MIDDLEFIELD BANC CORP
Form 10-Q
May 13, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20552

FORM 10 - Q

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

For the quarterly period ended March 31, 2015

Commission File Number 001-36613

Middlefield Banc Corp.

(Exact name of registrant as specified in its charter)

Ohio	**34 - 1585111**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

15985 East High Street, Middlefield, Ohio 44062-9263

(Address of principal executive offices)

(440) 632-1666

(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 website, 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 [ ] NO [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Small 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 [ ]

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date:

Class: Common Stock, without par value

Outstanding at May 13, 2015: 2,247,808

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MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

	March 31, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$32,727	$20,846
Federal funds sold	12,535	4,793
Cash and cash equivalents	45,262	25,639
Investment securities available for sale, at fair value	151,159	154,334
Loans held for sale	690	438
Loans	475,818	470,584
Less allowance for loan and lease losses	6,447	6,846
Net loans	469,371	463,738
Premises and equipment, net	9,927	9,980
Goodwill	4,559	4,559
Core deposit intangibles	106	116
Bank-owned life insurance	9,161	9,092
Other real estate owned	2,203	2,590
Accrued interest and other assets	7,496	7,045
TOTAL ASSETS	$699,934	677,531
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$105,728	$105,512
Interest-bearing demand	64,460	56,377
Money market	77,099	75,895
Savings	179,850	178,470
Time	190,006	169,858
Total deposits	617,143	586,112
Short-term borrowings	4,913	14,808
Other borrowings	10,533	10,624
Accrued interest and other liabilities	1,661	2,120
TOTAL LIABILITIES	634,250	613,664
STOCKHOLDERS' EQUITY		
Common stock, no par value; 10,000,000 shares authorized, 2,247,556 and 2,242,025 shares issued; 2,058,026 and 2,052,495 shares outstanding	35,706	35,529

Retained earnings	33,618	32,524
Accumulated other comprehensive income	3,094	2,548
Treasury stock, at cost; 189,530 shares	(6,734)	(6,734)
TOTAL STOCKHOLDERS' EQUITY	65,684	63,867
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$699,934	$677,531

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
INTEREST INCOME		
Interest and fees on loans	$5,843	$5,694
Interest-bearing deposits in other institutions	8	5
Federal funds sold	3	3
Investment securities:		
Taxable interest	395	509
Tax-exempt interest	759	755
Dividends on stock	27	23
Total interest income	7,035	6,989
INTEREST EXPENSE		
Deposits	831	940
Short-term borrowings	37	35
Other borrowings	23	32
Trust preferred securities	(8)	26
Total interest expense	883	1,033
NET INTEREST INCOME	6,152	5,956
Provision for loan losses	105	180
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,047	5,776
NONINTEREST INCOME		
Service charges on deposit accounts	441	441
Investment securities gains (losses), net	24	(6)
Earnings on bank-owned life insurance	69	67
Gain on sale of loans	53	-
Other income	209	213
Total noninterest income	796	715
NONINTEREST EXPENSE		
Salaries and employee benefits	2,360	2,016
Occupancy expense	349	321

Equipment expense	216	220
Data processing costs	250	214
Ohio state franchise tax	75	83
Federal deposit insurance expense	112	132
Professional fees	319	287
Loss (gain) on other real estate owned	88	(5)
Advertising expense	196	123
Other real estate expense	65	63
Directors fees	118	86
Other expense	663	689
Total noninterest expense	4,811	4,229
Income before income taxes	2,032	2,262
Income taxes	404	499
NET INCOME	$1,628	$1,763
EARNINGS PER SHARE		
Basic	$0.79	$0.87
Diluted	0.79	0.86
DIVIDENDS DECLARED PER SHARE	$0.26	$0.26

See accompanying notes to unaudited consolidated financial statements.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net income	$1,628	$1,763
Other comprehensive income:		
Net unrealized holding gain on available-for-sale securities	851	2,799
Tax effect	(289)	(952)
Reclassification adjustment for investment securities (gain) loss included in net income	(24)	6
Tax effect	8	(2)
Total other comprehensive income	546	1,851
Comprehensive income	$2,174	$3,614

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share data)

(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2014	$ 35,529	$ 32,524	$ 2,548	$ (6,734)	$ 63,867
Net income		1,628			1,628
Other comprehensive income			546		546
Dividend reinvestment and purchase plan (5,281 shares)	175				175
Stock options exercised (250 shares)	2				2
Cash dividends ($0.26 per share)		(534)			(534)
Balance, March 31, 2015	$ 35,706	$ 33,618	$ 3,094	$ (6,734)	$ 65,684

