Bank of Marin Bancorp
Form 10-Q
November 06, 2018
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, 2018

OR

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

For the transition period from __________________ to __________________

Commission File Number 001-33572

Bank of Marin Bancorp
(Exact name of Registrant as specified in its charter)

California	20-8859754
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
504 Redwood Blvd., Suite 100, Novato, CA	94947
(Address of principal executive office)	(Zip Code)

Registrant’s telephone number, including area code: (415) 763-4520

Indicate by check mark whether the registrant (1) has filed all reports 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 o

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

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

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

Emerging growth company o

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

Indicate by check mark if the registrant is a shell company, as defined in Rule 12b-2 of the Exchange Act.
Yes o No x

As of October 31, 2018, there were 6,974,765 shares of common stock outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CONDITION
September 30, 2018 and December 31, 2017

(in thousands, except share data; unaudited)	September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 142,718	$ 203,545
Investment securities		
Held-to-maturity, at amortized cost	164,222	151,032
Available-for-sale, at fair value	405,571	332,467
Total investment securities	569,793	483,499
Loans, net of allowance for loan losses of $15,817 and $15,767 at September 30, 2018 and December 31, 2017, respectively	1,713,054	1,663,246
Bank premises and equipment, net	7,602	8,612
Goodwill	30,140	30,140
Core deposit intangible	5,802	6,492
Interest receivable and other assets	76,606	72,620
Total assets	$ 2,545,715	$ 2,468,154
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	$ 1,109,909	$ 1,014,103
Interest bearing		
Transaction accounts	138,838	169,195
Savings accounts	178,171	178,473
Money market accounts	659,788	626,783
Time accounts	126,140	160,116
Total deposits	2,212,846	2,148,670
Subordinated debentures	5,831	5,739
Interest payable and other liabilities	18,435	16,720
Total liabilities	2,237,112	2,171,129
Stockholders' Equity		
Preferred stock, no par value, Authorized - 5,000,000 shares, none issued	—	—
Common stock, no par value, Authorized - 15,000,000 shares; Issued and outstanding - 6,982,179 and 6,921,542 at September 30, 2018 and December 31, 2017, respectively	145,498	143,967
Retained earnings	172,723	155,544
Accumulated other comprehensive loss, net of taxes	(9,618)	(2,486)
Total stockholders' equity	308,603	297,025
Total liabilities and stockholders' equity	$ 2,545,715	$ 2,468,154

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share amounts; unaudited)	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Interest income				
Interest and fees on loans	$20,284	$ 16,738	$58,795	$ 49,010
Interest on investment securities				
Securities of U.S. government agencies	2,953	1,525	8,288	4,577
Obligations of state and political subdivisions	546	511	1,788	1,632
Corporate debt securities and other	25	31	104	104
Interest on Federal funds sold and due from banks	400	406	1,088	623
Total interest income	24,208	19,211	70,063	55,946
Interest expense				
Interest on interest-bearing transaction accounts	58	24	158	74
Interest on savings accounts	18	17	54	48
Interest on money market accounts	337	133	789	360
Interest on time accounts	130	138	426	423
Interest on Federal Home Loan Bank ("FHLB") and other borrowings	1	—	2	—
Interest on subordinated debentures	125	111	362	328
Total interest expense	669	423	1,791	1,233
Net interest income	23,539	18,788	68,272	54,713
Provision for loan losses	—	—	—	—
Net interest income after provision for loan losses	23,539	18,788	68,272	54,713
Non-interest income				
Service charges on deposit accounts	475	438	1,407	1,337
Wealth Management and Trust Services	490	539	1,493	1,546
Debit card interchange fees, net	402	390	1,158	1,146
Merchant interchange fees, net	99	88	297	296
Earnings on bank-owned life insurance	227	209	685	628
Dividends on FHLB stock	194	177	582	585
(Losses) gains on investment securities, net	(90)	—	(79)	10
Other income	439	225	1,173	729
Total non-interest income	2,236	2,066	6,716	6,277
Non-interest expense				
Salaries and related benefits	8,069	7,344	25,402	22,106
Occupancy and equipment	1,444	1,364	4,462	4,063
Depreciation and amortization	532	489	1,625	1,433
Federal Deposit Insurance Corporation insurance	186	167	568	490
Data processing	950	946	3,354	2,848
Professional services	727	801	2,836	1,845
Directors' expense	173	175	530	557
Information technology	262	179	795	563
Provision for losses on off-balance sheet commitments	—	100	—	57
Other expense	1,628	1,471	4,989	4,716
Total non-interest expense	13,971	13,036	44,561	38,678
Income before provision for income taxes	11,804	7,818	30,427	22,312
Provision for income taxes	3,124	2,686	7,467	7,446
Net income	$8,680	$ 5,132	$22,960	$ 14,866

