AMES NATIONAL CORP
Form 10-Q
November 08, 2016
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**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 September 30, 2016

[_] 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 0-32637

**AMES NATIONAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **IOWA** | **42-1039071** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I. R. S. Employer Identification Number) |

**405 FIFTH STREET**

**AMES, IOWA 50010**

(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: **(515) 232-6251**

**Not Applicable**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 (Section 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, or a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer____ Accelerated filer __X__ Non-accelerated filer ____ Smaller reporting company ____

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

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

| | |
|---|---|
| **COMMON STOCK, $2.00 PAR VALUE** | **9,310,913** |
| (Class) | (Shares Outstanding at October 28, 2016) |

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AMES NATIONAL CORPORATION

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**
*(unaudited)*

| **ASSETS** | **September 30, 2016** | **December 31, 2015** |
|---|---|---|
| Cash and due from banks | $21,305,138 | $24,005,801 |
| Interest bearing deposits in financial institutions | 25,998,518 | 26,993,091 |
| Securities available-for-sale | 517,579,320 | 537,632,990 |
| Loans receivable, net | 740,321,874 | 701,328,171 |
| Loans held for sale | 1,188,415 | 539,370 |
| Bank premises and equipment, net | 16,342,418 | 17,007,798 |
| Accrued income receivable | 8,370,918 | 7,565,791 |
| Other real estate owned | 653,684 | 1,249,915 |
| Deferred income taxes | - | 1,276,571 |
| Core deposit intangible, net | 1,035,525 | 1,308,731 |
| Goodwill | 6,732,216 | 6,732,216 |
| Other assets | 815,950 | 1,106,698 |
| **Total assets** | $1,340,343,976 | $1,326,747,143 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| LIABILITIES | | |
| Deposits | | |
| Demand, noninterest bearing | $187,835,703 | $202,542,011 |
| NOW accounts | 302,133,497 | 298,227,493 |
| Savings and money market | 366,167,359 | 354,026,475 |
| Time, $250,000 and over | 35,663,074 | 36,956,653 |
| Other time | 170,009,512 | 182,440,490 |
| **Total deposits** | 1,061,809,145 | 1,074,193,122 |
| Securities sold under agreements to repurchase | 49,858,395 | 54,289,915 |
| Federal Home Loan Bank (FHLB) advances | 38,000,000 | 18,542,203 |
| Other borrowings | 13,000,000 | 13,000,000 |
| Deferred income taxes | 1,039,151 | - |
| Dividend payable | 1,955,292 | 1,862,183 |
| Accrued expenses and other liabilities | 3,945,268 | 3,609,663 |
| **Total liabilities** | 1,169,607,251 | 1,165,497,086 |
| STOCKHOLDERS' EQUITY | | |
| Common stock, $2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of September 30, 2016 and December 31, 2015 | 18,621,826 | 18,621,826 |
| Additional paid-in capital | 20,878,728 | 20,878,728 |

| | | |
|---|---|---|
| Retained earnings | 124,112,244 | 118,267,767 |
| Accumulated other comprehensive income - net unrealized gain on securities available-for-sale | 7,123,927 | 3,481,736 |
| **Total stockholders' equity** | 170,736,725 | 161,250,057 |
| **Total liabilities and stockholders' equity** | $1,340,343,976 | $1,326,747,143 |

See Notes to Consolidated Financial Statements.

