterly special asset review. In this review process, strengths and weaknesses are identified, evaluated and documented for each criticized and classified loan and borrower, strategic action plans are developed, risk ratings are confirmed and the loan's performance status is reviewed.

Management has determined certain portions of the loan portfolio to be homogeneous in nature and assigns like reserve factors for the following loan pool types: residential real estate, home equity loans and lines of credit, and consumer installment and personal lines of credit.

The reserve allocation for risk rated loan pools is developed by applying the following factors:

Historic: Management utilizes a computer model to develop the historical net charge-off experience which is used to formulate the assumptions employed in the migration analysis applied to estimate losses in the portfolio. Outstanding balance and charge-off information are input into the model and historical loss migration rate assumptions are developed to apply to pass, special mention, substandard and doubtful risk rated loans. A twelve-quarter rolling weighted-average is utilized to estimate probable incurred losses in the portfolios.

Qualitative: Qualitative adjustment factors for pass, special mention, substandard and doubtful ratings are developed and applied to risk rated loans to allow for: quality of lending policies and procedures; national and local economic and business conditions; changes in the nature and volume of the portfolio; experiences, ability and depth of lending management; changes in trends, volume and severity of past due, nonaccrual and classified loans and loss and recovery trends; quality of loan review systems; concentrations of credit and other external factors.

7. Loans Receivable and Related Allowance for Loan Losses (continued)

Management uses the following definitions for risk ratings:

Pass: Loans classified as pass typically exhibit good payment performance and have underlying borrowers with acceptable financial trends where repayment capacity is evident. These borrowers typically would have a sufficient cash flow that would allow them to weather an economic downturn and the value of any underlying collateral could withstand a moderate degree of depreciation due to economic conditions.

Special Mention: Loans classified as special mention are characterized by potential weaknesses that could jeopardize repayment as contractually agreed. These loans may exhibit adverse trends such as increasing leverage, shrinking profit margins and/or deteriorating cash flows. These borrowers would inherently be more vulnerable to the application of economic pressures.

Substandard: Loans classified as substandard exhibit weaknesses that are well-defined to the point that repayment is jeopardized. Typically, the Corporation is no longer adequately protected by both the apparent net worth and repayment capacity of the borrower.

Doubtful: Loans classified as doubtful have advanced to the point that collection or liquidation in full, on the basis of currently ascertainable facts, conditions and value, is highly questionable or improbable.

The following table presents the classes of the loan portfolio summarized by the aggregate pass and the criticized categories of special mention, substandard and doubtful within the Corporation's internal risk rating system as of June 30, 2016 and December 31, 2015:

(Dollar amounts in thousands)

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2016:						
Residential first mortgages	$ 182,961	$ -	$ -	$ 1,453	$ -	$ 184,414
Home equity and lines of credit	91,074	-	-	530	-	91,604

Commercial real estate	-	150,316	48	4,526	-	154,890
Commercial business	-	59,943	5,494	760	-	66,197
Consumer	7,050	-	-	-	-	7,050
Total	$ 281,085	$ 210,259	$ 5,542	$ 7,269	$ -	$ 504,155
December 31, 2015:						
Residential first mortgages	$ 138,096	$ -	$ -	$ 1,209	$ -	$ 139,305
Home equity and lines of credit	87,015	-	-	395	-	87,410
Commercial real estate	-	125,539	88	4,064	-	129,691
Commercial business	-	69,740	942	1,266	-	71,948
Consumer	6,742	-	-	-	-	6,742
Total	$ 231,853	$ 195,279	$ 1,030	$ 6,934	$ -	$ 435,096

7. Loans Receivable and Related Allowance for Loan Losses (continued)

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. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonperforming loans as of June 30, 2016 and December 31, 2015:

(Dollar amounts in thousands)

	Performing			Nonperforming		
	Accruing Loans Not Past Due	Accruing 30-59 Days Past Due	Accruing 60-89 Days Past Due	Accruing 90 Days + Past Due	Nonaccrual	Total Loans
June 30, 2016:						
Residential first mortgages	$181,180	$ 1,894	$ 194	$ -	$ 1,146	$184,414
Home equity and lines of credit	90,875	128	91	-	510	91,604
Commercial real estate	152,184	1,784	-	53	869	154,890
Commercial business	65,265	242	-	-	690	66,197
Consumer	6,987	60	3	-	-	7,050
Total loans	$496,491	$ 4,108	$ 288	$ 53	$ 3,215	$504,155
December 31, 2015:						
Residential first mortgages	$136,924	$ 1,097	$ 75	$ -	$ 1,209	$139,305
Home equity and lines of credit	86,691	308	16	-	395	87,410
Commercial real estate	128,945	-	-	-	746	129,691
Commercial business	71,229	-	-	-	719	71,948
Consumer	6,723	19	-	-	-	6,742
Total loans	$430,512	$ 1,424	$ 91	$ -	$ 3,069	$435,096

The following table presents the Corporation's nonaccrual loans by aging category as of June 30, 2016 and December 31, 2015:

(Dollar amounts in thousands)

	Not	30-59 Days	60-89 Days	90 Days +	Total

	Past Due	Past Due	Past Due	Past Due	Loans
June 30, 2016:					
Residential first mortgages	$ 74	$ -	$ 78	$ 994	$ 1,146
Home equity and lines of credit	12	4	-	494	510
Commercial real estate	579	-	-	290	869
Commercial business	661	-	-	29	690
Consumer	-	-	-	-	-
Total loans	$ 1,326	$ 4	$ 78	$ 1,807	$ 3,215
December 31, 2015:					
Residential first mortgages	$ 75	$ -	$ 79	$ 1,055	$ 1,209
Home equity and lines of credit	14	-	-	381	395
Commercial real estate	623	-	-	123	746
Commercial business	690	-	-	29	719
Consumer	-	-	-	-	-
Total loans	$ 1,402	$ -	$ 79	$ 1,588	$ 3,069

8. Goodwill and Intangible Assets

The following table summarizes the Corporation's acquired goodwill and intangible assets as of June 30, 2016 and December 31, 2015:

(Dollar amounts in thousands)	June 30, 2016		December 31, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Goodwill	$ 10,291	$ -	$ 3,664	$ -
Core deposit intangibles	4,259	3,578	4,027	3,473
Total	$ 14,550	$ 3,578	$ 7,691	$ 3,473

Goodwill resulted from four acquisitions. During the three and six months ended June 30, 2016, the Corporation recorded $6.6 million of goodwill related to the acquisition of United American (see Note 2). Goodwill represents the excess of the total purchase price paid for the acquisitions over the fair value of the identifiable assets acquired, net of the fair value of the liabilities assumed. Goodwill is not amortized but is evaluated for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. The Corporation has selected November 30 as the date to perform the annual impairment test. No goodwill impairment charges were recorded during 2015 or in the first six months of 2016.

The core deposit intangible asset, resulting from two acquisitions, is amortized using the double declining balance method over a weighted average estimated life of the related deposits and is not estimated to have a significant residual value. During the three and six month periods ending June 30, 2016, the Corporation recorded intangible amortization expense totaling $56,000 and $105,000, respectively, compared to $49,000 and $98,000, respectively, for the same periods in 2015. Core deposit intangible expense projected for the succeeding five years beginning 2016 is estimated to be $226,000, $235,000, $196,000, $26,000 and $20,000 per year, respectively, and $83,000 in total for years after 2020.

9. Stock Compensation Plans

In April 2014, the Corporation adopted the 2014 Stock Incentive Plan (the 2014 Plan), which is shareholder approved and permits the grant of restricted stock awards and options to its directors, officers and employees for up to 176,866 shares of common stock. As of June 30, 2016, 75,483 shares of restricted stock and 88,433 stock options remain available for issuance under the plan.