Net income per common share:				
Basic	$1.25	$ 0.84	$3.31	$ 2.43
Diluted	$1.23	$ 0.83	$3.27	$ 2.41
Weighted average shares:				
Basic	6,950	6,123	6,936	6,109
Diluted	7,055	6,191	7,031	6,179
Comprehensive income:				
Net income	$8,680	$ 5,132	$22,960	$ 14,866
Other comprehensive (loss) income				
Change in net unrealized gain or loss on available-for-sale securities	(2,120)	(362)	(9,421)	6,309
Reclassification adjustment for losses (gains) on available-for-sale securities in net income	90	—	79	(10)
Net unrealized loss on securities transferred from available-for-sale to held-to-maturity	—	—	(278)	(3,036)
Amortization of net unrealized losses on securities transferred from available-for-sale to held-to-maturity	128	135	396	299
Subtotal	(1,902)	(227)	(9,224)	3,562
Deferred tax (benefit) expense	(562)	(96)	(2,730)	1,499
Other comprehensive (loss) income, net of tax	(1,340)	(131)	(6,494)	2,063
Comprehensive income	$7,340	$ 5,001	$16,466	$ 16,929

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

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BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the three and nine months ended September 30, 2018 and 2017

(in thousands, except share data; unaudited)	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss ("AOCI"), Net of Taxes	Total
	Three months ended September 30, 2018				
Balance at July 1, 2018	6,991,821	$146,195	$166,281	$ (8,278)	$304,198
Net income	—	—	8,680	—	8,680
Other comprehensive loss	—	—	—	(1,340)	(1,340)
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	1,751	—	—	—	—
Stock issued under employee stock purchase plan	121	9	—	—	9
Stock issued under employee stock ownership plan ("ESOP")	3,400	297	—	—	297
Stock-based compensation - stock options	—	124	—	—	124
Stock-based compensation - restricted stock	—	176	—	—	176
Cash dividends paid on common stock ($0.32 per share)	—	—	(2,238)	—	(2,238)
Stock purchased by directors under director stock plan	239	19	—	—	19
Stock issued in payment of director fees	1,392	113	—	—	113
Stock repurchased, net of commissions	(16,545)	(1,435)	—	—	(1,435)
Balance at September 30, 2018	6,982,179	$145,498	$172,723	$ (9,618)	$308,603
	Three months ended September 30, 2017				
Balance at July 1, 2017	6,160,952	$88,949	$152,883	$ (1,099)	$240,733
Net income	—	—	5,132	—	5,132
Other comprehensive loss	—	—	—	(131)	(131)
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	2,893	—	—	—	—
Stock issued under ESOP	10,000	637	—	—	637
Stock-based compensation - stock options	—	141	—	—	141
Stock-based compensation - restricted stock	—	206	—	—	206
Cash dividends paid on common stock ($0.29 per share)	—	—	(1,788)	—	(1,788)
Stock purchased by directors under director stock plan	216	13	—	—	13
Stock issued in payment of director fees	1,690	106	—	—	106
Balance at September 30, 2017	6,175,751	$90,052	$156,227	$ (1,230)	$245,049

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the three and nine months ended September 30, 2018 and 2017

(in thousands, except share data; unaudited)	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss ("AOCI"), Net of Taxes	Total