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**
*(unaudited)*

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Interest income: | | | | |
| Loans, including fees | $8,236,401 | $7,808,414 | $24,124,973 | $22,920,161 |
| Securities: | | | | |
| Taxable | 1,425,366 | 1,506,702 | 4,392,602 | 4,639,398 |
| Tax-exempt | 1,329,071 | 1,433,537 | 4,117,893 | 4,399,623 |
| Interest bearing deposits and federal funds sold | 86,869 | 94,364 | 296,925 | 288,411 |
| **Total interest income** | 11,077,707 | 10,843,017 | 32,932,393 | 32,247,593 |
| Interest expense: | | | | |
| Deposits | 753,642 | 744,958 | 2,259,140 | 2,276,004 |
| Other borrowed funds | 274,297 | 257,791 | 796,006 | 898,565 |
| **Total interest expense** | 1,027,939 | 1,002,749 | 3,055,146 | 3,174,569 |
| **Net interest income** | 10,049,768 | 9,840,268 | 29,877,247 | 29,073,024 |
| Provision for loan losses | 234,703 | 37,797 | 440,787 | 1,036,610 |
| **Net interest income after provision for loan losses** | 9,815,065 | 9,802,471 | 29,436,460 | 28,036,414 |
| Noninterest income: | | | | |
| Wealth management income | 684,908 | 671,699 | 2,210,229 | 2,040,956 |
| Service fees | 426,711 | 445,706 | 1,228,416 | 1,285,063 |
| Securities gains, net | 64,917 | 111,622 | 296,110 | 608,926 |
| Gain on sale of loans held for sale | 339,501 | 206,072 | 773,512 | 705,370 |
| Merchant and card fees | 350,488 | 350,310 | 1,051,378 | 1,016,783 |
| Other noninterest income | 137,153 | 164,568 | 469,138 | 466,085 |
| **Total noninterest income** | 2,003,678 | 1,949,977 | 6,028,783 | 6,123,183 |
| Noninterest expense: | | | | |
| Salaries and employee benefits | 3,977,495 | 3,882,484 | 11,883,696 | 11,418,395 |
| Data processing | 824,429 | 720,232 | 2,366,293 | 2,089,363 |
| Occupancy expenses, net | 449,775 | 414,868 | 1,461,201 | 1,408,464 |
| FDIC insurance assessments | 109,289 | 169,692 | 434,808 | 519,962 |
| Professional fees | 296,720 | 346,665 | 889,721 | 951,835 |
| Business development | 239,917 | 254,757 | 696,033 | 719,689 |
| Other real estate owned expense (income), net | (91,173) | (104,380) | (87,564) | 605,830 |
| Core deposit intangible amortization | 86,492 | 103,251 | 273,206 | 326,249 |

| | | | | |
|---|---|---|---|---|
| Other operating expenses, net | 219,283 | 194,639 | 750,244 | 773,430 |
| **Total noninterest expense** | 6,112,227 | 5,982,208 | 18,667,638 | 18,813,217 |
| **Income before income taxes** | 5,706,516 | 5,770,240 | 16,797,605 | 15,346,380 |
| Provision for income taxes | 1,902,636 | 1,670,389 | 5,087,253 | 4,246,790 |
| **Net income** | $3,803,880 | $4,099,851 | $11,710,352 | $11,099,590 |
| Basic and diluted earnings per share | $0.41 | $0.44 | $1.26 | $1.19 |
| Dividends declared per share | $0.21 | $0.20 | $0.63 | $0.60 |

See Notes to Consolidated Financial Statements.

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
*(unaudited)*

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Net income | $3,803,880 | $4,099,851 | $11,710,352 | $11,099,590 |
| Other comprehensive income (loss), before tax: | | | | |
| Unrealized gains (losses) on securities before tax: | | | | |
| Unrealized holding gains (losses) arising during the period | (1,838,831) | 2,649,038 | 6,077,365 | 954,990 |
| Less: reclassification adjustment for gains realized in net income | 64,917 | 111,622 | 296,110 | 608,926 |
| Other comprehensive income (loss), before tax | (1,903,748) | 2,537,416 | 5,781,255 | 346,064 |
| Tax effect related to other comprehensive income (loss) | 704,387 | (938,843) | (2,139,064) | (128,044) |
| Other comprehensive income (loss), net of tax | (1,199,361) | 1,598,573 | 3,642,191 | 218,020 |
| Comprehensive income | $2,604,519 | $5,698,424 | $15,352,543 | $11,317,610 |

See Notes to Consolidated Financial Statements.