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
OPERATING ACTIVITIES		
Net income	$1,628	$1,763
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	105	180
Investment securities (gain) loss, net	(24)	6
Depreciation and amortization	180	202
Amortization of premium and discount on investment securities	189	182
Accretion of deferred loan fees, net	(241)	(76)
Origination of loans held for sale	(2,664)	-
Proceeds from sale of loans	2,465	-
Gain on sale of loans	(53)	-
Earnings on bank-owned life insurance	(69)	(67)
Deferred income tax	(305)	(156)
Loss (gain) on other real estate owned	88	(5)
Increase in accrued interest receivable	(454)	(391)
Decrease in accrued interest payable	(11)	(19)
Other, net	(407)	(481)
Net cash provided by operating activities	427	1,138
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	2,224	3,306
Proceeds from sale of securities	1,590	514
Increase in loans, net	(5,497)	(8,139)
Proceeds from the sale of other real estate owned	299	47
Purchase of premises and equipment	(108)	(156)
Net cash used for investing activities	(1,492)	(4,428)
FINANCING ACTIVITIES		
Net increase in deposits	31,031	25,930
Decrease in short-term borrowings, net	(9,895)	(5,489)
Repayment of other borrowings	(91)	(141)
Stock options exercised	2	-
Proceeds from dividend reinvestment and purchase plan	175	136

Cash dividends	(534)	(529)
Net cash provided by financing activities	20,688	19,907
Increase in cash and cash equivalents	19,623	16,617
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	25,639	26,193
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$45,262	$42,810
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$894	$1,052
Income taxes	-	610

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements of Middlefield Banc Corp. ("Company") include its bank subsidiary, The Middlefield Banking Company (“MB”), and a nonbank asset resolution subsidiary EMORECO, Inc. All significant inter-company items have been eliminated.

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management’s opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company’s financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2014, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U.S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with the Company’s Form 10-K for the year ended December 31, 2014. The results of the Company’s operations for any interim period are not necessarily indicative of the results of the Company’s operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-01, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects.* The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. This Update did not have a significant impact on the Company’s financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. The Company has included the disclosures related to this Update in Note 8.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of 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. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new accounting Update.

In June 2014, the FASB issued ASU 2014-10, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. The amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. For repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments also require enhanced disclosures. The accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application is prohibited. The disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date. This Update did not have a significant impact on the Company's financial statements.

In June 2014, the FASB issued ASU 2014-12, *Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments when the Terms of an Award Provide that a Performance Target Could Be Achieved After the Requisite Service Period*. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company’s financial statements.

In August 2014, the FASB issued ASU 2014-14, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40)*. The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. This Update did not have a significant impact on the Company’s financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements -Going Concern (Subtopic* 205-40). The amendments in this Update provide guidance in accounting principles generally accepted in the United States of America about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In November 2014, the FASB issued ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force).* This ASU clarifies how current U.S. GAAP should be interpreted in subjectively evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Public business entities are required to implement the new requirements in fiscal years and interim periods within those fiscal years beginning after December 15, 2015. This Update is not expected to have a significant impact on the Company’s financial statements.

In November 2014, the FASB issued ASU 2014-17, *Business Combinations (Topic 805): Pushdown Accounting.* The amendments in this Update apply to the separate financial statements of an acquired entity and its subsidiaries that are a business or nonprofit activity (either public or nonpublic) upon the occurrence of an event in which an acquirer (an individual or an entity) obtains control of the acquired entity. An acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs. If pushdown accounting is not applied in the reporting period in which the change-in-control event occurs, an acquired entity will have the option to elect to apply pushdown accounting in a subsequent reporting period to the acquired entity's most recent change-in-control event. The amendments in this Update are effective on November 18, 2014. After the effective date, an acquired entity can make an election to apply the guidance to future change-in-control events or to its most recent change-in-control event. This Update is not expected to have a significant impact on the Company’s financial statements.

In January 2015, the FASB issued ASU 2015-01, *Income Statement –Extraordinary and Unusual Items,* as part of its initiative to reduce complexity in accounting standards. This Update eliminates from GAAP the concept of extraordinary items. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. This Update is not expected to have a significant impact on the Company’s financial statements.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810).* The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments (1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30)*, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-04, *Compensation-Retirement Benefits (Topic 715),* as part of its initiative to reduce complexity in accounting standards. For an entity with a fiscal year-end that does not coincide with a month-end, the amendments in this Update provide a practical expedient that permits the entity to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end and apply that practical expedient consistently from year to year. The practical expedient should be applied consistently to all plans if an entity has more than one plan. The amendments in this Update are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Earlier application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangible – Goodwill and Other Internal Use Software (Topic 350-40)*, as part of its initiative to reduce complexity in accounting standards. This guidance will help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement. The amendments in this Update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. For public business entities, the Board decided that the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. For all other entities, the amendments will be effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted for all entities. This Update is not expected to have a significant impact on the Company’s financial statements.