	Nine months ended September 30, 2018				
Balance at January 1, 2018	6,921,542	$143,967	$155,544	$ (2,486)	$297,025
Net income	—	—	22,960	—	22,960
Other comprehensive loss	—	—	—	(6,494)	(6,494)
Reclassification of stranded tax effects in AOCI	—	—	638	(638)	—
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	51,826	534	—	—	534
Stock issued under employee stock purchase plan	386	28	—	—	28
Stock issued under ESOP	11,300	898	—	—	898
Restricted stock granted	18,520	—	—	—	—
Restricted stock surrendered for tax withholdings upon vesting	(658)	(45)	—	—	(45)
Restricted stock forfeited / cancelled	(6,028)	—	—	—	—
Stock-based compensation - stock options	—	566	—	—	566
Stock-based compensation - restricted stock	—	848	—	—	848
Cash dividends paid on common stock ($0.92 per share)	—	—	(6,419)	—	(6,419)
Stock purchased by directors under director stock plan	499	37	—	—	37
Stock issued in payment of director fees	2,735	204	—	—	204
Stock repurchased, net of commissions	(17,943)	(1,539)	—	—	(1,539)
Balance at September 30, 2018	6,982,179	$145,498	$172,723	$ (9,618)	$308,603
	Nine months ended September 30, 2017				
Balance at January 1, 2017	6,127,314	$87,392	$146,464	$ (3,293)	$230,563
Net income	—	—	14,866	—	14,866
Other comprehensive income	—	—	—	2,063	2,063
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	8,786	28	—	—	28
Stock issued under employee stock purchase plan	280	17	—	—	17
Stock issued under ESOP	21,732	1,335	—	—	1,335
Restricted stock granted	14,230	—	—	—	—
Stock-based compensation - stock options	—	423	—	—	423
Stock-based compensation - restricted stock	—	634	—	—	634
Cash dividends paid on common stock ($0.83 per share)	—	—	(5,103)	—	(5,103)
Stock purchased by directors under director stock plan	531	35	—	—	35
Stock issued in payment of director fees	2,878	188	—	—	188
Balance at September 30, 2017	6,175,751	90,052	156,227	(1,230)	245,049

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended September 30, 2018 and 2017

(in thousands; unaudited)	September 30, 2018	September 30, 2017
Cash Flows from Operating Activities:		
Net income	$ 22,960	$ 14,866
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for losses on off-balance sheet commitments	—	57
Noncash contribution expense to employee stock ownership plan	898	637
Noncash director compensation expense	219	170
Stock-based compensation expense	1,414	1,057
Amortization of core deposit intangible	690	354
Amortization of investment security premiums, net of accretion of discounts	2,172	2,204
Accretion of discount on acquired loans	(531)	(706)
Accretion of discount on subordinated debentures	92	117
Net change in deferred loan origination costs/fees	114	85
Loss (gain) on sale of investment securities	79	(10)
Depreciation and amortization	1,625	1,433
Gain on sale of repossessed assets	—	(1)
Earnings on bank-owned life insurance policies	(685)	(628)
Net change in operating assets and liabilities:		
Deferred rent and other rent-related expenses	(278)	38
Interest receivable and other assets	2,780	421
Interest payable and other liabilities	(265)	350
Total adjustments	8,324	5,578
Net cash provided by operating activities	31,284	20,444
Cash Flows from Investing Activities:		
Purchase of held-to-maturity securities	(1,988)	(4,496)
Purchase of available-for-sale securities	(174,617)	(51,130)
Proceeds from sale of available-for-sale securities	16,972	1,321
Proceeds from paydowns/maturities of held-to-maturity securities	15,947	22,352
Proceeds from paydowns/maturities of available-for-sale securities	45,917	37,126
Loans originated and principal collected, net	(50,315)	(37,370)
Purchase of premises and equipment	(615)	(1,143)
Proceeds from sale of other real estate owned or repossessed assets	—	170
Cash paid for low-income housing tax credit investment	(389)	(899)
Net cash used in investing activities	(149,088)	(34,069)
Cash Flows from Financing Activities:		
Net increase in deposits	64,176	118,270
Proceeds from stock options exercised	585	88
Payment of tax withholdings for stock options exercised and vesting of restricted stock	(96)	(60)
Proceeds from stock issued under employee and director stock purchase plans	65	750
Stock repurchased, net of commissions	(1,334)	—
Cash dividends paid on common stock	(6,419)	(5,103)
Net cash provided by financing activities	56,977	113,945
Net (decrease) increase in cash and cash equivalents	(60,827)	100,320
Cash and cash equivalents at beginning of period	203,545	48,804
Cash and cash equivalents at end of period	$ 142,718	$ 149,124

