PEOPLES BANCORP OF NORTH CAROLINA INC
Form 10-Q
August 07, 2018

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

FORM 10-Q

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

For the quarterly period ended: June 30, 2018

OR

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

For the transition period from __________ to __________

PEOPLES BANCORP OF NORTH CAROLINA, INC.
(Exact name of registrant as specified in its charter)

North Carolina
(State or other jurisdiction of incorporation or organization)

000-27205	56-2132396
(Commission File No.)	(IRS Employer Identification No.)

518 West C Street, Newton, North Carolina	28658
(Address of principal executive offices)	(Zip Code)

(828) 464-5620
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Yes No

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

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. 5,995,256 shares of common stock, outstanding at July 31, 2018.

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

Statements made in this Form 10-Q, other than those concerning historical information, should be considered forward-looking statements pursuant to the safe harbor provisions of the Securities Exchange Act of 1934 and the Private Securities Litigation Act of 1995. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management and on the information available to management at the time that this Form 10-Q was prepared. These statements can be identified by the use of words like “expect,” “anticipate,” “estimate,” and “believe,” variations of these words and other similar expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ include, but are not limited to, (1) competition in the markets served by the registrant and its subsidiaries, (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environments and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7) other risks and factors identified in other filings with the Securities and Exchange Commission, including but not limited to, those described in the registrant's Annual Report on Form 10-K for the year ended December 31, 2017.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PEOPLES BANCORP OF NORTH CAROLINA, INC.
Consolidated Balance Sheets
June 30, 2018 and December 31, 2017
(Dollars in thousands)

	June 30,	December 31,
Assets	2018	2017
	(Unaudited)	(Audited)
Cash and due from banks, including reserve requirements		
of $10,866 at 06/30/18 and $7,472 at 12/31/17	$45,481	53,186
Interest-bearing deposits	24,074	4,118
Cash and cash equivalents	69,555	57,304
Investment securities available for sale	210,055	229,321
Other investments	4,427	1,830
Total securities	214,482	231,151
Mortgage loans held for sale	671	857
Loans	781,884	759,764
Less allowance for loan losses	(6,277)	(6,366)
Net loans	775,607	753,398
Premises and equipment, net	19,606	19,911
Cash surrender value of life insurance	15,743	15,552
Other real estate	90	118
Accrued interest receivable and other assets	15,418	13,875
Total assets	$1,111,172	1,092,166
Liabilities and Shareholders' Equity		
Deposits:		
Noninterest-bearing demand	$313,976	285,406
NOW, MMDA & savings	489,426	498,445

Time, $250,000 or more	17,371	18,756
Other time	94,239	104,345
Total deposits	915,012	906,952
Securities sold under agreements to repurchase	46,570	37,757
Junior subordinated debentures	20,619	20,619
Accrued interest payable and other liabilities	10,805	10,863
Total liabilities	993,006	976,191
Commitments		
Shareholders' equity:		
Series A preferred stock, $1,000 stated value; authorized		
5,000,000 shares; no shares issued and outstanding	-	-
Common stock, no par value; authorized		
20,000,000 shares; issued and outstanding 5,995,256 shares	62,096	62,096
Retained earnings	55,198	50,286
Accumulated other comprehensive income	872	3,593
Total shareholders' equity	118,166	115,975
Total liabilities and shareholders' equity	$1,111,172	1,092,166

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC.
Consolidated Statements of Earnings
Three and Six Months Ended June 30, 2018 and 2017
(Dollars in thousands, except per share amounts)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Interest income:				
Interest and fees on loans	$9,386	8,689	18,455	16,969
Interest on due from banks	124	48	169	78
Interest on investment securities:				
U.S. Government sponsored enterprises	524	613	1,130	1,217
State and political subdivisions	980	1,067	1,976	2,151
Other	45	44	88	110
Total interest income	11,059	10,461	21,818	20,525
Interest expense:				
NOW, MMDA & savings deposits	186	143	362	275
Time deposits	110	120	215	248
FHLB borrowings	-	201	-	393
Junior subordinated debentures	198	145	369	280
Other	19	13	34	24
Total interest expense	513	622	980	1,220
Net interest income	10,546	9,839	20,838	19,305
Provision for (reduction of provision for) loan losses	231	49	262	(187)
Net interest income after provision for loan losses	10,315	9,790	20,576	19,492
Non-interest income:				
Service charges	1,056	1,094	2,080	2,200
Other service charges and fees	175	147	355	302
Gain on sale of securities	50	-	50	-

Mortgage banking income	240	319	456	665
Insurance and brokerage commissions	203	179	385	347
Appraisal management fee income	854	849	1,643	1,592
Gain/(loss) on sale and write-down of other real estate	(3)	-	3	(283)
Miscellaneous	1,441	1,341	2,780	2,548
Total non-interest income	4,016	3,929	7,752	7,371
Non-interest expense:				
Salaries and employee benefits	5,385	4,871	10,347	10,105
Occupancy	1,750	1,699	3,606	3,312
Professional fees	373	236	753	485
Advertising	260	366	501	612
Debit card expense	283	268	492	574
FDIC Insurance	84	87	167	173
Appraisal management fee expense	654	648	1,246	1,214
Other	1,771	1,808	3,490	3,869
Total non-interest expense	10,560	9,983	20,602	20,344
Earnings before income taxes	3,771	3,736	7,726	6,519
Income tax expense	595	925	1,247	1,503
Net earnings	$3,176	2,811	6,479	5,016
Basic net earnings per share	$0.53	0.47	1.08	0.84
Diluted net earnings per share	$0.53	0.47	1.08	0.83
Cash dividends declared per share	$0.13	0.11	0.26	0.22