In addition, the Corporation's 2007 Stock Incentive Plan and Trust (the 2007 Plan), which is shareholder approved, permits the grant of restricted stock awards and options to its directors, officers and employees for up to 177,496 shares of common stock. As of June 30, 2016, 1,313 shares of restricted stock and 45,283 stock options remain available for issuance under the plan.

Incentive stock options, non-incentive or compensatory stock options and share awards may be granted under the Plans. The exercise price of each option shall at least equal the market price of a share of common stock on the date of grant and have a contractual term of ten years. Options shall vest and become exercisable at the rate, to the extent and subject to such limitations as may be specified by the Corporation. Compensation cost related to share-based payment transactions must be recognized in the financial statements with measurement based upon the fair value of the equity instruments issued.

9. Stock Compensation Plans (continued)

A summary of option activity under the Plans as of June 30, 2016, and changes during the period then ended is presented below:

	Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted-Average Remaining Term (in years)
Outstanding as of January 1, 2016	73,000	$ 25.71	$ 9,000	1.6
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding as of June 30, 2016	73,000	$ 25.71	$ 8,640	1.1
Exercisable as of June 30, 2016	73,000	$ 25.71	$ 8,640	1.1

A summary of the status of the Corporation's nonvested restricted stock awards as of June 30, 2016, and changes during the period then ended is presented below:

	Shares	Weighted-Average Grant-date Fair Value
Nonvested at January 1, 2016	23,450	$ 24.38
Granted	-	-
Vested	(1,500)	24.51
Forfeited	-	-
Nonvested as of June 30, 2016	21,950	$ 24.37

For the three and six month periods ended June 30, 2016, the Corporation recognized $64,000 and $110,000, respectively, in stock compensation expense, compared to $55,000 and $108,000, respectively, for the same periods in 2015. As of June 30, 2016, there was $280,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.6 years. It is the Corporation's policy to issue shares on the vesting date for restricted stock awards. Unvested restricted stock awards do not receive dividends declared by the Corporation.

10. Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Corporation has the ability to access at the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect the Corporation’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

An asset or liability’s level is based on the lowest level of input that is significant to the fair value measurement.

The Corporation used the following methods and significant assumptions to estimate fair value:

Cash and cash equivalents – The carrying value of cash and due from banks and interest earning deposits with banks approximates fair value and are classified as Level 1.

10. Fair Value (continued)

Securities available for sale – The fair value of all investment securities are based upon the assumptions market participants would use in pricing the security. If available, investment securities are determined by quoted market prices (Level 1). Level 1 includes U.S. Treasury, federal agency securities and certain equity securities. For investment securities where quoted market prices are not available, fair values are calculated based on market prices on similar securities (Level 2). Level 2 includes U.S. Government sponsored entities and agencies, mortgage-backed securities, collateralized mortgage obligations, state and political subdivision securities and corporate debt securities. For investment securities where quoted prices or market prices of similar securities are not available, fair values are calculated by using unobservable inputs (Level 3) and may include certain equity securities held by the Corporation. The Level 3 equity security valuations were supported by an analysis prepared by the Corporation which relies on inputs such as the security issuer's publicly attainable financial information, multiples derived from prices in observed transactions involving comparable businesses and other market, financial and nonfinancial factors.

Loans – The fair value of loans receivable was estimated based on the discounted value of the future cash flows using the current rates being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification.

Impaired loans – At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive a specific allowance for loan losses. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. As of June 30, 2016, the Corporation did not have any impaired loans measured using the fair value of collateral, compared to loan balances of $643,000, net of a valuation allowance of $47,000, at December 31, 2015. There was no additional provision for loan losses recorded for impaired loans during the three and six month periods ended June 30, 2016. There was $235,000 of additional provision for loan losses recorded for impaired loans during the three and six month periods ended June 30, 2015.

Other real estate owned (OREO) – Assets acquired through or instead of foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. Management's ongoing review of appraisal information may result in additional discounts or adjustments to the valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or locale. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. As of June 30, 2016, the Corporation had no OREO measured at fair value. At December 31, 2015, OREO measured at fair value less costs to sell had a net carrying amount of $13,000, which consisted of the outstanding balance of $22,000 less write-downs of $9,000. There was no expense recorded during the three and six month periods ended June 30, 2016 associated with the write-down of OREO, compared $0 and $3,000, respectively for the three and six month periods ended June 30, 2015.

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed by the Corporation. Once received, management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Corporation compares the actual selling price of OREO that has been sold to the most recent appraisal to determine what additional adjustment should be made to the appraisal value to arrive at fair value. The most recent analysis performed indicated that a discount of 10% should be applied.

10. Fair Value (continued)

Federal bank stock – It is not practical to determine the fair value of federal bank stocks due to restrictions placed on its transferability.

Deposits – The fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, checking with interest, savings and money market accounts, is equal to the amount payable on demand resulting in either a Level 1 or Level 2 classification. The fair values of time deposits are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar maturities resulting in a Level 2 classification.

Borrowings – The fair value of borrowings with the FHLB is estimated using discounted cash flows based on current incremental borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Accrued interest receivable and payable – The carrying value of accrued interest receivable and payable approximates fair value. The fair value classification is consistent with the related financial instrument.

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollar amounts in thousands) Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
June 30, 2016:				
U.S. Treasury and federal agency	$1,512	$ 1,512	$ -	$ -
U.S. government sponsored entities and agencies	8,407	-	8,407	-
U.S. agency mortgage-backed securities: residential	29,504	-	29,504	-
U.S. agency collateralized mortgage obligations: residential	28,111	-	28,111	-
State and political subdivision	28,504	-	28,504	-
Corporate debt securities	8,058	-	8,058	-
Equity securities	2,049	1,914	-	135
	$106,145	$ 3,426	$ 102,584	$ 135

December 31, 2015:				
U.S. Treasury and federal agency	$1,466	$ 1,466	$ -	$ -
U.S. government sponsored entities and agencies	8,953	-	8,953	-
U.S. agency mortgage-backed securities: residential	33,150	-	33,150	-
U.S. agency collateralized mortgage obligations: residential	31,440	-	31,440	-
State and political subdivisions	28,591	-	28,591	-
Corporate debt securities	7,487	-	7,487	-
Equity securities	1,894	1,820	-	74
	$112,981	$ 3,286	$ 109,621	$ 74

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10. Fair Value (continued)

The Corporation's policy is to transfer assets or liabilities from one level to another when the methodology to obtain the fair value changes such that there are more or fewer unobservable inputs as of the end of the reporting period. During the three and six month periods ended June 30, 2016 and 2015, the Corporation had no transfers between levels. The following table presents changes in Level 3 assets measured on a recurring basis for the three and six month periods ended June 30, 2016 and 2015:

(Dollar amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Balance at the beginning of the period	$ 74	$ 828	$ 74	$ 898
Total gains or losses (realized/unrealized):	-	-	-	-
Included in earnings	-	-	-	-
Included in other comprehensive income	1	7	1	(63)
Acquired	60	-	60	-
Transfers in and/or out of Level 3	-	-	-	-
Balance at the end of the period	$ 135	$ 835	$ 135	$ 835

For assets measured at fair value on a non-recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollar amounts in thousands) Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2015:				
Impaired commercial business loans	$596	$ -	$ -	$ 596
Other residential real estate owned	13	-	-	13
	$609	$ -	$ -	$ 609

The following table presents quantitative information about Level 3 fair value measurements for assets measured at fair value on a non-recurring basis:

(Dollar amounts in thousands)		Valuation Techniques(s)	Unobservable Input (s)	Weighted Average	
December 31, 2015:					
Impaired commercial business loans	$ 596	Liquidation value of business assets	Adjustment for differences between comparable business assets	65	%
Other residential real estate owned	13	Sales comparison approach	Adjustment for differences between comparable sales	10	%

The two tables above exclude an impaired residential mortgage loan totaling $78,000 classified as a TDR which was measured using a discounted cash flow methodology at June 30, 2016. Excluded at December 31, 2015 were two impaired residential mortgage loans totaling $140,000, an $89,000 impaired commercial real estate loan and a $250,000 impaired commercial business loan classified as TDRs which were measured using a discounted cash flow methodology.