Supplemental disclosure of cash flow information:		
Cash paid in interest	$ 1,737	$ 1,131
Cash paid in income taxes	$ 4,900	$ 6,815
Supplemental disclosure of noncash investing and financing activities:		
Change in net unrealized gain or loss on available-for-sale securities	$ (9,421)	$ 6,309
Securities transferred from available-for-sale to held-to-maturity	$ 27,422	$ 128,965
Amortization of net unrealized loss on available-for-sale securities transferred to held-to-maturity	$ 396	$ 299
Stock issued to ESOP	$ 898	$ 637
Stock issued in payment of director fees	$ 204	$ 188
Subscription in low-income housing tax credit investment	$ 3,000	$ —
Repurchase of stock not yet settled	$ 205	$ —

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Presentation

The consolidated financial statements include the accounts of Bank of Marin Bancorp ("Bancorp"), a bank holding company, and its wholly-owned bank subsidiary, Bank of Marin (the "Bank"), a California state-chartered commercial bank. References to "we," "our," "us" mean Bancorp and the Bank that are consolidated for financial reporting purposes. The accompanying unaudited consolidated interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to those rules and regulations. Although we believe that the disclosures are adequate and the information presented is not misleading, we suggest that these interim financial statements be read in conjunction with the annual financial statements and the notes thereto included in our 2017 Annual Report on Form 10-K. In the opinion of Management, the unaudited consolidated financial statements reflect all adjustments, which are necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in stockholders' equity, and cash flows for the periods presented. All material intercompany transactions have been eliminated. The results of these interim periods may not be indicative of the results for the full year or for any other period.

The NorCal Community Bancorp Trusts I and II, respectively (the "Trusts") were formed for the sole purpose of issuing trust preferred securities. Bancorp is not considered the primary beneficiary of the Trusts (variable interest entities), therefore the Trusts are not consolidated in our consolidated financial statements, but rather the subordinated debentures are shown as a liability on our consolidated statements of condition (See Note 6, Borrowings). Bancorp accounts for its investment in the securities of the Trusts under the equity method, which is included in interest receivable and other assets in the consolidated statements of condition.

The following table shows: 1) weighted average basic shares, 2) potentially dilutive weighted average common shares related to stock options and unvested restricted stock awards, and 3) weighted average diluted shares. Basic earnings per share ("EPS") are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average number of potentially dilutive common shares. The number of potentially dilutive common shares included in the quarterly diluted EPS is computed using the average market prices during the three months included in the reporting period under the treasury stock method. The number of potentially dilutive common shares included in year-to-date diluted EPS is a year-to-date weighted average of potentially dilutive common shares included in each quarterly diluted EPS computation. In computing diluted EPS, we exclude anti-dilutive shares such as options whose exercise prices exceed the current common stock price, as they would not reduce EPS under the treasury method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of unvested restricted stock awards receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings. Under the two-class method, the difference in EPS is nominal for these participating securities.

(in thousands, except per share data)	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Weighted average basic shares outstanding	6,950	6,123	6,936	6,109
Potentially dilutive common shares related to:				
Stock options	88	53	79	55
Unvested restricted stock awards	17	15	16	15
Weighted average diluted shares outstanding	7,055	6,191	7,031	6,179
Net income	$8,680	$ 5,132	$22,960	$ 14,866

Basic EPS	$1.25	$ 0.84	$3.31	$ 2.43
Diluted EPS	$1.23	$ 0.83	$3.27	$ 2.41
Weighted average anti-dilutive shares not included in the calculation of diluted EPS	—	23	1	19

On October 22, 2018, the Bancorp announced a 2:1 stock split, payable on November 27, 2018, to shareholders of record at the close of business on November 9, 2018. Pro forma per share amounts are shown below to reflect the stock split, effective November 27, 2018.