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC.
Consolidated Statements of Comprehensive Income
Three and Six Months Ended June 30, 2018 and 2017
(Dollars in thousands)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net earnings	$3,176	2,811	6,479	5,016
Other comprehensive income:				
Unrealized holding gains (losses) on securities available for sale	(869)	2,107	(3,483)	2,694
Reclassification adjustment for gains on securities available for sale included in net earnings	(50)	-	(50)	-
Total other comprehensive income (loss), before income taxes	(919)	2,107	(3,533)	2,694
Income tax expense related to other comprehensive income:				
Unrealized holding gains (losses) on securities available for sale	(200)	758	(801)	742
Reclassification adjustment for gains on securities available for sale included in net earnings	(11)	-	(11)	-
Total income tax expense related to other comprehensive income (loss)	(211)	758	(812)	742
Total other comprehensive income (loss), net of tax	(708)	1,349	(2,721)	1,952
Total comprehensive income	$2,468	4,160	3,758	6,968

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC.
Consolidated Statements of Changes in Shareholders' Equity
Six Months Ended June 30, 2018 and 2017
(Dollars in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	Amount	Earnings	Income	Total
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Balance, December 31, 2017	5,995,256	$62,096	50,286	3,593	115,975
Cash dividends declared on common stock	-	-	(1,567)	-	(1,567)
Net earnings	-	-	6,479	-	6,479
Change in accumulated other comprehensive income, net of tax	-	-	-	(2,721)	(2,721)
Balance, June 30, 2018	5,995,256	$62,096	55,198	872	118,166
Balance, December 31, 2016	5,417,800	$44,187	60,254	2,987	107,428
Cash dividends declared on common stock	-	-	(1,316)	-	(1,316)
Restricted stock units exercised	30,654	852	-	-	852
Net earnings	-	-	5,016	-	5,016
Change in accumulated other comprehensive income, net of tax	-	-	-	1,952	1,952
Balance, June 30, 2017	5,448,454	$45,039	63,954	4,939	113,932

See accompanying Notes to Consolidated Financial Statements.

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PEOPLES BANCORP OF NORTH CAROLINA, INC.
Consolidated Statements of Cash Flows
Six Months Ended June 30, 2018 and 2017
(Dollars in thousands)

	2018	2017
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net earnings	$6,479	5,016
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation, amortization and accretion	2,418	2,506
Provision (reduction of provision) for loan losses	262	(187)
Deferred income taxes	(7)	(1,122)
Gain on sale of investment securities	(50)	-
Gain on sale of other real estate	(3)	-
Write-down of other real estate	-	283
Loss on sale of premises and equipment	2	32
Restricted stock expense	139	471
Proceeds from sales of mortgage loans held for sale	18,475	34,845
Origination of mortgage loans held for sale	(18,289)	(32,649)
Change in:		
Cash surrender value of life insurance	(191)	(399)
Other assets	(1,249)	230
Other liabilities	(197)	(240)
Net cash provided by operating activities	7,789	8,786
Cash flows from investing activities:		
Purchases of investment securities available for sale	(17,347)	(3,138)
Proceeds from sales, calls and maturities of investment securities available for sale	23,384	4,285
Proceeds from paydowns of investment securities available for sale	8,519	8,682
Purchases of other investments	(2,611)	
Proceeds from paydowns on other investments	29	
Purchases of FHLB stock	(4)	(45)
Net change in loans	(22,044)	(21,423)
Purchases of premises and equipment	(898)	(3,980)
Proceeds from sale of other real estate and repossessions	128	-

Net cash used by investing activities	(10,844)	(15,619)
Cash flows from financing activities:		
Net change in deposits	8,060	(433)
Net change in securities sold under agreement to repurchase	8,813	13,543
Proceeds from Fed Funds purchased	850	-
Repayments of Fed Funds purchased	(850)	-
Cash dividends paid on common stock	(1,567)	(1,316)
Net cash provided by financing activities	15,306	11,794
Net change in cash and cash equivalents	12,251	4,961
Cash and cash equivalents at beginning of period	57,304	70,094
Cash and cash equivalents at end of period	$69,555	75,055

PEOPLES BANCORP OF NORTH CAROLINA, INC.
Consolidated Statements of Cash Flows, continued
Six Months Ended June 30, 2018 and 2017
(Dollars in thousands)

	2018	2017
	(Unaudited)	(Unaudited)
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$973	1,241
Income taxes	$252	40
Noncash investing and financing activities:		
Change in unrealized gain on investment securities available for sale, net	$(2,721)	1,952
Issuance of accrued restricted stock units	$-	(852)
Transfers of loans to other real estate and repossessions	$97	-

See accompanying Notes to Consolidated Financial Statements.

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PEOPLES BANCORP OF NORTH CAROLINA, INC.

Notes to Consolidated Financial Statements (Unaudited)

(1)
Summary of Significant Accounting Policies

The consolidated financial statements include the financial statements of Peoples Bancorp of North Carolina, Inc. and its wholly owned subsidiary, Peoples Bank (the "Bank"), along with the Bank's wholly owned subsidiaries, Peoples Investment Services, Inc. ("PIS"), Real Estate Advisory Services, Inc. ("REAS"), Community Bank Real Estate Solutions, LLC ("CBRES") and PB Real Estate Holdings, LLC (collectively called the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

The Bank operates three banking offices focused on the Latino population that were formerly operated as a division of the Bank under the name Banco de la Gente ("Banco"). These offices are now branded as Bank branches and considered a separate market territory of the Bank as they offer normal and customary banking services as are offered in the Bank's other branches such as the taking of deposits and the making of loans.

The consolidated financial statements in this report (other than the Consolidated Balance Sheet at December 31, 2017) are unaudited. In the opinion of management, all adjustments (none of which were other than normal accruals) necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with generally accepted accounting principles in the United States ("GAAP"). Actual results could differ from those estimates.

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of the specific accounting guidance. A description of the Company's significant accounting policies can be found in Note 1 of the Notes to Consolidated Financial Statements in the Company's 2017 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 3, 2018 Annual Meeting of Shareholders.