10. Fair Value (continued)

The following table sets forth the carrying amount and estimated fair values of the Corporation's financial instruments included in the consolidated balance sheet as of June 30, 2016 and December 31, 2015:

(Dollar amounts in thousands)

	Carrying	Fair Value Measurements using:			
Description	Amount	Total	Level 1	Level 2	Level 3
June 30, 2016:					
Financial Assets:					
Cash and cash equivalents	$38,561	$38,561	$38,561	$-	$-
Securities available for sale	106,145	106,145	3,426	102,584	135
Loans, net	498,724	510,898	-	-	510,898
Federal bank stock	3,764	N/A	N/A	N/A	N/A
Accrued interest receivable	1,837	1,837	53	336	1,448
	$649,031	$657,441	$42,040	$102,920	$512,481
Financial Liabilities:					
Deposits	596,886	599,829	422,785	177,044	-
Borrowed funds	37,500	39,544	-	39,544	-
Accrued interest payable	254	254	6	248	-
	$634,640	$639,627	$422,791	$216,836	$-

	Carrying	Fair Value Measurements using:			
	Amount	Total	Level 1	Level 2	Level 3
December 31, 2015:					
Financial Assets:					
Cash and cash equivalents	$11,546	$11,546	$11,546	$-	$-
Securities available for sale	112,981	112,981	3,286	109,621	74
Loans, net	429,891	436,009	-	-	436,009
Federal bank stock	4,240	N/A	N/A	N/A	N/A
Accrued interest receivable	1,501	1,501	64	299	1,138
	$560,159	$562,037	$14,896	$109,920	$437,221
Financial Liabilities:					
Deposits	489,887	491,781	376,409	115,372	-
Borrowed funds	49,250	50,636	-	50,636	-
Accrued interest payable	179	179	5	174	-
	$539,316	$542,596	$376,414	$166,182	$-

11. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The final rules implementing Basel Committee on Banking Supervision’s capital guidelines for U.S. banks (BASEL III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019.

Quantitative measures established by the regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, Tier 1 capital and common equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined).

11. Regulatory Matters (continued)

In 2015, the Board of Governors of the Federal Reserve System amended its Small Bank Holding Company Policy Statement by increasing the policy's consolidated assets threshold from $500 million to $1 billion. The primary benefit of being deemed a "small bank holding company' is the exemption from the requirement to maintain consolidated regulatory capital ratios; instead, regulatory capital ratios only apply at the subsidiary bank level. In addition, the Bank in its March 31, 2015 quarterly filing made a one-time permanent election to continue to exclude accumulated other comprehensive income from capital.

As of June 30, 2016, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category.

The following table sets forth certain information concerning the Bank's regulatory capital as of the dates presented:

(Dollar amounts in thousands)	June 30, 2016		December 31, 2015	
	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets:				
Actual	$57,760	12.84%	$ 56,090	13.99 %
For capital adequacy purposes	35,977	8.00 %	32,070	8.00 %
To be well capitalized	44,971	10.00%	40,087	10.00 %
Tier 1 capital to risk-weighted assets:				
Actual	$52,325	11.64%	$ 51,073	12.74 %
For capital adequacy purposes	26,982	6.00 %	24,052	6.00 %
To be well capitalized	35,977	8.00 %	32,070	8.00 %
Common Equity Tier 1 capital to risk-weighted assets:				
Actual	$52,325	11.64%	$ 51,073	12.74 %
For capital adequacy purposes	20,237	4.50 %	18,039	4.50 %
To be well capitalized	29,231	6.50 %	26,057	6.50 %
Tier 1 capital to average assets:				
Actual	$52,325	7.68 %	$ 51,073	8.83 %
For capital adequacy purposes	27,269	4.00 %	23,131	4.00 %
To be well capitalized	34,086	5.00 %	28,914	5.00 %

12. Accumulated Other Comprehensive Income (Loss)

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss), net of tax, for the three months ended June 30, 2016 and 2015 and summarizes the significant amounts reclassified out of each component of accumulated other comprehensive income:

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at April 1, 2016	$ 630	$(3,514)	$(2,884)
Other comprehensive income before reclassification	461	-	461
Amounts reclassified from accumulated other comprehensive income (loss)	(53)	-	(53)
Net current period other comprehensive income	408	-	408
Accumulated Other Comprehensive Income (Loss) at June 30, 2016	$ 1,038	$(3,514)	$(2,476)

(Dollar amounts in thousands) Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income For the three months ended June 30, 2016	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	$ 81	Net gain on sale of available-for-sale securities
	(28)	Provision for income taxes
Total reclassifications for the period	$ 53	Net of tax

(Dollar amounts in thousands)	Unrealized Gains and Losses on	Defined Benefit

	Available-for-Sale Securities	Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at April 1, 2015	$ 883	$(3,196)	$(2,313)
Other comprehensive income before reclassification	(829)	-	(829)
Amounts reclassified from accumulated other comprehensive income (loss)	(22)	-	(22)
Net current period other comprehensive income	(851)	-	(851)
Accumulated Other Comprehensive Income (Loss) at June 30, 2015	$ 32	$(3,196)	$(3,164)

(Dollar amounts in thousands) Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Income For the three months ended June 30, 2015	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	$ 34	Net gain on sale of available-for-sale securities
	(12)	Provision for income taxes
Total reclassifications for the period	$ 22	Net of tax

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12. Accumulated Other Comprehensive Income (Loss) (continued)

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss), net of tax, for the six months ended June 30, 2016 and 2015 and summarizes the significant amounts reclassified out of each component of accumulated other comprehensive income:

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at January 1, 2016	$ (248)	$(3,514)	$(3,762)
Other comprehensive income before reclassification	1,340	-	1,340
Amounts reclassified from accumulated other comprehensive income (loss)	(55)	-	(55)
Net current period other comprehensive income	1,285	-	1,285
Accumulated Other Comprehensive Income (Loss) at June 30, 2016	$ 1,037	$(3,514)	$(2,476)

(Dollar amounts in thousands) Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income For the six months ended June 30, 2016	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	$ 83	Net gain on sale of available-for-sale securities
	(28)	Provision for income taxes
Total reclassifications for the period	$ 55	Net of tax

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals

Accumulated Other Comprehensive Income (Loss) at January 1, 2015	$ 198	$(3,196)	$(2,998)
Other comprehensive income before reclassification	(144)	-	(144)
Amounts reclassified from accumulated other comprehensive income (loss)	(22)	-	(22)
Net current period other comprehensive income	(166)	-	(166)
Accumulated Other Comprehensive Income (Loss) at June 30, 2015	$ 32	$(3,196)	$(3,164)

(Dollar amounts in thousands) Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income For the six months ended June 30, 2015	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	$ 34	Net gain on sale of available-for-sale securities
	(12)	Provision for income taxes
Total reclassifications for the period	$ 22	Net of tax

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13. New Accounting Standards

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, "*Recognition and Measurement of Financial Assets and Financial Liabilities.*" This ASU requires that all equity investments be measured at fair value with changes in the fair value to be recognized through net income unless accounted for under the equity method of accounting or those that result in consolidation of the investee. This ASU also requires that an entity present separately in other comprehensive income 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. In addition, this ASU eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement to disclose the methods 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 for public business entities. This ASU is effective for annual periods beginning after December 15, 2017, and interim periods therein. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