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Basic EPS	$ 0.62	$ 0.42	$ 1.66	$ 1.22
Diluted EPS	$ 0.62	$ 0.41	$ 1.63	$ 1.20

Note 2: Recently Adopted and Issued Accounting Standards

Accounting Standards Adopted in 2018

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of this ASU (and all subsequent updates) is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. This ASU establishes a five-step model that must be used to recognize revenue that requires the entity to identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies the performance obligation. The ASU does not apply to the majority of our revenue, including revenue associated with financial instruments, such as loans and investment securities, and certain non-interest income, such as earnings on bank-owned life insurance, dividends on Federal Home Loan Bank ("FHLB") stock, gains or losses on sales of investment securities, and deposit overdraft charges. The standard allowed the use of either the full retrospective or modified retrospective transition method. We elected to apply the modified retrospective transition method to incomplete contracts as of the initial date of application on January 1, 2018. The adoption of the new standards did not have a material impact on our financial condition or results of operations as revenue recognition under the new standards did not change significantly from our current practice of recognizing the in-scope non-interest income. In addition, we did not retroactively revise prior period amounts or record a cumulative adjustment to retained earnings upon adoption. We considered the nature, amount, timing, and uncertainty of revenue from contracts with customers and determined that significant revenue streams are sufficiently disaggregated in the consolidated statements of comprehensive income.

Descriptions of our significant revenue-generating transactions that are within the scope of the new revenue recognition standards, which are presented in the consolidated statements of comprehensive income as components of non-interest income, are as follows:

- Wealth Management & Trust ("WM&T") fees - WM&T services include, but are not limited to: customized investment advisory and management; administrative services such as bill pay and tax reporting; trust administration, estate settlement, custody and fiduciary services. Performance obligations for investment advisory and management services are generally satisfied over time. Revenue is recognized monthly according to a tiered fee schedule based on the client's month-end market value of assets under our management. WM&T does not earn revenue based on performance or incentives. Costs associated with WM&T revenue-generating activities, such as payments to sub-advisors, are recorded separately as part of professional service expenses when incurred.

- Deposit account service charges - Service charges on deposit accounts consist of monthly maintenance fees, business account analysis fees, business online banking fees, check order charges, and other deposit account-related fees. Performance obligations for monthly maintenance fees and account analysis fees are satisfied, and the related revenue recognized, when we complete our performance obligation each month. Performance obligations related to transaction-based services (such as check orders) are satisfied, and the related revenue recognized, at a point in time when completed, except for business accounts subject to analysis where the transaction-based fees are part of the monthly account analysis fees.

- Debit card interchange fees - We issue debit cards to our consumer and small business customers that allow them to purchase goods and services from merchants in person, online, or via mobile devices using funds held in their demand deposit accounts held with us. Debit cards issued to our customers are part of global electronic payment networks (such as Visa) who pass a portion of the merchant interchange fees to debit card-issuing member banks like us when our customers make purchases through their networks. Performance obligations for debit card services are satisfied and revenue is recognized daily as the payment networks process transactions. Because we act in an agent capacity, we determined that network costs previously recorded as a component of non-interest expense should be netted with interchange fees recorded in non-interest income.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU make improvements to accounting standards related to financial instruments, including the following:

- Requires equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.
- Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When impairment exists, an entity is required to measure the investment at fair value.
- Eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value required under current standards for financial instruments measured at amortized cost on the consolidated balance sheet.
- Requires public companies to use the exit price notion when measuring and disclosing the fair value of financial instruments.
- Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
- Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

We adopted the requirements of this ASU effective January 1, 2018, which did not have a material impact on our financial condition and results of operations. The fair value of our loans held for investment, which is recorded at amortized cost, now incorporates the exit price notion reflecting factors such as a liquidity premium. See Note 3, Fair Value of Assets and Liabilities.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU provides guidance on how to present and classify eight specific cash flow topics in the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The amendments should be applied using a retrospective transition method to each period presented, if practical. We adopted the requirements of this ASU effective January 1, 2018, which did not impact our financial condition, results of operations, or related financial statement disclosures for the periods presented.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments are intended to help companies evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses and provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments should be applied prospectively and are effective for annual periods after December 31, 2017, including interim periods within those periods. We adopted the amendments effective January 1, 2018, which did not impact our financial condition, results of operations, or related financial statement disclosures for the periods presented.