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**
*(unaudited)*
**Nine Months Ended September 30, 2016 and 2015**

| | Common Stock | Additional Paid-in-Capital | Retained Earnings | Accumulated Other Comprehensive Income, Net of Taxes | Total Stockholders' Equity |
|---|---|---|---|---|---|
| **Balance, December 31, 2014** | $18,621,826 | $ 20,878,728 | $110,701,847 | $ 4,472,017 | $154,674,418 |
| Net income | - | - | 11,099,590 | - | 11,099,590 |
| Other comprehensive income | - | - | - | 218,020 | 218,020 |
| Cash dividends declared, $0.60 per share | - | - | (5,586,548 ) | - | (5,586,548 ) |
| **Balance, September 30, 2015** | $18,621,826 | $ 20,878,728 | $116,214,889 | $ 4,690,037 | $160,405,480 |
| | | | | | |
| **Balance, December 31, 2015** | $18,621,826 | $ 20,878,728 | $118,267,767 | $ 3,481,736 | $161,250,057 |
| Net income | - | - | 11,710,352 | - | 11,710,352 |
| Other comprehensive income | - | - | - | 3,642,191 | 3,642,191 |
| Cash dividends declared, $0.63 per share | - | - | (5,865,875 ) | - | (5,865,875 ) |
| **Balance, September 30, 2016** | $18,621,826 | $ 20,878,728 | $124,112,244 | $ 7,123,927 | $170,736,725 |

See Notes to Consolidated Financial Statements.

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
*(unaudited)*
**Nine Months Ended September 30, 2016 and 2015**

| | **2016** | **2015** |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $11,710,352 | $11,099,590 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 440,787 | 1,036,610 |
| Provision for off-balance sheet commitments | 12,000 | 7,000 |
| Amortization, net | 2,327,654 | 2,590,850 |
| Amortization of core deposit intangible asset | 273,206 | 326,249 |
| Depreciation | 885,202 | 812,607 |
| Deferred income taxes | 176,658 | 526,700 |
| Securities gains, net | (296,110) | (608,926) |
| Loss on sale of premises and equipment, net | 2,769 | 1,132 |
| Impairment of other real estate owned | 28,039 | 614,687 |
| (Gain) on sale of other real estate owned, net | (131,127) | (88,164) |
| Change in assets and liabilities: | | |
| (Increase) in loans held for sale | (649,045) | (211,472) |
| (Increase) in accrued income receivable | (805,127) | (1,069,704) |
| Decrease in other assets | 286,238 | 321,674 |
| Increase in accrued expenses and other liabilities | 323,605 | 546,791 |
| **Net cash provided by operating activities** | 14,585,101 | 15,905,624 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of securities available-for-sale | (49,668,267) | (87,374,515) |
| Proceeds from sale of securities available-for-sale | 18,738,154 | 21,305,694 |
| Proceeds from maturities and calls of securities available-for-sale | 54,611,331 | 60,365,412 |
| Net (increase) decrease in interest bearing deposits in financial institutions | 994,573 | (8,691,970) |
| Decrease in federal funds sold | - | 6,000 |
| Net (increase) in loans | (39,394,414) | (32,535,238) |
| Net proceeds from the sale of other real estate owned | 755,906 | 4,594,675 |
| Purchase of bank premises and equipment, net | (218,081) | (1,679,676) |
| Other | - | (28,812) |
| **Net cash (used in) investing activities** | (14,180,798) | (44,038,430) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Increase (decrease) in deposits | (12,358,477) | 9,357,287 |
| Increase (decrease) in securities sold under agreements to repurchase | (4,431,520) | 800,552 |
| Payments on FHLB borrowings and other borrowings | (1,542,203) | (10,414,260) |
| Proceeds from short-term FHLB borrowings, net | 21,000,000 | 36,200,000 |
| Dividends paid | (5,772,766) | (5,400,329) |

| | | |
|---|---|---|
| **Net cash provided by (used in) financing activities** | (3,104,966) | 30,543,250 |
| **Net increase (decrease) in cash and due from banks** | (2,700,663) | 2,410,444 |
| CASH AND DUE FROM BANKS | | |
| Beginning | 24,005,801 | 23,730,257 |
| Ending | $21,305,138 | $26,140,701 |

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**
*(unaudited)*
**Nine Months Ended September 30, 2016 and 2015**

| | **2016** | **2015** |
|---|---|---|
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash payments for: | | |
| Interest | $3,145,519 | $3,377,794 |
| Income taxes | 4,223,653 | 3,246,791 |
| | | |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES | | |
| Transfer of loans receivable to other real estate owned | $56,587 | $74,609 |

See Notes to Consolidated Financial Statements.