In February 2016, the FASB issued ASU 2016-02, "*Leases.*" This ASU requires lessees to record most leases on their balance sheet but recognize expenses in the income statement in a manner similar to current accounting treatment. This ASU changes the guidance on sale-leaseback transactions, initial direct costs and lease execution costs, and, for lessors, modifies the classification criteria and the accounting for sales-type and direct financing leases. This ASU is effective for annual periods beginning after December 15, 2018, and interim periods therein. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

In March 2016, the FASB issued ASU 2016-09, "*Improvements to Employee Share-Based Payment Accounting.*" This ASU simplifies certain aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods therein. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

In June 2016, the FASB issued ASU 2016-13, "*Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*" This ASU significantly changes the way impairment of financial instruments is recognized by requiring immediate recognition of estimated credit losses expected to occur over the remaining life of the financial instruments. The main provisions of the guidance include (1) replacing the "incurred loss" approach under current GAAP with an "expected loss" model for instruments measured at amortized cost, (2) requiring entities to record an allowance for available-for-sale debt securities rather than reduce the carrying amount of the investments, as is required by the other-than-temporary impairment model under current GAAP, and (3) a simplified accounting model for purchased credit-impaired debt securities and loans. The ASU is effective for interim and annual reporting periods beginning after December 15, 2019, although early adoption is permitted. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section discusses the consolidated financial condition and results of operations of Emclaire Financial Corp and its wholly owned subsidiaries for the three and six months ended June 30, 2016, compared to the same periods in 2015 and should be read in conjunction with the Corporation's Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC and with the accompanying consolidated financial statements and notes presented on pages 1 through 28 of this Form 10-Q.

This Form 10-Q, including the financial statements and related notes, contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, objectives, expected operating results and the assumptions upon which those statements are based. Forward looking statements include without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and are typically identified with words such as "may," "could," "should," "will," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" or words or phrases of simil
We caution that the forward looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Actual results, performances or achievements could differ materially from those contemplated, expressed or implied by the forward looking statements. Therefore, we caution you not to place undue reliance on our forward looking information and statements. Except as required by applicable law or regulation, we will not update the forward looking statements to reflect actual results or changes in factors affecting the forward looking statements.

CHANGES IN FINANCIAL CONDITION

Total assets increased $97.0 million, or 16.2%, to $697.6 million at June 30, 2016 from $600.6 million at December 31, 2015. This increase resulted primarily from an increase in cash and equivalents and loans receivable of $27.0 million and $68.8 million, respectively. Total liabilities increased $95.0 million, or 17.4%, to $642.8 million at June 30, 2016 from $547.8 million at December 31, 2015, resulting primarily from a $107.0 million increase in customer deposits, partially offset by an $11.8 million decrease in short-term borrowed funds. Deposit growth consisted of a $104.0 million, or 21.8%, increase in interest bearing deposits and a $3.0 million, or 2.5%, increase in noninterest-bearing deposits. The increases in the assets and liabilities of the Corporation were primarily driven by the April 30, 2016 acquisition of United American Savings Bank (United American). The acquisition added $66.1 million in loans receivable and $72.7 million in customer deposits. In connection with the acquisition, the Corporation recorded goodwill of $6.6 million and a core deposit intangible of $232,000. For more information regarding the acquisition, see Note 2 to the Corporation's consolidated financial statements for June 30, 2016.

Stockholders' equity increased $2.0 million, or 3.8%, to $54.9 million at June 30, 2016 from $52.8 million at December 31, 2015. Book value and tangible book value per common share were $25.56 and $20.44, respectively, at June 30, 2016, compared to $24.64 and $22.67, respectively, at December 31, 2015. The decrease in tangible book value per common share resulted from $6.6 million of goodwill recorded from the acquisition of United American.

At June 30, 2016, the Bank was considered "well-capitalized" with a Tier 1 leverage ratio, Common Equity Tier 1 ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio of 7.68%, 11.64%, 11.64% and 12.84%, respectively. The Bank was also considered "well-capitalized" at December 31, 2015 with a Tier 1 leverage ratio, Common Equity Tier 1 ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio of 8.83%, 12.74%, 12.74% and 13.99%, respectively. The decrease in the capital ratios between the two respective periods occurred as the Bank's average assets increased following the United American acquisition.

RESULTS OF OPERATIONS

Comparison of Results for the Three Months Ended June 30, 2016 and 2015

General. Net income increased $3,000 to $930,000 for the three months ended June 30, 2016 from $927,000 for the same period in 2015. This increase was the result of increases in net interest income and noninterest income of $320,000 and $94,000, respectively, and an $82,000 decrease in the provision for loan losses, partially offset by increases in noninterest expense and the provision for income taxes of $453,000 and $40,000, respectively.

Net interest income. Tax equivalent net interest income increased $291,000, or 6.2%, to $5.0 million for the three months ended June 30, 2016 from $4.7 million for the three months ended June 30, 2015. This increase was attributed to an increase in tax equivalent interest income of $596,000, partially offset by an increase in interest expense of $305,000.

Interest income. Tax equivalent interest income increased $596,000, or 11.0%, to $6.0 million for the three months ended June 30, 2016 from $5.4 million for the same period in 2015. This increase was attributed to increases in interest earned on loans and interest earning deposits with banks and dividends on federal bank stocks of $713,000, $24,000 and $23,000, respectively, partially offset by a decreases in interest earned on securities of $164,000.

Tax equivalent interest earned on loans receivable increased $713,000, or 15.6%, to $5.3 million for the three months ended June 30, 2016 compared to $4.6 million for the same period in 2015. This increase resulted from a $84.1 million, or 21.2% increase in average loans, accounting for an increase of $932,000 in interest income. The increase in loans receivable was primarily related to the acquisition of United American in April 2016. Partially offsetting this favorable volume variance, the average yield on loans decreased 20 basis points to 4.42% for the three months ended June 30, 2016, versus 4.62% for the same period in 2015. This unfavorable yield variance accounted for a $219,000 decrease in interest income.

Tax equivalent interest earned on securities decreased $164,000, or 20.0%, to $656,000 for the three months ended June 30, 2016 compared to $820,000 for the three months ended June 30, 2015. This decrease resulted from a $37.9 million, or 25.3%, decrease in the average balance of securities, accounting for a $220,000 decrease in interest income. Partially offsetting the unfavorable volume variance, the average yield on securities increased 16 basis points to 2.36% for the three months ended June 30, 2016 versus 2.20% for the same period in 2015. This favorable yield variance accounted for a $56,000 increase in interest income.

Interest earned on deposits with banks increased $24,000 to $43,000 for the three months ended June 30, 2016 compared to $19,000 for the three months ended June 30, 2015. This increase resulted from a $17.7 million increase in the average balance of interest-earning deposits, accounting for an increase of $23,000 in interest income. The average yield on these accounts increased 1 basis point to 0.53% for the three months ended June 30, 2016, versus 0.52% for the same period in 2015, accounting for a $1,000 increase in interest income.

Dividends on federal bank stocks increased $23,000, or 79.3%, to $52,000 for the three months ended June 30, 2016 from $29,000 for the same period in 2015. This increase was primarily due to an increase in the average balance of federal bank stocks of $1.5 million, or 63.5%, to $3.8 million compared to $2.3 million for the same period in 2015, accounting for a $20,000 increase in interest income. Additionally, the average yield on these assets increased 50 basis points to 5.55% for the three months ended June 30, 2016, versus 5.05% for the same period in 2015, accounting for a $3,000 increase in interest income.

Interest expense. Interest expense increased $305,000, or 42.8%, to $1.0 million for the three months ended June 30, 2016 from $712,000 for the same period in 2015. This increase in interest expense can be attributed to increases in interest incurred on deposits and borrowed funds of $186,000 and $119,000, respectively.