In May 2017, the FASB issued ASU No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU applies to entities that change the terms or conditions of a share-based payment award. The FASB adopted this ASU to provide clarity in what constitutes a modification and to reduce diversity in practice in applying Topic 718. In order for a change to a share-based arrangement to not require Topic 718 modification accounting treatment, all of the following must be met: no change in fair value, no change in vesting conditions and no change in the balance sheet classification of the modified award. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted, including adoption in an interim period. The amendments should be applied prospectively to an award modified on or after the adoption date. We adopted the requirements of this ASU effective January 1, 2018, which did not impact our financial condition, results of operation, or related financial statement disclosures.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This amendment changes both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting and increase transparency as to the scope and results of hedging programs. The ASU is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We early adopted the amendments of this ASU in the second quarter of 2018, and elected to perform hedge effectiveness assessments using a qualitative approach instead of quantitative regression analysis going forward. The adoption of this ASU had an immaterial impact to our financial results. The amendments also require additional disclosures, which are included in Note 9, Derivative Financial Instruments and Hedging Activities.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This amendment helps organizations address certain stranded income tax effects in accumulated other comprehensive income (AOCI) resulting from the enactment of the Tax Cuts and Jobs Act of 2017. The ASU requires financial statement preparers to disclose a description of the accounting policy for releasing income tax effects from AOCI, whether or not they elect to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act of 2017, and information about the other income tax effects that are reclassified. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The amendments in this ASU should be applied in either the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate tax rate in the Tax Cuts and Jobs Act of 2017 is recognized. We early adopted this ASU in the first quarter of 2018. See Note 7, Stockholders' Equity.

Accounting Standards Not Yet Effective

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The amendments in this ASU intend to increase transparency and comparability among organizations by recognizing an asset, which represents the right to use the asset for the lease term, and a lease liability, which is a lessee's obligation to make lease payments measured on a discounted basis. This ASU generally applies to leasing arrangements exceeding a twelve-month term. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective method of adoption. In July 2018, the FASB issued two amendments to ASU 2016-02: ASU No. 2018-10, Codification Improvements to Topic 842, Leases, which provides various corrections and clarifications to ASU 2016-02; and ASU No. 2018-11, Leases (Topic 842): Targeted Improvements, which provides a new optional transition method and provides a lessor with practical expedients for separating lease and non-lease components of a lease. Early application of the amendments is permitted. We intend to adopt this ASU during the first quarter of 2019, as required. We completed an inventory of our lease agreements and selected a lease accounting software solution. We are in the process of abstracting and inputting lease-related data, developing policies and procedures, and designing related internal controls. As of September 30, 2018, our undiscounted operating lease obligations that were off-balance sheet totaled $15.4 million (See Note 8, Commitments and Contingencies). Upon adoption of this ASU, the present values of leases currently classified as operating leases will be recognized as lease assets and liabilities on our consolidated balance sheets. Additional disclosures of key information about our leasing arrangements will also be required. We do not expect that the ASU will have a material impact on our retained earnings, capital ratios, results of operations or return on average assets when adopted.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the new guidance, entities will be required to present financial assets at the net amount expected to be collected. The measurement of expected credit losses will be based on historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of a credit over its remaining life. In addition, the ASU amends the accounting for expected credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We have formed an internal Current Expected Credit Loss ("CECL") committee and are working with our third party vendor to determine the appropriate methodologies and resources to utilize in preparation for transition to the new accounting standards. The impact of this ASU on our financial condition and results of operations is not known at this time.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This update simplifies the accounting for share-based payment transactions for acquiring goods and services from nonemployees, applying some of the same requirements as employee share-based payment transactions. The ASU will not affect the accounting for share-based payment awards to nonemployee directors, which will continue to be treated as employee share-based transactions under the current standards. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We do not expect that the ASU will have a material impact on our financial condition or results of operations, as it is not our practice to issue stock-based awards to pay for goods and services from nonemployees, other than nonemployee directors.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this ASU remove, modify and add disclosure requirements for the fair value reporting of assets and liabilities. The modifications and additions relate to Level 3 fair value measurements at the end of the reporting period. ASU 2018-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. Entities making this election are permitted to early adopt the eliminated or modified disclosure requirements and delay the adoption of all the new disclosure requirements until the ASU's effective date. We do not expect that the ASU will have a material impact on our financial condition or results of operations.