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**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

Notes to Consolidated Financial Statements *(unaudited)*

1. Significant Accounting Policies

The consolidated financial statements for the three and nine months ended September 30, 2016 and 2015 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 (the “Annual Report”). The consolidated financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the “Banks”). All significant intercompany balances and transactions have been eliminated in consolidation.

Goodwill: Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually or whenever events change and circumstances indicate that it is more likely than not that an impairment loss has occurred. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. The second step, if necessary, measures the amount of impairment, if any.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium. At September 30, 2016, Company management has performed a goodwill impairment assessment and determined goodwill was not impaired.

Current Accounting Developments: In January 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities.* The update enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by updating certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Among other changes, the update includes requiring changes in fair value of equity securities with readily determinable fair value to be recognized in net income and clarifies that entities should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entities' other deferred tax assets. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017, and is to be applied on a modified retrospective basis. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU requires a lessee to recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Consistent with current Generally Accepted Accounting Principles (“GAAP”), the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. Unlike current GAAP, which requires that only capital leases be recognized on the balance sheet, the ASC requires that both types of leases by recognized on the balance sheet. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2018. Early application is permitted. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

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In February 2016, the FASB issued ASU Update No. 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. Among other items the ASC requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017. The effect of the adoption of this guidance has not yet been determined by the Company.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019. The effect of the adoption of this guidance has not yet been determined by the Company.

2. Dividends

On August 10, 2016, the Company declared a cash dividend on its common stock, payable on November 15, 2016 to stockholders of record as of November 1, 2016, equal to $0.21 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three and nine months ended September 30, 2016 and 2015 were 9,310,913. The Company had no potentially dilutive securities outstanding during the periods presented.

4. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company’s off-balance sheet arrangements have occurred since December 31, 2015.

5. Fair Value Measurements

Assets and liabilities carried at fair value are required to be classified and disclosed according to the process for determining fair value. There are three levels of determining fair value.

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

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Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following table presents the balances of assets measured at fair value on a recurring basis by level as of September 30, 2016 and December 31, 2015. *(in thousands)*

| Description | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **2016** | | | | |
| U.S. government treasuries | $1,505 | $1,505 | $- | $ - |
| U.S. government agencies | 108,222 | - | 108,222 | - |
| U.S. government mortgage-backed securities | 82,685 | - | 82,685 | - |
| State and political subdivisions | 266,535 | - | 266,535 | - |
| Corporate bonds | 54,678 | - | 54,678 | - |
| Equity securities, other | 3,954 | - | 3,954 | - |
| | $517,579 | $1,505 | $516,074 | $ - |
| **2015** | | | | |
| U.S. government treasuries | $1,467 | $1,467 | $- | $ - |
| U.S. government agencies | 106,445 | - | 106,445 | - |
| U.S. government mortgage-backed securities | 98,079 | - | 98,079 | - |
| State and political subdivisions | 277,597 | - | 277,597 | - |
| Corporate bonds | 50,889 | - | 50,889 | - |
| Equity securities, other | 3,156 | - | 3,156 | - |
| | $537,633 | $1,467 | $536,166 | $ - |

Level 1 securities include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets.  U.S government mortgage-backed securities, state and political subdivisions, most corporate bonds and other equity securities are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security’s terms and conditions, among other things.

The Company's policy is to recognize transfers between levels at the end of each reporting period, if applicable. There were no transfers between levels of the fair value hierarchy during the nine months ended September 30, 2016.

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Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level within the valuation hierarchy as of September 30, 2016 and December 31, 2015. *(in thousands)*

| Description | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **2016** | | | | |
| Loans receivable | $1,185 | $ - | $ - | $1,185 |
| Other real estate owned | 654 | - | - | 654 |
| Total | $1,839 | $ - | $ - | $1,839 |
| **2015** | | | | |
| Loans receivable | $603 | $ - | $ - | $603 |
| Other real estate owned | 1,250 | - | - | 1,250 |
| Total | $1,853 | $ - | $ - | $1,853 |

Loans Receivable: Loans in the tables above consist of impaired credits held for investment. In accordance with the loan impairment guidance, impairment was measured based on the fair value of collateral less estimated selling costs for collateral dependent loans. Fair value for impaired loans is based upon appraised values of collateral adjusted for trends observed in the market. A valuation allowance was recorded for the excess of the loan's recorded investment over the amounts determined by the collateral value method. This valuation allowance is a component of the allowance for loan losses. The Company considers these fair value measurements as level 3.