Recently Issued Accounting Pronouncements
In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, (Topic 606): Revenue from Contracts with Customers. ASU No. 2014-09 provides guidance on the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. ASU No. 2014-09 is effective for reporting periods beginning after December 15, 2017.

The Company has applied ASU No. 2014-09 using a modified retrospective approach. The Company's revenue is comprised of net interest income and noninterest income. The scope of ASU No. 2014-09 explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of the Company's revenues are not affected. Appraisal management fee income and expense from the Bank's subsidiary, CBRES, was reported as a net amount prior to March 31, 2018, which was included in miscellaneous non-interest income. This income and expense is now reported on separate line items under non-interest income and non-interest expense. See below for additional information related to revenue generated from contracts with customers.

Revenue and Method of Adoption

The majority of our revenue is derived primarily from interest income from receivables (loans) and securities. Other revenues are derived from fees received in connection with deposit accounts, investment advisory, and appraisal services. On January 1, 2018, we adopted the requirements of ASU No. 2014-09. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Company adopted ASU No. 2014-09 using the modified retrospective transition approach which does not require restatement of prior periods. The method was selected as there were no material changes in the timing of revenue recognition resulting in no comparability issues with prior periods. This adoption method is considered a change in accounting principle requiring additional disclosure of the nature of and reason for the change, which is solely a result of the adoption of the required standard. When applying the modified retrospective approach under ASU No. 2014-09, the Company has elected, as a practical expedient, to apply this approach only to contracts that were not completed as of January 1, 2018. A completed contract is considered to be a contract for which all (or substantially all) of the revenue was recognized in accordance with revenue guidance that was in effect before January 1, 2018. There were no uncompleted contracts as of January 1, 2018 for which application of the new standard required an adjustment to retained earnings.

The following disclosures involve our material income streams derived from contracts with customers which are within the scope of ASU No. 2014-09. Through our wholly-owned subsidiary, PIS, we contract with a registered investment advisor to perform investment advisory services on behalf of our customers. We receive commissions from this third party investment advisor based on the volume of business that our customers do with such investment advisor. Total revenue recognized from these contracts for the six months ended June 30, 2018 was $384,000. The Company utilizes third parties to contract with our customers to perform debit and credit card clearing services. These third parties pay us commissions based on the volume of transactions that they process on behalf of our customers. Total revenue recognized for the six months ended June 30, 2018 from the contract with these third parties was $1.9 million. Through our wholly-owned subsidiary, REAS, we provide property appraisal services for negotiated fee amounts on a per appraisal basis. Total revenue recognized for the six months ended June 30, 2018 from these contracts with customers was $278,000. Through our wholly-owned subsidiary, CBRES, we provide appraisal management services. Total revenue recognized for the six months ended June 30, 2018 from these contracts with customers was $1.6 million. Due to the nature of our relationship with the customers that we provide services, we do not incur costs to obtain contracts and there are no material incremental costs to fulfill these contracts that should be capitalized.

Disaggregation of Revenue. Our portfolio of services provided to our customers consists of over 50,000 active contracts. We have disaggregated revenue according to timing of the transfer of service. Total revenue for the six months ended June 30, 2018 derived from contracts in which services are transferred at a point in time was approximately 5.7 million. None of our revenue is derived from contracts in which services are transferred over time. Revenue is recognized as the services are provided to the customers. Economic factors impacting the customers could affect the nature, amount, and timing of these cash flows, as unfavorable economic conditions could impair the customers' ability to provide payment for services. For our deposit contracts, this risk is mitigated as we generally deduct payments from customers' accounts as services are rendered. For our appraisal services, the risk is mitigated in that the appraisal is not released until payment is received.

Contract Balances. The timing of revenue recognition, billings, and cash collections results in billed accounts receivable on the balance sheet. Most contracts call for payment by a charge or deduction to the respective customer account but there are some that require a receipt of payment from the customer. For fee per transaction contracts, the customers are billed as the transactions are processed. We have no contracts in which customers are billed in advance for services to be performed. These would create contract liabilities or deferred revenue, as the customers pay in advance for services. There are no contract liabilities or accounts receivables balances that are material to the Company's balance sheet.

Performance Obligations. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASU No. 2014-09. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Performance obligations are satisfied as the service is provided to the customer at a point in time. There are no significant financing components in our contracts. Excluding deposit and appraisal service revenues which are primarily billed at a point in time as a fee for services incurred, all other contracts within the scope of ASU No. 2014-09 contain variable consideration in that fees earned are derived from market values of accounts which determine the amount of consideration to which we are entitled. The variability is resolved when the services are provided. The contracts do not include obligations for returns, refunds, or warranties. The contracts are specific to the amounts owed to the Company for services performed during a period should the contracts be terminated.

Significant Judgements. All of the contracts create performance obligations that are satisfied at a point in time excluding some immaterial deposit revenues. Revenue is recognized as services are billed to the customers. Variable consideration does exist for contracts related to our contract with the registered investment advisor as some revenues are based on market values of accounts at the end of the period.

In January 2016, FASB issued ASU No. 2016-01, (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU No. 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU No. 2016-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance did not have a material impact on the Company’s results of operations, financial position or disclosures.

In February 2016, FASB issued ASU No. 2016-02, (Topic 842): Leases. ASU No. 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU No. 2016-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018.

The Company expects to adopt ASU No. 2016-02 using the modified retrospective method and practical expedients for transition. The practical expedients allow the Company to largely account for its existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. The Company has started an initial evaluation of its leasing contracts and activities and has started developing its methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments (at December 31, 2017, the future minimum lease payments were $4.8 million). While the Company does not expect there to be a material change in the timing of expense recognition, it is too early in the evaluation process to determine if there will be a material change to the timing of expense recognition. The Company is evaluating its existing disclosures and may need to provide additional information as a result of adoption of ASU No. 2016-02.