In August 2018, the FASB issued ASU No. 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. This standard aligns the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software, regardless of whether they convey a license to the hosted software. The accounting for the service element of a hosting arrangement that is a service contract is not affected by this ASU. The amendments are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We do not expect that the ASU will have a material impact on our financial condition or results of operations.

In October 2018, the FASB issued ASU No. 2018-16, Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes. This update adds an alternative fifth permissible U.S. benchmark rate to be used for hedge accounting purposes. As we have already adopted the amendments in ASU 2017-12, which changed both the designation and measurement guidance for qualifying hedging relationships, the amendments in ASU 2018-16 are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted in any interim period upon issuance of this ASU if an entity already has adopted ASU 2017-12. We expect this amendment to affect the presentation of our hedging activities, but we do not expect it to have a material impact on our financial condition or results of operations.

Note 3: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

We group our assets and liabilities that are measured at fair value in three levels within the fair value hierarchy, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuations are based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuations for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Valuations are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Values are determined using pricing models and discounted cash flow models and may include significant Management judgment and estimation.

Transfers between levels of the fair value hierarchy are recognized through our monthly and/or quarterly valuation process in the reporting period during which the event or circumstances that caused the transfer occurred. No such transfers occurred during the first nine months of 2018 or 2017.

The following table summarizes our assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measurement Categories: Changes in Fair Value Recorded In[1]
September 30, 2018					
Securities available-for-sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies	$246,220	$ —	$246,220	$ —	OCI
SBA-backed securities	40,181	—	40,181	—	OCI
Debentures of government sponsored agencies	42,914	—	42,914	—	OCI
Privately-issued collateralized mortgage obligations	370	—	370	—	OCI
Obligations of state and political subdivisions	73,373	—	73,373	—	OCI
Corporate bonds	2,513	—	2,513	—	OCI
Derivative financial assets (interest rate contracts)	436	—	436	—	NI
Derivative financial liabilities (interest rate contracts)	163	—	163	—	NI
December 31, 2017					
Securities available-for-sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies	$188,061	$ —	$188,061	$ —	OCI
SBA-backed securities	25,982	—	25,817	165	OCI
Debentures of government sponsored agencies	12,938	—	12,938	—	OCI
Privately-issued collateralized mortgage obligations	1,431	—	1,431	—	OCI
Obligations of state and political subdivisions	97,491	—	97,491	—	OCI
Corporate bonds	6,564	—	6,564	—	OCI
Derivative financial assets (interest rate contracts)	74	—	74	—	NI
Derivative financial liabilities (interest rate contracts)	740	—	740	—	NI

[1] Other comprehensive income ("OCI") or net income ("NI").

Securities available-for-sale are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) are used to determine the fair value of securities available-for-sale. If quoted market prices are not available, we obtain pricing information from reputable third-party service providers, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, probability of default, loss severity and credit spreads (Level 2). Level 2 securities include obligations of state and political subdivisions, U.S. agencies or government-sponsored agencies' debt securities, mortgage-backed securities, government agency-issued, privately-issued collateralized mortgage obligations, and corporate bonds. As of September 30, 2018 and December 31, 2017, there were no Level 1 securities. As of December 31, 2017, we had one Level 3 available-for-sale U.S. government agency obligation, which was paid off during the second quarter of 2018.

Securities held-to-maturity may be written down to fair value (determined using the same techniques discussed above for securities available-for-sale) as a result of other-than-temporary impairment, and we did not record any write-downs during the nine months ended September 30, 2018 or September 30, 2017.