Other Real Estate Owned: Other real estate owned in the table above consists of real estate obtained through foreclosure. Other real estate owned is recorded at fair value less estimated selling costs, at the date of transfer, with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs, with any impairment amount recorded as a noninterest expense. The carrying value of other real estate owned is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value less estimated selling costs. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. A valuation allowance was recorded for the excess of the asset's recorded investment over the amount determined by the fair value, less estimated selling costs. This valuation allowance is a component of the allowance for other real estate owned. The valuation allowance was $426,000 as of September 30, 2016 and $681,000 as of December 31, 2015. The Company considers these fair value measurements as level 3.

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The significant inputs used in the fair value measurements for Level 3 assets measured at fair value on a nonrecurring basis as of September 30, 2016 and December 31, 2015 are as follows: *(in thousands)*

| | **2016** Estimated Fair Value | Valuation Techniques | Unobservable Inputs | Range (Average) | |
|---|---|---|---|---|---|
| Impaired Loans | $ 1,185 | Evaluation of collateral | Estimation of value | NM* | |
| Other real estate owned | $ 654 | Appraisal | Appraisal adjustment | 6% - 8% | (7%) |

| | **2015** Estimated Fair Value | Valuation Techniques | Unobservable Inputs | Range (Average) | |
|---|---|---|---|---|---|
| Impaired Loans | $ 603 | Evaluation of collateral | Estimation of value | NM* | |
| Other real estate owned | $ 1,250 | Appraisal | Appraisal adjustment | 6% - 10% | (8%) |

* Not Meaningful. Evaluations of the underlying assets are completed for each impaired loan with a specific reserve. The types of collateral vary widely and could include accounts receivables, inventory, a variety of equipment and real estate. Collateral evaluations are reviewed and discounted as appropriate based on knowledge of the specific type of collateral. In the case of real estate, an independent appraisal may be obtained. Types of discounts considered included aging of receivables, condition of the collateral, potential market for the collateral and estimated disposal costs. These discounts will vary from loan to loan, thus providing a range would not be meaningful.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

**Fair value of financial instruments:**

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases in which quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Company.

The following disclosures represent financial instruments in which the ending balances at September 30, 2016 and December 31, 2015 are not carried at fair value in their entirety on the consolidated balance sheets.

Cash and due from banks and interest bearing deposits in financial institutions: The recorded amount of these assets approximates fair value.

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Securities available-for-sale: Fair value measurement for Level 1 securities is based upon quoted prices. Fair value measurement for Level 2 securities are based upon quoted prices, if available. If quoted prices are not available, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things. Level 1 securities include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets.  U.S government mortgage-backed securities, state and political subdivisions, some corporate bonds and other equity securities are reported at fair value utilizing Level 2 inputs.

Loans receivable: The fair value of loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates, which reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the historical experience, with repayments for each loan classification modified, as required, by an estimate of the effect of current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate.

Loans held for sale: The fair value of loans held for sale is based on prevailing market prices.

Deposits: Fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market accounts, are equal to the amount payable on demand as of the respective balance sheet date. Fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Securities sold under agreements to repurchase: The carrying amounts of securities sold under agreements to repurchase approximate fair value because of the generally short-term nature of the instruments.

FHLB advances and other borrowings: Fair values of FHLB advances and other borrowings are estimated using discounted cash flow analysis based on interest rates currently being offered with similar terms.

Accrued income receivable and accrued interest payable: The carrying amounts of accrued income receivable and accrued interest payable approximate fair value.