In June 2016, FASB issued ASU No. 2016-13, (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU No. 2016-13 provides guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. ASU No. 2016-13 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018.

The Company will apply the amendments to ASU No. 2016-13 through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in the first quarter of 2019, the Company does not expect to elect that option. The Company is evaluating the impact of ASU No. 2016-13 on its consolidated financial statements. The Company anticipates that ASU No. 2016-13 will have no material impact on the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. In addition to the Company's allowance for loan losses, it will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In January 2017, FASB issued ASU No. 2017-01, (Topic 805): Clarifying the Definition of a Business. ASU No. 2017-01 adds guidance to assist companies and other reporting organizations with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU No. 2017-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In January 2017, FASB issued ASU No. 2017-04, (Topic 350): Simplifying the Test for Goodwill Impairment. ASU No. 2017-04 provides guidance to simplify the accounting related to goodwill impairment. ASU No. 2017-04 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In February 2017, FASB issued ASU No. 2017-05, (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. ASU No. 2017-05 clarifies the scope of established guidance on nonfinancial asset derecognition (issued as part of the new revenue standard, ASU No. 2014-09, Revenue from Contracts with Customers), as well as the accounting for partial sales of nonfinancial assets. ASU No. 2017-05 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In March 2017, FASB issued ASU No. 2017-07, (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Costs. ASU No. 2017-07 amended the requirements related to the income statement presentation of the components of net periodic benefit cost for an entity's sponsored defined benefit pension and other postretirement plans. ASU No. 2017-07 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In March 2017, FASB issued ASU No. 2017-08, (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. ASU No. 2017-08 amended the requirements related to the amortization period for certain purchased callable debt securities held at a premium. ASU No. 2017-08 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In May 2017, FASB issued ASU No. 2017-09, (Topic 718): Scope of Modification Accounting. ASU No. 2017-09 amended the requirements related to changes to the terms or conditions of a share-based payment award. ASU No. 2017-09 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In September 2017, FASB issued ASU No. 2017-13, Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842). ASU No. 2017-13 updated the Revenue from Contracts with Customers and the Leases Topics of the Accounting Standards Codification. The amendments incorporate into the Accounting Standards Codification recent Securities Exchange Commission ("SEC") guidance about certain public business entities (PBEs) electing to use the non-PBE effective dates solely to adopt the FASB's new standards on revenue and leases. ASU No. 2017-13 was effective upon issuance. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In November 2017, FASB issued ASU No. 2017-14, Income Statement—Reporting Comprehensive, Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606). ASU No. 2017-14 incorporates into the Accounting Standards Codification recent SEC guidance related to revenue recognition. ASU No. 2017-14 was effective upon issuance. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In February 2018, FASB issued ASU 2018-02, Income Statement (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU No. 2018-02 requires companies to reclassify the stranded effects in other comprehensive income to retained earnings as a result of the change in the tax rates under the Tax Cuts and Jobs Act ("TCJA"). The Company has opted to early adopt this pronouncement by retrospective application to each period in which the effect of the change in the tax rate under the TCJA is recognized. The impact of the reclassification from other comprehensive income to retained earnings at December 31, 2017 was $607,000.

In February 2018, FASB issued ASU 2018-03, Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities. ASU No. 2018-03 clarifies certain aspects of the guidance issued in ASU 2016-01. ASU No. 2018-03 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In March 2018, FASB issued ASU 2018-04, Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273 (SEC Update). ASU No. 2018-04 incorporates recent SEC guidance which was issued in order to make the relevant interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulation. ASU No. 2018-04 was effective upon issuance. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In March 2018, FASB issued ASU 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (SEC Update). ASU No. 2018-05 incorporates recent SEC guidance related to the income tax accounting implications of the TCJA. ASU No. 2018-05 was effective upon issuance. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

In May 2018, FASB issued ASU 2018-06, Codification Improvements to Topic 942: Financial Services—Depository and Lending. ASU No. 2018-06 eliminates a reference to the Office of the Comptroller of the Currency's Banking Circular 202, Accounting for Net Deferred Tax Charges, from the Accounting Standards Codification. The Office of the Comptroller of the Currency published the guidance in 1985 but has since rescinded it. The amendments were effective upon issuance. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or disclosures.

Other accounting standards that have been issued or proposed by FASB or other standards-setting bodies are not expected to have a material impact on the Company's results of operations, financial position or disclosures.

(2)
Investment Securities

Investment securities available for sale at June 30, 2018 and December 31, 2017 are as follows:

(Dollars in thousands)

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$46,213	321	813	45,721
U.S. Government sponsored enterprises	38,528	10	1,001	37,537
State and political subdivisions	122,930	2,749	144	125,535
Corporate bonds	1,000	12	-	1,012
Trust preferred securities	250	-	-	250
Total	$208,921	3,092	1,958	210,055

(Dollars in thousands)

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$53,124	814	329	53,609
U.S. Government sponsored enterprises	40,504	140	264	40,380
State and political subdivisions	129,276	4,310	16	133,570
Corporate bonds	1,500	12	-	1,512
Trust preferred securities	250	-	-	250
Total	$224,654	5,276	609	229,321

The current fair value and associated unrealized losses on investments in securities with unrealized losses at June 30, 2018 and December 31, 2017 are summarized in the tables below, with the length of time the individual securities have been in a continuous loss position.