On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming an orderly transaction. Valuation adjustments may be made to reflect both our own credit risk and the counterparties' credit risk in determining the fair value of the derivatives. Level 2 inputs for the valuations are limited to observable market prices for London Interbank Offered Rate ("LIBOR") and Overnight Index Swap ("OIS") rates (for the very short term), quoted prices for LIBOR futures contracts, observable market prices for LIBOR and OIS swap rates, and one-month and three-month LIBOR basis spreads at commonly quoted intervals. Mid-market pricing of the inputs is used as a practical expedient in the fair value measurements. We project spot rates at reset days specified by each swap contract to determine future cash flows, then discount to present value using either LIBOR or OIS curves depending on whether the swap positions are fully collateralized as of the measurement date. When the value of any collateral placed with counterparties is less than the interest rate derivative liability, a credit valuation adjustment ("CVA") is applied to reflect the credit risk we pose to counterparties. We have used the spread between the Standard & Poor's BBB rated U.S. Bank Composite rate and LIBOR for the closest maturity term corresponding to the duration of the swaps to derive the CVA. A similar credit risk adjustment, correlated to the credit standing of the counterparty, is made when collateral posted by the counterparty does not fully cover their liability to us. For further discussion on our methodology in valuing our derivative financial instruments, refer to Note 9, Derivative Financial Instruments and Hedging Activities.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets, such as impaired loans that are collateral dependent and other real estate owned ("OREO"). As of September 30, 2018 and December 31, 2017, we did not carry any assets measured at fair value on a non-recurring basis.

Disclosures about Fair Value of Financial Instruments

The following table summarizes fair value estimates for financial instruments as of September 30, 2018 and December 31, 2017, excluding financial instruments recorded at fair value on a recurring basis (summarized in the first table in this note). The carrying amounts in the following table are recorded in the consolidated statements of condition under the indicated captions. Further, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements such as bank-owned life insurance policies ("BOLI") and non-maturity deposit liabilities. Additionally, we hold shares of FHLB stock and Visa Inc. Class B common stock at cost. These shares are restricted from resale, except among member banks, and their values are discussed in Note 4, Investment Securities.

	September 30, 2018			December 31, 2017		
(in thousands)	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets (recorded at amortized cost)						
Cash and cash equivalents	$142,718	$142,718	Level 1	$203,545	$203,545	Level 1
Investment securities held-to-maturity	164,222	158,106	Level 2	151,032	151,032	Level 2
Loans, net	1,713,054	1,683,109	Level 3	1,663,246	1,650,198	Level 3
Interest receivable	7,366	7,366	Level 2	7,501	7,501	Level 2
Financial liabilities (recorded at amortized cost)						
Time deposits	126,140	124,796	Level 2	160,116	159,540	Level 2
Subordinated debentures	5,831	7,505	Level 3	5,739	5,118	Level 3
Interest payable	155	155	Level 2	191	191	Level 2

Commitments - The value of unrecognized financial instruments is estimated based on the fee income associated with the commitments which, in the absence of credit exposure, is considered to approximate their settlement value. The fair value of commitment fees was not material at September 30, 2018 or December 31, 2017.

Note 4: Investment Securities

Our investment securities portfolio consists of obligations of state and political subdivisions, corporate bonds, U.S. government agency securities, including residential and commercial mortgage-backed securities (“MBS”) and collateralized mortgage obligations (“CMOs”) issued or guaranteed by Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), Small Business Administration ("SBA"), or Government National Mortgage Association ("GNMA"), debentures issued by government-sponsored agencies such as FNMA, Federal Farm Credit Bureau, FHLB and FHLMC, and privately issued CMOs, as reflected in the following table.

	September 30, 2018				December 31, 2017			
	Amortized	Fair	Gross Unrealized		Amortized	Fair	Gross Unrealized	
(in thousands)	Cost	Value	Gains	(Losses)	Cost	Value	Gains	(Losses)
Held-to-maturity:								
Securities of U.S. government agencies:								
MBS pass-through securities issued by FHLMC and FNMA	$91,237	$86,962	$—	$(4,275)	$100,376	$100,096	$234	$(514)
SBA-backed securities	8,723	8,489	—	(234)	—	—	—	—
CMOs issued by FNMA	11,646	11,254	—	(392)	—	—	—	—
CMOs issued by FHLMC	34,169	32,868	—	(1,301)	31,010	30,938	2	(74)
CMOs issued by GNMA	3,734	3,694	—	(40)	—	—	—	—
Obligations of state and political subdivisions	14,713	14,839	160	(34				