Commitments to extend credit and standby letters of credit: The fair values of commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and credit worthiness of the counterparties. The carrying value and fair value of the commitments to extend credit and standby letters of credit are not considered significant.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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The estimated fair values of the Company's financial instruments as described above as of September 30, 2016 and December 31, 2015 are as follows: *(in thousands)*

| | | 2016 | | 2015 | |
|---|---|---|---|---|---|
| | Fair Value Hierarchy Level | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | | |
| Cash and due from banks | Level 1 | $21,305 | $21,305 | $24,006 | $24,006 |
| Interest bearing deposits | Level 1 | 25,999 | 25,999 | 26,993 | 26,993 |
| Securities available-for-sale | See previous table | 517,579 | 517,579 | 537,633 | 537,633 |
| Loans receivable, net | Level 2 | 740,322 | 741,279 | 701,328 | 702,438 |
| Loans held for sale | Level 2 | 1,188 | 1,188 | 539 | 539 |
| Accrued income receivable | Level 1 | 8,371 | 8,371 | 7,566 | 7,566 |
| Financial liabilities: | | | | | |
| Deposits | Level 2 | $1,061,809 | $1,063,219 | $1,074,193 | $1,075,289 |
| Securities sold under agreements to repurchase | Level 1 | 49,858 | 49,858 | 54,290 | 54,290 |
| FHLB advances | Level 2 | 38,000 | 38,304 | 18,542 | 19,017 |
| Other borrowings | Level 2 | 13,000 | 13,510 | 13,000 | 13,807 |
| Accrued interest payable | Level 1 | 348 | 348 | 413 | 413 |

The methodologies used to determine fair value as of September 30, 2016 did not change from the methodologies described in the December 31, 2015 Annual Financial Statements.

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6. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of September 30, 2016 and December 31, 2015 are summarized below: *(in thousands)*

| **2016:** | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| U.S. government treasuries | $ 1,454 | $ 51 | $ - | $ 1,505 |
| U.S. government agencies | 105,400 | 2,865 | (43 ) | 108,222 |
| U.S. government mortgage-backed securities | 79,916 | 2,769 | - | 82,685 |
| State and political subdivisions | 261,981 | 4,823 | (269 ) | 266,535 |
| Corporate bonds | 53,566 | 1,163 | (51 ) | 54,678 |
| Equity securities, other | 3,954 | - | - | 3,954 |
| | $ 506,271 | $ 11,671 | $ (363 ) | $ 517,579 |

| **2015:** | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| U.S. government treasuries | $ 1,444 | $ 23 | $ - | $ 1,467 |
| U.S. government agencies | 105,948 | 797 | (300 ) | 106,445 |
| U.S. government mortgage-backed securities | 96,373 | 1,828 | (123 ) | 98,078 |
| State and political subdivisions | 273,771 | 4,359 | (533 ) | 277,597 |
| Corporate bonds | 51,414 | 227 | (751 ) | 50,890 |
| Equity securities, other | 3,156 | - | - | 3,156 |
| | $ 532,106 | $ 7,234 | $ (1,707 ) | $ 537,633 |

The proceeds, gains and losses from securities available-for-sale are summarized as follows: *(in thousands)*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Proceeds from sales of securities available-for-sale | $ 5,852 | $ 5,926 | $ 18,738 | $ 21,306 |
| Gross realized gains on securities available-for-sale | 66 | 126 | 303 | 623 |
| Gross realized losses on securities available-for-sale | (1 ) | (14 ) | (7 ) | (14 ) |

| | | | | |
|---|---|---|---|---|
| Tax provision applicable to net realized gains on securities available-for-sale | 29 | 42 | 110 | 227 |

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Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as of September 30, 2016 and December 31, 2015 are as follows: *(in thousands)*

| **2016:** | Less than 12 Months Estimated Fair Value | Unrealized Losses | 12 Months or More Estimated Fair Value | Unrealized Losses | Total Estimated Fair Value | Unrealized Losses |
|---|---|---|---|---|---|---|
| Securities available-for-sale: | | | | | | |
| U.S. government agencies | $4,014 | $ (43) | $- | $ - | $4,014 | $ (43) |
| State and political subdivisions | 22,711 | (262) | 1,725 | (7) | 24,436 | (269) |
| Corporate bonds | 2,106 | (14) | 3,275 | (37) | 5,381 | (51) |
| | $28,831 | $ (319) | $5,000 | $ (44) | $33,831 | $ (363) |

| **2015:** | Less than 12 Months Fair Value | Unrealized Losses | 12 Months or More Fair Value | Unrealized Losses | Total Fair Value | Unrealized Losses |
|---|---|---|---|---|---|---|
| Securities available-for-sale: | | | | | | |
| U.S. government agencies | $30,245 | $ (253) | $3,121 | $ (47) | $33,366 | $ (300) |
| U.S. government mortgage-backed securities | 22,842 | (123) | - | - | 22,842 | (123) |
| State and political subdivisions | 38,202 | (414) | 11,096 | (119) | 49,298 | (533) |
| Corporate bonds | 22,091 | (249) | 14,614 | (502) | 36,705 | (751) |
| | $113,380 | $ (1,039) | $28,831 | $ (668) | $142,211 | $ (1,707) |