Interest expense incurred on deposits increased $186,000, or 34.8%, to $721,000 for the three months ended June 30, 2016 compared to $535,000 for the same period in 2015. The average cost of interest-bearing deposits increased 11 basis points to 0.65% for the three months ended June 30, 2016, compared to 0.54% for the same period in 2015, resulting in a $119,000 increase in interest expense. Additionally, the average balance of interest-bearing deposits increased $47.0 million, or 11.7%, to $448.1 million for the three months ended June 30, 2016, compared to $401.1 million for the same period in 2015 causing a $67,000 increase in interest expense. This increase was primarily due to the acquisition of United American in April 2016. In addition, average noninterest bearing deposits increased $5.3 million, or 4.4%, to $124.2 million from $118.9 million.

Interest expense incurred on borrowed funds increased $119,000, or 67.2%, to $296,000 for the three months ended June 30, 2016, compared to $177,000 for the same period in the prior year. The average balance of borrowed funds increased $18.8 million, or 97.1%, to $38.1 million for the three months ended June 30, 2016, compared to $19.3 million for the same period in 2015 causing a $144,000 increase in interest expense. Partially offsetting this unfavorable variance, the average cost of borrowed funds decreased 55 basis points, or 15.0%, to 3.12% for the three months ended June 30, 2016 compared to 3.67% for the same period in 2015 causing a $25,000 decrease in interest expense.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include nonaccrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan fees. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

(Dollar amounts in thousands)	Three months ended June 30,					
	2016			2015		
	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate
Interest-earning assets:						
Loans, taxable	$454,059	$4,972	4.40 %	$371,078	$4,254	4.60 %
Loans, tax exempt	26,267	303	4.63 %	25,140	308	4.92 %
Total loans receivable	480,326	5,275	4.42 %	396,218	4,562	4.62 %
Securities, taxable	83,092	441	2.13 %	116,703	520	1.79 %
Securities, tax exempt	28,490	215	3.03 %	32,731	300	3.67 %
Total securities	111,582	656	2.36 %	149,434	820	2.20 %
Interest-earning deposits with banks	32,343	43	0.53 %	14,682	19	0.52 %
Federal bank stocks	3,767	52	5.55 %	2,304	29	5.05 %
Total interest-earning cash equivalents	36,110	95	1.06 %	16,986	48	1.13 %
Total interest-earning assets	628,018	6,026	3.86 %	562,638	5,430	3.87 %
Cash and due from banks	2,514			2,435		
Other noninterest-earning assets	42,778			33,542		
Total Assets	$673,310			$598,615		
Interest-bearing liabilities:						
Interest-bearing demand deposits	$291,053	$154	0.21 %	$281,312	$108	0.15 %
Time deposits	157,033	567	1.45 %	119,793	427	1.43 %
Total interest-bearing deposits	448,086	721	0.65 %	401,105	535	0.54 %
Borrowed funds, short-term	5,417	63	4.67 %	4,334	27	2.49 %
Borrowed funds, long-term	32,688	233	2.86 %	15,000	150	4.01 %
Total borrowed funds	38,105	296	3.12 %	19,334	177	3.67 %
Total interest-bearing liabilities	486,191	1,017	0.84 %	420,439	712	0.68 %

Noninterest-bearing demand deposits	124,178	-	-	118,917	-	-
Funding and cost of funds	610,369	1,017	0.67 %	539,356	712	0.53 %
Other noninterest-bearing liabilities	8,768			8,316		
Total Liabilities	619,137			547,672		
Stockholders' Equity	54,173			50,943		
Total Liabilities and Stockholders' Equity	$673,310			$598,615		
Net interest income		$5,009			$4,718	
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			3.02 %			3.19 %
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.21 %			3.36 %

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Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in volume (changes in volume multiplied by prior year rate), rate (change in rate multiplied by prior year volume) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

(Dollar amounts in thousands)	Three months ended June 30, 2016 versus 2015 Increase (Decrease) due to		
	Volume	Rate	Total
Interest income:			
Loans	$ 932	$ (219)	$ 713
Securities	(220)	56	(164)
Interest-earning deposits with banks	23	1	24
Federal bank stocks	20	3	23
Total interest-earning assets	755	(159)	596
Interest expense:			
Interest-bearing deposits	67	119	186
Borrowed funds, short-term	8	28	36
Borrowed funds, long-term	136	(53)	83
Total interest-bearing liabilities	211	94	305
Net interest income	$ 544	$ (253)	$ 291

Provision for loan losses. The Corporation records provisions for loan losses to maintain a level of total allowance for loan losses that management believes, to the best of its knowledge, covers all probable incurred losses estimable at each reporting date. Management considers historical loss experience, the present and prospective financial condition of borrowers, current conditions (particularly as they relate to markets where the Corporation originates loans), the status of nonperforming assets, the estimated underlying value of the collateral and other factors related to the collectability of the loan portfolio.

Information pertaining to the allowance for loan losses and nonperforming assets for the three months ended June 30, 2016 and 2015 is as follows:

(Dollar amounts in thousands)	As of or for the three months ended June 30, 2016	2015
Balance at the beginning of the period	$5,352	$5,340
Provision for loan losses	121	203
Charge-offs	(47)	(210)
Recoveries	5	37
Balance at the end of the period	$5,431	$5,370
Nonperforming loans	$3,268	$5,455
Nonperforming assets	3,415	5,752
Nonperforming loans to total loans	0.65 %	1.36 %
Nonperforming assets to total assets	0.49 %	0.96 %
Allowance for loan losses to total loans	1.08 %	1.34 %
Allowance for loan losses to non-performing loans	166.19%	98.44%

Nonperforming loans increased $39,000 to $3.3 million at June 30, 2016 from $3.2 million at March 31, 2016. Of the $3.3 million in nonperforming loans, $1.3 million were not past due at June 30, 2016.

As of June 30, 2016, the Corporation’s classified and criticized assets amounted to $12.8 million, or 1.8% of total assets, with $7.3 million classified as substandard and $5.5 million identified as special mention. This compares to classified and criticized assets of $12.7 million, or 2.1% of total assets, with $6.7 million classified as substandard and $6.0 million identified as special mention at March 31, 2016.

The provision for loan losses decreased $82,000, or 40.4%, to $121,000 for the three months ended June 30, 2016 from $203,000 for the same period in the prior year as a result of improved historic loss factors and an increase in the collateral value of an impaired commercial loan relationship.

Noninterest income. Noninterest income increased $94,000, or 11.1%, to $942,000 for the three months ended June 30, 2016, compared to $848,000 for the same period in the prior year. This increase resulted primarily from a $47,000 increase in net gains on the sale of securities. During the three months ended June 30, 2016, the Corporation realized securities gains of $81,000 related to a balance sheet management strategy whereby securities were sold to prepay a $5.0 million FHLB long-term advance and the related securities gains were used to offset the impact if the prepayment penalties associated with the early retirement of the advance. During the three months ended June 30, 2015, the Corporation recorded securities gains of $34,000 related to the sale of a mortgage-backed security. Also contributing to the increase in noninterest income were increases in interchange fees, loan servicing fees and overdraft charges.

Noninterest expense. Noninterest expense increased $453,000, or 11.3%, to $4.5 million for the three months ended June 30, 2016 compared to $4.0 million for the same period in 2015. This increase in noninterest expense can be attributed to increases in compensation and benefits, acquisition costs, premises and equipment and other noninterest expense of $127,000, $92,000, $37,000 and $187,000, respectively.

Compensation and employee benefits expense increased $127,000, or 6.2%, to $2.2 million for the three months ended June 30, 2016 compared to $2.1 million for the same period in the prior year. This increase was primarily the result of increases in salaries, retirement benefits, insurance benefits and payroll taxes of $94,000, $35,000, $25,000 and $15,000, respectively, partially offset by a decrease in incentive expense of $46,000. The increases in compensation and employee benefits related expenses were due primarily to the addition of the branch office in the United American acquisition in April 2016.