NOTE 2 - STOCK-BASED COMPENSATION

The Company had no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of March 31, 2015 and 2014.

Stock option activity during the three months ended March 31 is as follows:

	2015	Weighted-average Exercise Price	2014	Weighted-average Exercise Price
Outstanding, January 1	46,451	$ 27.90	58,581	$ 28.38
Exercised	(375)	$ 17.55	-	-
Outstanding, March 31	46,076	$ 27.99	58,581	$ 28.38
Exercisable, March 31	46,076	$ 27.99	58,581	$ 28.38

NOTE 3 - EARNINGS PER SHARE

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the average shares outstanding. Diluted earnings per share adds the dilutive effects of stock options to average shares outstanding.

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

	For the Three Months Ended March 31,	
	2015	2014
Weighted-average common shares outstanding	2,243,190	2,223,010
Average treasury stock shares	(189,530)	(189,530)

Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	2,053,660	2,033,480
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	9,207	6,035
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	2,062,867	2,039,515

Options to purchase 46,076 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding as of the three months ended March 31, 2015. For the three months ended March 31, 2015, 27,250 were considered dilutive based on the market price exceeding the strike price.

Options to purchase 58,581 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding during the three months ended March 31, 2014. For the three months ended March 31, 2014, 27,375 were considered dilutive based on the market price exceeding the strike price.

NOTE 4 - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following levels:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

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

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

The following tables present the assets measured on a recurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

March 31, 2015

(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$ -	$22,921	$ -	$22,921
Obligations of states and political subdivisions	-	96,097	-	96,097
Mortgage-backed securities in government- sponsored entities		28,517		28,517
Private-label mortgage-backed securities	-	2,725	-	2,725
Total debt securities	-	150,260	-	150,260
Equity securities in financial institutions	-	899	-	899
Total	$ -	$151,159	$ -	$151,159

		December 31, 2014		
	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$ -	$22,896	$ -	$22,896
Obligations of states and political subdivisions	-	98,345	-	98,345
Mortgage-backed securities in government- sponsored entities	-	29,391	-	29,391
Private-label mortgage-backed securities	-	2,919	-	2,919
Total debt securities	-	153,551	-	153,551
Equity securities in financial institutions	-	783	-	783
Total	$ -	$154,334	$ -	$154,334

The Company obtains fair values from an independent pricing service which represent either quoted market prices for the identical securities (Level I inputs) or fair values determined by pricing models using a market approach that considers observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems (Level II).

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of March 31, 2015 or December 31, 2014.

The Company uses prices compiled by third party vendors due to improvements in third party pricing methodology that have narrowed the variances between third party vendor prices and actual market prices.

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

		March 31, 2015		
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$ -	$ -	$ 11,059	$ 11,059
Other real estate owned	-	-	2,203	2,203

		December 31, 2014		
	Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$ -	$ -	$ 12,772	$ 12,772
Other real estate owned	-	-	2,590	2,590

The Company values other real estate owned at the estimated fair value of the underlying collateral less expected selling costs. Such values are estimated primarily using appraisals and reflect a market value approach. Due to the significance of the Level III inputs, other real estate owned has been classified as Level III.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company uses Level III inputs to determine fair value:

(Dollar amounts in thousands)	Quantitative Information about Level III Fair Value Measurements							
			Valuation	Unobservable	Range			
	Fair Value Estimate		Techniques	Input	(Weighted Average)			
	March 31, 2015	December 31, 2014						
Impaired loans	$ 11,059	$ 12,772	Appraisal of collateral (1)	Appraisal adjustments (2)	0%	to	-128.1%	(-31.1%)
Other real estate owned	$ 2,203	$ 2,590	Appraisal of collateral (1)	Appraisal adjustments (2)	0%	to	-10.0%	(-7.5%)

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The estimated fair value of the Company’s financial instruments is as follows:

	March 31, 2015				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$45,262	$45,262	$-	$-	$45,262
Investment securities Available for sale	151,159	-	151,159	-	151,159
Loans held for sale	690	-	690	-	690
Net loans	469,371	-	-	481,581	481,581
Bank-owned life insurance	9,161	9,161	-	-	9,161
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,549	2,549	-	-	2,549
Financial liabilities:					
Deposits	$617,143	$427,137	$-	$186,893	$614,030
Short-term borrowings	4,913	4,913	-	-	4,913
Other borrowings	10,533	-	-	12,528	12,528
Accrued interest payable	304	304	-	-	304

	December 31, 2014				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(in thousands)				
Financial assets:					
Cash and cash equivalents	$25,639	$25,639	$-	$-	$25,639
Investment securities Available for sale	154,334	-	154,334	-	154,334
Loans held for sale	438	-	438	-	438
Net loans	463,738	-	-	475,019	475,019
Bank-owned life insurance	9,092	9,092			