Gross unrealized losses on debt securities totaled $363,000 as of September 30, 2016. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, state or political subdivision, or corporations. Management then determines whether downgrades by bond rating agencies have occurred, and reviews industry analysts' reports. The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates. Management concluded that the gross unrealized losses on debt securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

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7. Loans Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three and nine months ended September 30, 2016 and 2015 is as follows: *(in thousands)*

| | **Three Months Ended September 30, 2016** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Construction Real Estate | 1-4 Family Residential Real Estate | Commercial Real Estate | Agricultural Real Estate | Commercial | Agricultural | Consumer and Other | Total |
| Balance, June 30, 2016 | $758 | $ 1,742 | $ 3,890 | $ 834 | $ 1,439 | $ 1,219 | $ 253 | $10,135 |
| Provision (credit) for loan losses | 121 | 32 | (89) | - | 169 | 12 | (10) | 235 |
| Recoveries of loans charged-off | 15 | 1 | - | - | 75 | - | 2 | 93 |
| Loans charged-off | - | - | - | - | (1) | - | (11) | (12) |
| Balance, September 30, 2016 | $894 | $ 1,775 | $ 3,801 | $ 834 | $ 1,682 | $ 1,231 | $ 234 | $10,451 |

| | **Nine Months Ended September 30, 2016** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Construction Real Estate | 1-4 Family Residential Real Estate | Commercial Real Estate | Agricultural Real Estate | Commercial | Agricultural | Consumer and Other | Total |
| Balance, December 31, 2015 | $999 | $ 1,806 | $ 3,557 | $ 760 | $ 1,371 | $ 1,256 | $ 239 | $9,988 |
| Provision (credit) for loan losses | (135) | (34) | 244 | 74 | 308 | (25) | 9 | 441 |
| Recoveries of loans charged-off | 30 | 3 | - | - | 81 | - | 7 | 121 |
| Loans charged-off | - | - | - | - | (78) | - | (21) | (99) |
| Balance, September 30, 2016 | $894 | $ 1,775 | $ 3,801 | $ 834 | $ 1,682 | $ 1,231 | $ 234 | $10,451 |

| | **Three Months Ended September 30, 2015** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Construction Real Estate | 1-4 Family Residential Real Estate | Commercial Real Estate | Agricultural Real Estate | Commercial | Agricultural | Consumer and Other | Total |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Balance, June 30, 2015 | $823 | $ 1,826 | $ 3,590 | $ 812 | $ 1,263 | $ 1,338 | $ 220 | $9,872 |
| Provision for loan losses | 130 | (10) | (129) | (20) | 97 | (44) | 14 | 38 |
| Recoveries of loans charged-off | 15 | 2 | - | - | - | - | 16 | 33 |
| Loans charged-off | - | (1) | - | - | - | - | (15) | (16) |
| Balance, September 30, 2015 | $968 | $ 1,817 | $ 3,461 | $ 792 | $ 1,360 | $ 1,294 | $ 235 | $9,927 |

| | Nine Months Ended September 30, 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Construction Real Estate | 1-4 Family Residential Real Estate | Commercial Real Estate | Agricultural Real Estate | Commercial | Agricultural | Consumer and Other | Total |
| Balance, December 31, 2014 | $495 | $ 1,648 | $ 3,214 | $ 737 | $ 1,247 | $ 1,312 | $ 186 | $8,839 |
| Provision for loan losses | 438 | 154 | 247 | 55 | 113 | (18) | 48 | 1,037 |
| Recoveries of loans charged-off | 35 | 22 | - | - | - | - | 24 | 81 |
| Loans charged-off | - | (7) | - | - | - | - | (23) | (30) |
| Balance, September 30, 2015 | $968 | $ 1,817 | $ 3,461 | $ 792 | | | | |