(Dollars in thousands)

	June 30, 2018					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$18,692	255	11,373	558	30,065	813
U.S. Government		-				
sponsored enterprises	26,635	663	9,891	338	36,526	1,001
State and political subdivisions	9,760	117	964	27	10,724	144
Total	$55,087	1,035	22,228	923	77,315	1,958

(Dollars in thousands)

	December 31, 2017					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$8,701	75	11,259	254	19,960	329
U.S. Government sponsored enterprises	12,661	98	10,067	166	22,728	264
State and political subdivisions	798	2	1,501	14	2,299	16
Total	$22,160	175	22,827	434	44,987	609

At June 30, 2018, unrealized losses in the investment securities portfolio relating to debt securities totaled $2.0 million. The unrealized losses on these debt securities arose due to changing interest rates and are considered to be temporary. From the June 30, 2018 tables above, 15 out of 153 securities issued by state and political subdivisions contained unrealized losses and 35 out of 43 securities issued by U.S. Government sponsored enterprises contained unrealized losses. These unrealized losses are considered temporary because of acceptable financial condition and results of operations of entities that issued each security and the repayment sources of principal and interest on U.S. Government sponsored enterprises, including mortgage-backed securities, are government backed.

The amortized cost and estimated fair value of investment securities available for sale at June 30, 2018, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

June 30, 2018

(Dollars in thousands)

	Amortized Cost	Estimated Fair Value
Due within one year	$22,613	22,809
Due from one to five years	97,045	98,725
Due from five to ten years	37,351	37,068
Due after ten years	5,449	5,482
Mortgage-backed securities	46,213	45,721
Trust preferred securities	250	250
Total	$208,921	210,055

Proceeds from sales of securities available for sale during the three and six months ended June 30, 2018 were $14.0 million and resulted in net gains of $50,000. No securities available for sale were sold during the three and six months ended June 30, 2017.

Securities with a fair value of approximately $89.5 million and $105.6 million at June 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes as required by law.

(3)
Loans

Major classifications of loans at June 30, 2018 and December 31, 2017 are summarized as follows:

(Dollars in thousands)

	June 30, 2018	December 31, 2017
Real estate loans:		
Construction and land development	$79,769	84,987
Single-family residential	250,620	246,703
Single-family residential - Banco de la Gente stated income	35,847	37,249
Commercial	269,792	248,637
Multifamily and farmland	28,667	28,937
Total real estate loans	664,695	646,513
Loans not secured by real estate:		
Commercial loans	93,580	89,022
Farm loans	1,023	1,204
Consumer loans	9,422	9,888
All other loans	13,164	13,137
Total loans	781,884	759,764
Less allowance for loan losses	6,277	6,366
Total net loans	$775,607	753,398

The Bank grants loans and extensions of credit primarily within the Catawba Valley region of North Carolina, which encompasses Catawba, Alexander, Iredell and Lincoln counties, and also in Mecklenburg, Wake and Durham counties of North Carolina. Although the Bank has a diversified loan portfolio, a substantial portion of the loan portfolio is collateralized by improved and unimproved real estate, the value of which is dependent upon the real estate market. Risk characteristics of the major components of the Bank’s loan portfolio are discussed below:

Construction and land development loans – The risk of loss is largely dependent on the initial estimate of whether the property’s value at completion equals or exceeds the cost of property construction and the availability of take-out financing. During the construction phase, a number of factors can result in delays or cost overruns. If the estimate is inaccurate or if actual construction costs exceed estimates, the value of the property securing the loan may be insufficient to ensure full repayment when completed through a permanent loan, sale of the property, or by seizure of collateral. As of June 30, 2018, construction and land development loans comprised approximately 10% of the Bank’s total loan portfolio.

Single-family residential loans – Declining home sales volumes, decreased real estate values and higher than normal levels of unemployment could contribute to losses on these loans. As of June 30, 2018, single-family residential loans comprised approximately 37% of the Bank’s total loan portfolio, and include Banco’s single-family residential stated income loans, which were approximately 5% of the Bank’s total loan portfolio.

Commercial real estate loans – Repayment is dependent on income being generated in amounts sufficient to cover operating expenses and debt service. These loans also involve greater risk because they are generally not fully amortizing over a loan period, but rather have a balloon payment due at maturity. A borrower’s ability to make a balloon payment typically will depend on being able to either refinance the loan or timely sell the underlying property. As of June 30, 2018, commercial real estate loans comprised approximately 35% of the Bank’s total loan portfolio.

Commercial loans – Repayment is generally dependent upon the successful operation of the borrower’s business. In addition, the collateral securing the loans may depreciate over time, be difficult to appraise, be illiquid or fluctuate in value based on the success of the business. As of June 30, 2018, commercial loans comprised approximately 12% of the Bank’s total loan portfolio.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all of the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following tables present an age analysis of past due loans, by loan type, as of June 30, 2018 and December 31, 2017:

June 30, 2018

(Dollars in thousands)

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Total Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Real estate loans:						
Construction and land development	$631	-	631	79,138	79,769	-
Single-family residential	1,251	481	1,732	248,888	250,620	-
Single-family residential - Banco de la Gente stated income	940	232	1,172	34,675	35,847	-
Commercial	946	202	1,148	268,644	269,792	-
Multifamily and farmland	-	-	-	28,667	28,667	-
Total real estate loans	3,768	915	4,683	660,012	664,695	-
Loans not secured by real estate:						
Commercial loans	4	94	98	93,482	93,580	-
Farm loans	-	-	-	1,023	1,023	-
Consumer loans	158	5	163	9,259	9,422	-
All other loans	-	-	-	13,164	13,164	-
Total loans	$3,930	1,014	4,944	776,940	781,884	-

December 31, 2017

(Dollars in thousands)

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Total Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Real estate loans:						
Construction and land development	$277	-	277	84,710	84,987	-
Single-family residential	3,241	193	3,434	243,269	246,703	-
Single-family residential - Banco de la Gente stated income	4,078	465	4,543	32,706	37,249	-
Commercial	588	-	588	248,049	248,637	-
Multifamily and farmland	-	12	12	28,925	28,937	-
Total real estate loans	8,184	670	8,854	637,659	646,513	-
Loans not secured by real estate:						
Commercial loans	53	100	153	88,869	89,022	-
Farm loans	-	-	-	1,204	1,204	-
Consumer loans	113	5	118	9,770	9,888	-
All other loans	-	-	-	13,137	13,137	-
Total loans	$8,350	775	9,125	750,639	759,764	-