Costs related to the acquisition of United American totaled $92,000 for the three months ended June 30, 2016. These costs included legal fees, system conversion costs and other professional fees of $50,000, $32,000 and $10,000, respectively.

Other noninterest expense increased $187,000, or 19.1%, to $1.2 million for the three months ended June 30, 2016 compared to $1.0 million for the same period in the prior year. Included in other noninterest expense for the quarter ended June 30, 2016 was a prepayment penalty of $71,000 associated with the aforementioned early retirement of an FHLB advance. Also contributing to the increase were operating costs associated with the branch office acquired from United American and increased disaster recovery related costs.

The Corporation recognized $56,000 of core deposit intangible amortization expense during the second quarter of 2016 compared to $49,000 for the same period in 2015. This amortization relates to a branch acquisition completed in the third quarter of 2009 and a bank acquisition completed in April 2016. Further discussion of goodwill and intangible assets related to the acquisitions can be found in Note 2 to the "Notes to Consolidated Financial Statements" beginning on page 6.

Provision for income taxes. The provision for income taxes increased $40,000, or 16.2%, to $287,000 for the three months ended June 30, 2016 compared to $247,000 for the same period in the prior year. This increase was driven primarily by an increase in the Corporation's effective tax rate to 23.6% for the three months ended June 30, 2016 compared to 21.0% for the same period in the prior year. The Corporation's effective tax rate increased primarily due to certain non-deductible acquisition related expenses.

Comparison of Results for the Six Months Ended June 30, 2016 and 2015

General. Net income increased $24,000, or 1.4%, to $1.73 million for the six months ended June 30, 2016 from $1.71 million for the same period in 2015. This increase was the result of increases in net interest income and noninterest income of $532,000 and $95,000, respectively, and a $69,000 decrease in provision for loan losses, partially offset by increases in noninterest expense and provision for income taxes of $506,000 and $166,000, respectively.

Net interest income. Tax equivalent net interest income increased $476,000, or 5.2%, to $9.7 million for the six months ended June 30, 2016 from $9.2 million for the six months ended June 30, 2015. This increase can be attributed to an increase in tax equivalent interest income of $885,000, partially offset by an increase in interest expense of $409,000.

Interest income. Tax equivalent interest income increased $885,000, or 8.3%, to $11.5 million for the six months ended June 30, 2016 from $10.6 million for the same period in 2015. This increase can be attributed to increases in interest earned on loans and interest earning deposits with banks of $1.2 million and $28,000, respectively, partially offset by decreases in interest earned on securities and dividends on federal bank stocks of $345,000 and $15,000, respectively.

Tax equivalent interest earned on loans receivable increased $1.2 million, or 13.7%, to $10.1 million for the six months ended June 30, 2016 compared to $8.9 million for the same period in 2015. This increase resulted from a $69.0 million, or 17.7% increase in average loans, accounting for an increase of $1.5 million in interest income. The increase resulted from strong loan growth during the second half of 2015 and the first half of 2016 and the acquisition of United American in April 2016. Partially offsetting this favorable volume variance, the average yield on loans decreased 17 basis points to 4.41% for the six months ended June 30, 2016, versus 4.58% for the same period in 2015. This unfavorable yield variance accounted for a $304,000 decrease in interest income.

Tax equivalent interest earned on securities decreased $345,000, or 20.8%, to $1.3 million for the six months ended June 30, 2016 compared to $1.7 million for the six months ended June 30, 2015. This decrease resulted from a $38.3 million, or 25.6%, decrease in the average balance of securities, accounting for a $445,000 decrease in interest income. Partially offsetting the unfavorable volume variance, the average yield on securities increased 13 basis points to 2.36% for the six months ended June 30, 2016 versus 2.23% for the same period in 2015. This favorable yield variance accounted for a $100,000 increase in interest income.

Interest earned on deposits with banks increased $28,000, or 82.4%, to $62,000 for the six months ended June 30, 2016 compared to $34,000 for the six months ended June 30, 2015. This increase resulted from a $10.2 million increase in the average balance of interest-earning deposits, accounting for an increase of $27,000 in interest income. The average yield on these accounts increased 2 basis points to 0.53% for the six months ended June 30, 2016, versus 0.51% for the same period in 2015, accounting for a $1,000 increase in interest income.

Dividends on federal bank stocks decreased $15,000, or 14.7%, to $87,000 for the six months ended June 30, 2016 from $102,000 for the same period in 2015. This decrease was primarily due to a one-time special dividend paid in the first quarter of 2015 by the Federal Home Loan Bank of Pittsburgh, partially offset by an increase in the average balance of federal bank stocks of $1.3 million, or 55.1%, to $3.5 million compared to $2.3 million for the same period in 2015, accounting for a $42,000 increase in interest income.

Interest expense. Interest expense increased $409,000, or 28.4%, to $1.8 million for the six months ended June 30, 2016 from $1.4 million for the same period in 2015. This increase in interest expense can be attributed to increases in interest incurred on deposits and borrowed funds of $228,000 and $181,000, respectively.

Interest expense incurred on deposits increased $228,000, or 21.1%, to $1.3 million for the six months ended June 30, 2016 compared to $1.1 million for the same period in 2015. The average cost of interest-bearing deposits increased 8 basis points to 0.63% for the six months ended June 30, 2016, compared to 0.55% for the same period in 2015, resulting in a $165,000 increase in interest expense. Additionally, the average balance of interest-bearing deposits increased $22.4 million, or 5.6%, to $419.4 million for the six months ended June 30, 2016, compared to $397.1 million for the same period in 2015 causing a $63,000 increase in interest expense. In addition, average noninterest bearing deposits increased $4.1 million, or 3.5%, to $120.2 million from $116.1 million.

Interest expense incurred on borrowed funds increased $181,000, or 50.4%, to $540,000 for the six months ended June 30, 2016, compared to $359,000 for the same period in the prior year. The average balance of borrowed funds increased $17.9 million, or 92.5%, to $37.3 million for the six months ended June 30, 2016, compared to $19.4 million for the same period in 2015 causing a $272,000 increase in interest expense. Partially offsetting this unfavorable variance, the average cost of borrowed funds decreased 83 basis points, or 22.2%, to 2.91% for the six months ended June 30, 2016 compared to 3.74% for the same period in 2015 causing a $91,000 decrease in interest expense.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include nonaccrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan fees. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

(Dollar amounts in thousands)	Six months ended June 30,					
	2016			2015		
	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate
Interest-earning assets:						
Loans, taxable	$432,717	$9,452	4.39 %	$364,868	$8,238	4.55 %
Loans, tax exempt	26,399	619	4.72 %	25,258	616	4.92 %
Total loans receivable	459,116	10,071	4.41 %	390,126	8,854	4.58 %
Securities, taxable	82,887	874	2.12 %	116,960	1,045	1.80 %
Securities, tax exempt	28,623	436	3.06 %	32,894	610	3.74 %
Total securities	111,510	1,310	2.36 %	149,854	1,655	2.23 %
Interest-earning deposits with banks	23,577	62	0.53 %	13,369	34	0.51 %
Federal bank stocks	3,517	87	4.97 %	2,267	102	9.07 %
Total interest-earning cash equivalents	27,094	149	1.11 %	15,636	136	1.75 %
Total interest-earning assets	597,720	11,530	3.88 %	555,616	10,645	3.86 %
Cash and due from banks	2,439			2,403		
Other noninterest-earning assets	39,237			33,007		
Total Assets	$639,396			$591,026		
Interest-bearing liabilities:						
Interest-bearing demand deposits	$280,454	$285	0.20 %	$276,825	$209	0.15 %
Time deposits	138,954	1,024	1.48 %	120,233	872	1.46 %
Total interest-bearing deposits	419,408	1,309	0.63 %	397,058	1,081	0.55 %
Borrowed funds, short-term	3,448	65	3.77 %	4,369	60	2.76 %
Borrowed funds, long-term	33,846	475	2.82 %	15,000	299	4.03 %
Total borrowed funds	37,294	540	2.91 %	19,369	359	3.74 %