The following table presents non-accrual loans as of June 30, 2018 and December 31, 2017:

(Dollars in thousands)

	June 30, 2018	December 31, 2017
Real estate loans:		
Construction and land development	$123	14
Single-family residential	1,829	1,634
Single-family residential - Banco de la Gente stated income	1,467	1,543
Commercial	768	396
Multifamily and farmland	-	12
Total real estate loans	4,187	3,599
Loans not secured by real estate:		
Commercial loans	94	100
Consumer loans	11	12
Total	$4,292	3,711

At each reporting period, the Bank determines which loans are impaired. Accordingly, the Bank's impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan that is collateral-dependent is calculated based on the fair value of its collateral. The fair value of the collateral is based on appraisals performed by REAS, a subsidiary of the Bank. REAS is staffed by certified appraisers that also perform appraisals for other companies. Factors, including the assumptions and techniques utilized by the appraiser, are considered by management. If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses. An allowance for each impaired loan that is not collateral dependent is calculated based on the present value of projected cash flows. If the recorded investment in the impaired loan exceeds the present value of projected cash flows, a valuation allowance is recorded as a component of the allowance for loan losses. Impaired loans under $250,000 are not individually evaluated for impairment with the exception of the Bank's troubled debt restructured ("TDR") loans in the residential mortgage loan portfolio, which are individually evaluated for impairment. Accruing impaired loans were $24.3 million, $24.6 million and $22.4 million at June 30, 2018, December 31, 2017 and June 30, 2017, respectively. Interest income recognized on accruing impaired loans was $697,000, $1.4 million, and $740,000 for the six months ended June 30, 2018, the year ended December 31, 2017 and the six months ended June 30, 2017, respectively. No interest income is recognized on non-accrual impaired loans subsequent to their classification as non-accrual.

The following table presents impaired loans as of June 30, 2018:

June 30, 2018

(Dollars in thousands)

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Recorded Investment in Impaired Loans	Related Allowance
Real estate loans:					
Construction and land development	$357	-	357	357	8
Single-family residential	4,992	725	4,267	4,992	39
Single-family residential - Banco de la Gente stated income	16,213	-	16,213	16,213	1,082
Commercial	2,489	402	2,087	2,489	20
Multifamily and farmland	-	-	-	-	-
Total impaired real estate loans	24,051	1,127	22,924	24,051	1,149
Loans not secured by real estate:					
Commercial loans	96	94	2	96	-
Consumer loans	133	-	133	133	2
Total impaired loans	$24,280	1,221	23,059	24,280	1,151

The following table presents the average impaired loan balance and the interest income recognized by loan class for the three and six months ended June 30, 2018 and 2017.

(Dollars in thousands)

	Three months ended	Six months ended

	June 30, 2018		June 30, 2017		June 30, 2018		June 30, 2017	
	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized
Real estate loans:								
Construction and land development	$373	5	304	2	341	11	265	6
Single-family residential	6,306	66	4,595	63	6,325	135	5,185	131
Single-family residential - Banco de la Gente stated income	14,841	230	17,539	232	14,981	467	17,271	469
Commercial	2,304	42	3,831	66	2,359	80	3,778	125
Multifamily and farmland	-	-	45	-	4	-	56	-
Total impaired real estate loans	23,824	343	26,314	363	24,010	693	26,555	731
Loans not secured by real estate:								
Commercial loans	98	-	129	3	100	-	95	3
Farm loans (non RE)	-	-	-	-	-	-	-	-
Consumer loans	141	2	221	3	146	4	215	6
Total impaired loans	$24,063	345	26,664	369	24,256	697	26,865	740

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The following table presents impaired loans as of and for the year ended December 31, 2017:

December 31, 2017

(Dollars in thousands)

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Recorded Investment in Impaired Loans	Related Allowance	Average Outstanding Impaired Loans	YTD Interest Income Recognized
Real estate loans:							
Construction and land development	$282	-	277	277	6	253	17
Single-family residential	5,226	1,135	3,686	4,821	41	5,113	265
Single-family residential - Banco de la Gente stated income	17,360	-	16,805	16,805	1,149	16,867	920
Commercial	2,761	807	1,661	2,468	1	3,411	148
Multifamily and farmland	78	-	12	12	-	28	-
Total impaired real estate loans	25,707	1,942	22,441	24,383	1,197	25,672	1,350
Loans not secured by real estate:							
Commercial loans	264	100	4	104	-	149	3
Consumer loans	158	-	154	154	2	194	9
Total impaired loans	$26,129	2,042	22,599	24,641	1,199	26,015	1,362

Changes in the allowance for loan losses for the three and six months ended June 30, 2018 and 2017 were as follows:

(Dollars in thousands)	Real Estate Loans								
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer and All Other	Unallocated
Six months ended June 30, 2018:									
Allowance for loan losses:									
Beginning balance	$804	1,812	1,280	1,193	72	574	-	155	476
Charge-offs	-	(43)	-	(271)	(5)	(2)	-	(186)	-
Recoveries	3	27	-	7	1	16	-	102	-
Provision	(139)	(158)	(47)	491	4	(1)	-	79	33
Ending balance	$668	1,638	1,233	1,420	72	587	-	150	509
Three months ended June 30, 2018:									
Allowance for loan losses:									
Beginning balance	$651	1,640	1,265	1,298	73	706	-	136	604
Charge-offs	-	(43)	-	(271)	-	(2)	-	(85)	-
Recoveries	1	22	-	4	-	8	-	39	-
Provision	16	19	(32)	389	(1)	(125)	-	60	(95)
Ending balance	$668	1,638	1,233	1,420	72	587	-	150	509
Allowance for loan losses at June 30, 2018:									
Ending balance:									

individually evaluated for impairment	$-	2	1,066	18	-	-	-	-	-
Ending balance: collectively evaluated for impairment	668	1,636	167	1,402	72	587	-	150	509
Ending balance	$668	1,638	1,233	1,420	72	587	-	150	509
Loans at June 30, 2018:									
Ending balance	$79,769	250,620	35,847	269,792	28,667	93,580	1,023	22,586	-
Ending balance: individually evaluated for impairment	$95	2,132	14,975	2,103	-	94	-	-	-
Ending balance: collectively evaluated for impairment	$79,674	248,488	20,872	267,689	28,667	93,486	1,023	22,586	-