Total interest-bearing liabilities	456,702	1,849	0.81	%	416,427	1,440	0.70	%
Noninterest-bearing demand deposits	120,201	-	-		116,128	-	-	
Funding and cost of funds	576,903	1,849	0.64	%	532,555	1,440	0.55	%
Other noninterest-bearing liabilities	8,631				8,626			
Total Liabilities	585,534				541,181			
Stockholders' Equity	53,862				49,845			
Total Liabilities and Stockholders' Equity	$639,396				$591,026			
Net interest income		$9,681				$9,205		
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			3.07	%			3.16	%
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.24	%			3.34	%

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Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in volume (changes in volume multiplied by prior year rate), rate (change in rate multiplied by prior year volume) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

(Dollar amounts in thousands)	Six months ended June 30, 2015 versus 2014 Increase (Decrease) due to		
	Volume	Rate	Total
Interest income:			
Loans	$ 1,521	$ (304)	$ 1,217
Securities	(445)	100	(345)
Interest-earning deposits with banks	27	1	28
Federal bank stocks	42	(57)	(15)
Total interest-earning assets	1,145	(260)	885
Interest expense:			
Interest-bearing deposits	63	165	228
Borrowed funds, short-term	(14)	19	5
Borrowed funds, long-term	286	(110)	176
Total interest-bearing liabilities	335	74	409
Net interest income	$ 810	$ (334)	$ 476

Provision for loan losses. The Corporation records provisions for loan losses to maintain a level of total allowance for loan losses that management believes, to the best of its knowledge, covers all probable incurred losses estimable at each reporting date. Management considers historical loss experience, the present and prospective financial condition of borrowers, current conditions (particularly as they relate to markets where the Corporation originates loans), the status of nonperforming assets, the estimated underlying value of the collateral and other factors related to the collectability of the loan portfolio.

Information pertaining to the allowance for loan losses and nonperforming assets for the six months ended June 30, 2016 and 2015 is as follows:

(Dollar amounts in thousands)	As of or for the six months ended June 30, 2016		2015	
Balance at the beginning of the period	$ 5,205		$ 5,224	
Provision for loan losses	302		371	
Charge-offs	(88	)	(300	)
Recoveries	12		75	
Balance at the end of the period	$ 5,431		$ 5,370	
Non-performing loans	$ 3,268		$ 5,455	
Non-performing assets	3,415		5,752	
Non-performing loans to total loans	0.65	%	1.36	%
Non-performing assets to total assets	0.49	%	0.96	%
Allowance for loan losses to total loans	1.08	%	1.34	%
Allowance for loan losses to non-performing loans	166.19	%	98.44	%

Nonperforming loans increased $199,000 to $3.3 million at June 30, 2016 from $3.1 million at December 31, 2015. The increase in nonperforming loans was primarily due to a commercial real estate loan placed on nonaccrual status during the quarter ended March 31, 2016. Of the $3.3 million in nonperforming loans, $974,000 related to one commercial loan relationship and $1.3 million were not past due at June 30, 2016.

As of June 30, 2016, the Corporation’s classified and criticized assets amounted to $12.8 million, or 1.8% of total assets, with $7.3 million classified as substandard and $5.5 million identified as special mention. This compares to classified and criticized assets of $8.0 million, or 1.3% of total assets, with $6.9 million classified as substandard and $1.0 million identified as special mention at December 31, 2015. This increase was related to one commercial loan relationship consisting of three loans totaling $5.0 million being identified as special mention during the quarter ended March 31, 2016.

The provision for loan losses decreased $69,000, or 18.6%, to $302,000 for the six months ended June 30, 2016 from $371,000 for the same period in the prior year as a result of improved historic loss factors and an increase in the collateral value of an impaired commercial loan relationship.

Noninterest income. Noninterest income increased $95,000, or 5.8%, to $1.7 million for the six months ended June 30, 2016, compared to $1.6 million for the same period in the prior year. This increase primarily resulted from a $49,000 increase in net gains on the sale of securities. During the six months ended June 30, 2016, the Corporation realized securities gains of $83,000, of which $81,000 related to a balance sheet management strategy whereby securities were sold to prepay a $5.0 million FHLB long-term advance and the related securities gains were used to offset the impact of prepayment penalties associated with the early retirement of the advance. During the six months ended June 30, 2016, the Corporation recorded securities gains of $34,000 related to the sale of a mortgage-backed security. Also contributing to the increase in noninterest income were increases in interchange fees, loan servicing fees and overdraft charges.

Noninterest expense. Noninterest expense increased $506,000, or 6.3%, to $8.5 million for the six months ended June 30, 2016, compared to $8.0 million for the same period in the prior year. This increase in noninterest expense can be attributed to increases in acquisition costs, compensation and benefits and premises and equipment of $401,000, $107,000 and $54,000, respectively, partially offset by decreases in other noninterest expense and federal deposit insurance of $43,000 and $13,000, respectively.

Costs related to the acquisition of United American totaled $401,000 for the six months ended June 30, 2016. These costs included legal fees, system conversion costs and other costs of $194,000, $132,000 and $75,000, respectively.

Compensation and employee benefits expense increased $107,000, or 2.6%, to $4.2 million for the six months ended June 30, 2016, compared to $4.1 million for the same period in the prior year. This increase was primarily the result of increases in salaries, retirement benefits, insurance benefits and payroll taxes of $97,000, $18,000, $22,000 and $19,000, respectively, partially offset by a decrease in incentive expense of $25,000. The increases in compensation and employee benefits related expenses were due primarily to the addition of the branch office in the United American acquisition in April 2016.

Premises and equipment expense increased $54,000, or 4.1%, to $1.4 million for the six months ended June 30, 2016, compared to $1.3 million for the same period in the prior year. This increase was primarily the result of increases in equipment depreciation, office rent, utilities and real estate taxes of $49,000, $29,000, $24,000 and $11,000, respectively, partially offset by a $33,000 decrease in equipment service contracts.

Other noninterest expense increased $43,000, or 2.3%, to $1.8 million for the six months ended June 30, 2016 compared to $1.9 million for the same period in the prior year. Included in other noninterest expense for the six months ended June 30, 2016 was a prepayment penalty of $71,000 associated with the aforementioned early retirement of an FHLB advance.

The Corporation recognized $105,000 of core deposit intangible amortization expense during the first half of 2016 compared to $98,000 for the same period in 2015. This amortization relates to a branch acquisition completed in the third quarter of 2009 and a bank acquisition completed in April 2016. Further discussion of goodwill and intangible assets related to the acquisitions can be found in Note 2 to the “Notes to Consolidated Financial Statements” beginning on page 6.

Provision for income taxes. The provision for income taxes increased $166,000, or 39.8%, to $583,000 for the six months ended June 30, 2016 compared to $417,000 for the same period in the prior year. This increase was driven primarily by an increase in the Corporation's effective tax rate to 25.2% for the six months ended June 30, 2016 compared to 19.6% for the same period in the prior year. The Corporation's effective tax rate increased primarily due to certain non-deductible acquisition related expenses.

LIQUIDITY

The Corporation's primary sources of funds generally have been deposits obtained through the offices of the Bank, borrowings from the FHLB, Federal Reserve and other correspondent banks, and amortization and prepayments of outstanding loans and maturing securities. During the six months ended June 30, 2016, the Corporation used its sources of funds primarily to fund loan purchases and advances and repay short term borrowed funds. As of June 30, 2016, the Corporation had outstanding loan commitments, including undisbursed loans and amounts available under credit lines, totaling $80.4 million, and standby letters of credit totaling $126,000.