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(Dollars in thousands)

	Real Estate Loans								
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer and All Other	Unallocated
Six months ended June 30, 2017: Allowance for loan losses:									
Beginning balance	$1,152	2,126	1,377	1,593	52	675	-	204	371
Charge-offs	-	(44)	-	(66)	-	(37)	-	(182)	-
Recoveries	10	16	-	14	-	15	-	78	-
Provision	21	(279)	(84)	(78)	23	51	-	58	101
Ending balance	$1,183	1,819	1,293	1,463	75	704	-	158	472
Three months ended June 30, 2017: Allowance for loan losses:									
Beginning balance	$969	2,003	1,328	1,655	73	628	-	178	429
Charge-offs	-	(24)	-	-	(66)	(35)	-	(73)	-
Recoveries	3	9	-	6	-	7	-	28	-
Provision	211	(169)	(35)	(198)	68	104	-	25	43
Ending balance	$1,183	1,819	1,293	1,463	75	704	-	158	472
Allowance for loan losses at June 30, 2017: Ending balance:									

individually evaluated for impairment	$-	-	1,103	65	-	27	-	-	-
Ending balance: collectively evaluated for impairment	1,183	1,819	190	1,398	75	677	-	158	472
Ending balance	$1,183	1,819	1,293	1,463	75	704	-	158	472
Loans at June 30, 2017:									
Ending balance	$71,213	240,993	38,875	243,957	30,125	94,567	1,591	23,717	-
Ending balance: individually evaluated for impairment	$-	1,152	16,792	3,724	-	230	-	-	-
Ending balance: collectively evaluated for impairment	$71,213	239,841	22,083	240,233	30,125	94,337	1,591	23,717	-

The provision for loan losses for the three months ended June 30, 2018 was an expense of $231,000, as compared to an expense of $49,000 for the three months ended June 30, 2017. The increase in the provision for loan losses is primarily attributable to a $36.9 million increase in loans from June 30, 2017 to June 30, 2018.

The provision for loan losses for the six months ended June 30, 2018 was an expense of $262,000, as compared to a credit of $187,000 for the six months ended June 30, 2017. The increase in the provision for loan losses is primarily attributable to a $36.9 million increase in loans from June 30, 2017 to June 30, 2018.

The Company utilizes an internal risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. These risk grades are evaluated on an ongoing basis. A description of the general characteristics of the eight risk grades is as follows:

Risk Grade 1 – Excellent Quality: Loans are well above average quality and a minimal amount of credit risk exists. Certificates of deposit or cash secured loans or properly margined actively traded stock or bond secured loans would fall in this grade.

Risk Grade 2 – High Quality: Loans are of good quality with risk levels well within the Company’s range of acceptability. The organization or individual is established with a history of successful performance though somewhat susceptible to economic changes.

Risk Grade 3 – Good Quality: Loans of average quality with risk levels within the Company's range of acceptability but higher than normal. This may be a new organization or an existing organization in a transitional phase (e.g. expansion, acquisition, market change).

Risk Grade 4 – Management Attention: These loans have higher risk and servicing needs but still are acceptable. Evidence of marginal performance or deteriorating trends is observed. These are not problem credits presently, but may be in the future if the borrower is unable to change its present course.

Risk Grade 5 – Watch: These loans are currently performing satisfactorily, but there has been some recent past due history on repayment and there are potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Company's position at some future date.

Risk Grade 6 – Substandard: A Substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or the collateral pledged (if there is any). There is a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. There is a distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Risk Grade 7 – Doubtful: Loans classified as Doubtful have all the weaknesses inherent in loans classified as Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off.

Risk Grade 8 – Loss: Loans classified as Loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this worthless loan even though partial recovery may be realized in the future. Loss is a temporary grade until the appropriate authority is obtained to charge the loan off.

The following tables present the credit risk profile of each loan type based on internally assigned risk grades as of June 30, 2018 and December 31, 2017:

June 30, 2018

(Dollars in thousands)

	Real Estate Loans									
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer	All Other	Total
1- Excellent Quality	$472	7,134	-	-	-	574	-	576	-	8,75
2- High Quality	20,688	125,870	-	29,624	477	23,450	-	3,305	2,259	205
3- Good Quality	49,044	91,359	14,373	218,439	25,325	61,998	870	4,909	10,128	476
4- Management Attention	4,411	18,816	14,727	17,868	1,750	7,168	153	590	777	66,2
5- Watch	4,884	3,996	3,112	3,093	1,115	283	-	20	-	16,5
6- Substandard	270	3,445	3,635	768	-	107	-	22	-	8,24
7- Doubtful	-	-	-	-	-	-	-	-	-	-
8- Loss	-	-	-	-	-	-	-	-	-	-

Total	$79,769	250,620	35,847	269,792	28,667	93,580	1,023	9,422	13,164	781

December 31, 2017

(Dollars in thousands)

	Real Estate Loans								
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer	All Other
1- Excellent Quality	$152	8,590	-	-	-	446	-	791	-
2- High Quality	20,593	120,331	-	34,360	561	17,559	-	3,475	2,410
3- Good Quality	53,586	89,120	14,955	196,439	25,306	65,626	1,085	5,012	9,925
4- Management Attention	4,313	20,648	15,113	13,727	1,912	5,051	119	562	802
5- Watch	6,060	4,796	3,357	3,671	1,146	223	-	23	-
6- Substandard	283	3,218	3,824	440	12	117	-	25	-
7- Doubtful	-	-	-	-	-	-	-	-	-
8- Loss	-	-	-	-	-	-	-	-	-
Total	$84,987	246,703	37,249	248,637	28,937	89,022	1,204	9,888	13,137

Current year TDR modifications, past due TDR loans and non-accrual TDR loans totaled $1.8 million and $4.5 million at June 30, 2018 and December 31, 2017, respectively. The terms of these loans have been renegotiated to provide a concession to original terms, including a reduction in principal or interest as a result of the deteriorating financial position of the borrower. There was $33,000 and $21,000 in performing loans classified as TDR loans at June 30, 2018 and December 31, 2017, respectively.

The following table presents an analysis of TDR loan modifications during the three and six months ended June 30, 2018.

Three and six months ended June 30, 2018

(Dollars in thousands)

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate loans			
Single-family residential	1	$33	33
Total real estate TDR loans	1	33	33
Total TDR loans	1	$33	33

During the three and six months ended June 30, 2018, one loan was modified that was considered to be a new TDR loan. The interest rate was modified on this TDR loan.

There were no new TDR modifications during the three and six months ended June 30, 2017.

There were no loans modified as TDR that defaulted during the three and six months ended June 30, 2018 and 2017, which were within 12 months of their modification date. Generally, a TDR loan is considered to be in default once it becomes 90 days or more past due following a modification.

(4)
Net Earnings Per Share

Net earnings per share is based on the weighted average number of shares outstanding during the period while the effects of potential shares outstanding during the period are included in diluted earnings per share. The average market price during the year is used to compute equivalent shares.

The reconciliation of the amounts used in the computation of both “basic earnings per share” and “diluted earnings per share” for the three and six months ended June 30, 2018 and 2017 is as follows:

For the three months ended June 30, 2018

	Net Earnings (Dollars in thousands)	Weighted Average Number of Shares	Per Share Amount
Basic earnings per share	$3,176	5,995,256	$0.53
Effect of dilutive securities:			

Restricted stock units	-	18,917	
Diluted earnings per share	$3,176	6,014,173	$0.53

For the six months ended June 30, 2018

	Net Earnings (Dollars in thousands)	Weighted Average Number of Shares	Per Share Amount
Basic earnings per share	$6,479	5,995,256	$1.08
Effect of dilutive securities:			
Restricted stock units	-	17,964	
Diluted earnings per share	$6,479	6,013,220	$1.08

For the three months ended June 30, 2017

	Net Earnings (Dollars in thousands)	Weighted Average Number of Shares	Per Share Amount
Basic earnings per share	$2,811	5,989,414	$0.47
Effect of dilutive securities:			
Restricted stock units	-	95,171	
Diluted earnings per share	$2,811	6,084,585	$0.47

For the six months ended June 30, 2017

	Net Earnings (Dollars in thousands)	Weighted Average Number of Shares	Per Share Amount
Basic earnings per share	$5,016	5,979,764	$0.84
Effect of dilutive securities:			
Restricted stock units	-	93,664	
Diluted earnings per share	$5,016	6,073,428	$0.83

In November 2017, the Board of Directors of the Company declared a 10% stock dividend. As a result of the stock dividend, each shareholder received one new share of stock for every ten shares of stock they held as of the record date of December 4, 2017. The payable date for the stock dividend was December 15, 2017. All previously reported per share amounts have been restated to reflect this stock dividend.

(5)
Stock-Based Compensation

The Company has an Omnibus Stock Ownership and Long Term Incentive Plan that was approved by shareholders on May 7, 2009 (the "Plan") whereby certain stock-based rights, such as stock options, restricted stock, restricted stock units, performance units, stock appreciation rights or book value shares, may be granted to eligible directors and employees. A total of 280,933 shares are currently reserved for possible issuance under the Plan. All stock-based rights under the Plan must be granted or awarded by May 7, 2019 (i.e., ten years from the Plan effective date).

The Company granted 32,465 restricted stock units under the Plan at a grant date fair value of $7.18 per share during the first quarter of 2012, of which 5,891 restricted stock units were forfeited by the executive officers of the Company as required by the agreement with the U.S. Department of the Treasury in conjunction with the Company's participation in the Capital Purchase Program under the Troubled Asset Relief Program. In July 2012, the Company granted 5,891 restricted stock units at a grant date fair value of $7.50 per share. The Company granted 29,475 restricted stock units under the Plan at a grant date fair value of $10.82 per share during the second quarter of 2013. The Company granted 23,162 restricted stock units under the Plan at a grant date fair value of $14.27 per share during the first quarter of 2014. The Company granted 16,583 restricted stock units under the Plan at a grant date fair value of $16.34 per share during the first quarter of 2015. The Company granted 5,544 restricted stock units under the Plan at a grant date fair value of $16.91 per share during the first quarter of 2016. The Company granted 4,114 restricted stock units under the Plan at a grant date fair value of $25.00 per share during the first quarter of 2017. The Company granted 3,725 restricted stock units under the Plan at a grant date fair value of $31.43 per share during the first quarter of 2018. The number of restricted stock units granted and grant date fair values have been restated to reflect the 10% stock dividend during the fourth quarter of 2017. The Company recognizes compensation expense on the restricted stock units over the period of time the restrictions are in place (five years from the grant date for the 2012 grants, four years from the grant date for the 2013, 2015, 2016, 2017 and 2018 grants and three years from the grant date for the 2014 grants). The amount of expense recorded each period reflects the changes in the Company’s stock price during such period. As of June 30, 2018, the total unrecognized compensation expense related to the restricted stock unit grants under the Plan was $334,000.

The Company recogni