At June 30, 2016, time deposits amounted to $174.1 million, or 29.2% of the Corporation's total consolidated deposits, including approximately $57.6 million of which are scheduled to mature within the next year. Management of the Corporation believes (i) it has adequate resources to fund all of its commitments, (ii) all of its commitments will be funded as required by related maturity dates and (iii) based upon past experience and current pricing policies, it can adjust the rates of time deposits to retain a substantial portion of maturing liabilities if necessary.

Aside from liquidity available from customer deposits or through sales and maturities of securities, the Corporation has alternative sources of funds such as a term borrowing capacity from the FHLB and the Federal Reserve's discount window. At June 30, 2016, the Corporation had borrowed funds of $37.5 million consisting of $30.0 million of long-term FHLB advances, a $5.0 million long-term advance with a correspondent bank and $2.5 million outstanding on a line of credit with a correspondent bank. At June 30, 2016, the Corporation's borrowing capacity with the FHLB, net of funds borrowed and other commitments, was $151.7 million.

Management is not aware of any conditions, including any regulatory recommendations or requirements, which would adversely impact its liquidity or its ability to meet funding needs in the ordinary course of business.

RECENT REGULATORY DEVELOPMENTS

The final rules implementing the Basel Committee on Banking Supervision's (BCBS) capital guidelines for U.S. banks were approved by the FRB and FDIC. Under the final rules, minimum requirements increased for both the quantity and quality of capital. The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total Capital to risk-weighted assets of 8.0% and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer comprised of common equity Tier 1 capital was also established above the regulatory minimum capital requirements. This capital conservation buffer was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and will increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revised the definition and calculation of Tier 1 capital, Total Capital and risk-weighted assets. The phase-in period for the final rules became effective on January 1, 2015 with full compliance with all of the final rules' requirements phased in over a multi-year schedule to be fully phased-in by January 1, 2019.

At June 30, 2016, the Bank exceeded all minimum capital requirements under these capital guidelines.

CRITICAL ACCOUNTING POLICIES

The Corporation's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates or judgments. Certain policies inherently have a greater reliance on the use of estimates, and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates or judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily though the use of internal cash flow modeling techniques.

The most significant accounting policies followed by the Corporation are presented in Note 1 to the consolidated financial statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2015. These policies, along with the disclosures presented in the other financial statement notes provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions and where changes in those estimates and assumptions could have a significant impact on the financial statements. Management has identified the following as critical accounting policies.

Allowance for loan losses. The Corporation considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than its other significant accounting policies. The balance in the allowance for loan losses is determined based on management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions and other pertinent factors, including management's assumptions as to delinquencies, recoveries and losses. All of these factors may be susceptible to significant change. Among the many factors affecting the allowance for loan losses, some are quantitative while others require qualitative judgment. Although management believes its process for determining the allowance adequately considers all of the potential factors that could potentially result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from management's estimates, additional provisions for loan losses may be required that would adversely impact the Corporation's financial condition or earnings in future periods.

Other-than-temporary impairment. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery.

Goodwill and intangible assets. Goodwill represents the excess cost over fair value of assets acquired in a business combination. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. The impairment test is a two-step process that begins with an initial impairment evaluation. If the initial evaluation suggests that an impairment of the asset value exists, the second step is to determine the amount of the impairment. If the tests conclude that goodwill is impaired, the carrying value is adjusted and an impairment charge is recorded. As of November 30, 2015, the required annual impairment test of goodwill was performed and management concluded that no impairment existed as of that date. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk for the Corporation consists primarily of interest rate risk exposure and liquidity risk. Since virtually all of the interest-earning assets and interest-bearing liabilities are at the Bank, virtually all of the interest rate risk and liquidity risk lies at the Bank level. The Bank is not subject to currency exchange risk or commodity price risk, and has no trading portfolio, and therefore, is not subject to any trading risk. In addition, the Bank does not participate in hedging transactions such as interest rate swaps and caps. Changes in interest rates will impact both income and expense recorded and also the market value of long-term interest-earning assets and interest-bearing liabilities. Interest rate risk and liquidity risk management is performed at the Bank level. Although the Bank has a diversified loan portfolio, loans outstanding to individuals and businesses depend upon the local economic conditions in the immediate trade area.

One of the primary functions of the Corporation's asset/liability management committee is to monitor the level to which the balance sheet is subject to interest rate risk. The goal of the asset/liability committee is to manage the relationship between interest rate sensitive assets and liabilities, thereby minimizing the fluctuations in the net interest margin, which achieves consistent growth of net interest income during periods of changing interest rates.

Interest rate sensitivity is the result of differences in the amounts and repricing dates of the Bank's rate sensitive assets and rate sensitive liabilities. These differences, or interest rate repricing "gap", provide an indication of the extent that the Corporation's net interest income is affected by future changes in interest rates. A gap is considered positive when the amount of interest rate-sensitive assets exceeds the amount of interest rate-sensitive liabilities and is considered negative when the amount of interest rate-sensitive liabilities exceeds the amount of interest rate-sensitive assets. Generally, during a period of rising interest rates, a negative gap would adversely affect net interest income while a positive gap would result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would result in an increase in net interest income and a positive gap would adversely affect net interest income. The closer to zero that gap is maintained, generally, the lesser the impact of market interest rate changes on net interest income.

Assumptions about the timing and variability of cash flows are critical in gap analysis. Particularly important are the assumptions driving mortgage prepayments and the expected attrition of the core deposits portfolios. These assumptions are based on the Corporation's historical experience, industry standards and assumptions provided by a federal regulatory agency, which management believes most accurately represents the sensitivity of the Corporation's assets and liabilities to interest rate changes. As of June 30, 2016, the Corporation's interest-earning assets maturing or repricing within one year totaled $212.4 million while the Corporation's interest-bearing liabilities maturing or repricing within one-year totaled $185.0 million, providing an excess of interest-earning assets over interest-bearing liabilities of $27.4 million. At June 30, 2016, the percentage of the Corporation's assets to liabilities maturing or repricing within one year was 114.8%.

For more information, see “Market Risk Management” in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2015.

Item 4. Controls and Procedures

The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation’s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Corporation’s management, including its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure based on the definition of “disclosure controls and procedures” in Rule 13a-15(e).

As of June 30, 2016, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation’s management, including the Corporation’s CEO and CFO, of the effectiveness of the design and operation of the Corporation’s disclosure controls and procedures. Based on the foregoing, the Corporation’s CEO and CFO concluded that the Corporation’s disclosure controls and procedures were effective. There have been no significant changes in the Corporation’s internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Corporation completed its evaluation.

There has been no change made in the Corporation's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation is involved in various legal proceedings occurring in the ordinary course of business. It is the opinion of management, after consultation with legal counsel, that these matters will not materially affect the Corporation's consolidated financial position or results of operations.

Item 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

(a) Not applicable.

(b) Not applicable.

Item 6. Exhibits

Exhibit 31.1	Rule 13a-14(a) Certification of Principal Executive Officer
Exhibit 31.2	Rule 13a-14(a) Certification of Principal Financial Officer
Exhibit 32.1	CEO Certification Pursuant to 18 U.S.C. Section 1350
Exhibit 32.2	CFO Certification Pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		EMCLAIRE FINANCIAL CORP
Date:	August 12, 2016	By:/s/ William C. Marsh William C. Marsh Chairman of the Board, President and Chief Executive Officer
Date:	August 12, 2016	By:/s/ Matthew J. Lucco Matthew J. Lucco Chief Financial Officer Treasurer

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