Section 1: 10-Q (SECOND QUARTER 2019 10-Q)

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Section 1: 10-Q (10-Q)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☑ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2019

☐ **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: 001-38458

LEVEL ONE BANCORP, INC.

(Exact name of registrant as specified in its charter)

Michigan (State or other jurisdiction of incorporation or organization)	**71-1015624** (I.R.S. Employer Identification No.)
32991 Hamilton Court **Farmington Hills, MI** (Address of principal executive offices)	**48334** (Zip code)

(248) 737-0300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading symbol(s)	Name of each exchange on which registered
Common Stock, no par value	**LEVL**	**Nasdaq Global Select Market**

Securities registered pursuant to Section 12(g) of the Act: **None**

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 ☐ Accelerated filer ☐

Non-accelerated filer ☑ Smaller reporting company ☑

Emerging growth company ☑

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. ☐

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

As of August 5, 2019, the number of shares outstanding of the registrant's Common Stock, no par value, was 7,730,530 shares.

Level One Bancorp, Inc.

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PART 1. FINANCIAL INFORMATION
Item 1 - Financial Statements

LEVEL ONE BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	June 30, 2019	December 31, 2018
Assets	*(Unaudited)*	
Cash and cash equivalents	**$ 50,120**	$ 33,296
Securities available-for-sale	**218,145**	204,258
Federal Home Loan Bank stock	**8,325**	8,325
Mortgage loans held for sale, at fair value	**22,822**	5,595
Loans:		
Originated loans	**1,088,395**	1,041,898
Acquired loans	**78,106**	84,667
Total loans	**1,166,501**	1,126,565
Less: Allowance for loan losses	**(12,353)**	(11,566)
Net loans	**1,154,148**	1,114,999
Premises and equipment	**13,188**	13,242
Goodwill	**9,387**	9,387
Other intangible assets, net	**359**	447
Bank-owned life insurance	**11,992**	11,866
Income tax benefit	**791**	2,467
Other assets	**16,099**	12,333
Total assets	**$ 1,505,376**	$ 1,416,215
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	**$ 317,747**	$ 309,384
Interest-bearing demand deposits	**50,605**	52,804
Money market and savings deposits	**315,477**	287,575
Time deposits	**545,616**	484,872
Total deposits	**1,229,445**	1,134,635
Borrowings	**76,934**	99,574
Subordinated notes	**14,920**	14,891
Other liabilities	**21,210**	15,355
Total liabilities	**1,342,509**	1,264,455
Shareholders' equity		
Common stock, no par value per share:		
Authorized—20,000,000 shares		
Issued and outstanding—7,728,280 shares at June 30, 2019 and 7,750,216 shares at December 31, 2018	**89,442**	90,621
Retained earnings	**69,295**	62,891
Accumulated other comprehensive income (loss), net of tax	**4,130**	(1,752)
Total shareholders' equity	**162,867**	151,760
Total liabilities and shareholders' equity	**$ 1,505,376**	$ 1,416,215

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME — (UNAUDITED)

(In thousands, except per share data)	For the three months ended June 30, 2019	For the three months ended June 30, 2018	For the six months ended June 30, 2019	For the six months ended June 30, 2018
Interest income				
Originated loans, including fees	**$ 14,125**	$ 11,833	**$ 28,019**	$ 23,011
Acquired loans, including fees	**1,637**	2,293	**3,394**	4,719
Securities:				
Taxable	**980**	667	**1,916**	1,241
Tax-exempt	**595**	380	**1,140**	731
Federal funds sold and other	**320**	207	**630**	452
Total interest income	**17,657**	15,380	**35,099**	30,154
Interest Expense				
Deposits	**4,617**	2,487	**8,738**	4,665
Borrowed funds	**346**	225	**699**	444
Subordinated notes	**253**	253	**503**	503
Total interest expense	**5,216**	2,965	**9,940**	5,612
Net interest income	**12,441**	12,415	**25,159**	24,542
Provision expense (benefit) for loan losses	**429**	(710)	**851**	(156)
Net interest income after provision for loan losses	**12,012**	13,125	**24,308**	24,698
Noninterest income				
Service charges on deposits	**662**	618	**1,287**	1,260
Net gain on sales of securities	**7**	—	**—**	—
Mortgage banking activities	**2,316**	404	**3,436**	640
Net gain on sale of commercial loans	**—**	11	**—**	11
Other charges and fees	**492**	419	**1,040**	913
Total noninterest income	**3,477**	1,452	**5,763**	2,824
Noninterest expense				
Salary and employee benefits	**7,193**	6,169	**14,106**	12,125
Occupancy and equipment expense	**1,168**	1,074	**2,372**	2,120
Professional service fees	**385**	471	**747**	737
Marketing expense	**288**	291	**464**	433
Printing and supplies expense	**104**	112	**172**	216
Data processing expense	**606**	511	**1,201**	947
Other expense	**1,423**	1,077	**2,473**	2,262
Total noninterest expense	**11,167**	9,705	**21,535**	18,840
Income before income taxes	**4,322**	4,872	**8,536**	8,682
Income tax provision	**767**	860	**1,514**	1,502
Net income	**$ 3,555**	$ 4,012	**$ 7,022**	$ 7,180
Per common share data:				
Basic earnings per common share	**$ 0.46**	$ 0.54	**$ 0.91**	$ 1.02
Diluted earnings per common share	**$ 0.45**	$ 0.53	**$ 0.89**	$ 1.00
Cash dividends declared per common share	**$ 0.04**	$ 0.03	**$ 0.08**	$ 0.06
Weighted average common shares outstanding—basic	**7,741**	7,456	**7,746**	7,050
Weighted average common shares outstanding—diluted	**7,856**	7,613	**7,862**	7,211

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME — (UNAUDITED)

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	**2019**	**2018**	**2019**	**2018**
Net income	**$ 3,555**	$ 4,012	**$ 7,022**	$ 7,180
Other comprehensive income:				
Unrealized holding gains (losses) on securities available-for-sale arising during the period	**4,835**	(264)	**7,447**	(2,769)
Reclassification adjustment for gains included in income	**(7)**	—	**—**	—
Tax effect[1]	**(1,015)**	56	**(1,565)**	581
Net unrealized gains (losses) on securities available-for-sale, net of tax	**3,813**	(208)	**5,882**	(2,188)
Total comprehensive income, net of tax	**$ 7,368**	$ 3,804	**$ 12,904**	$ 4,992

[1] Includes $1 thousand of tax expense related to reclassification for the three months ended June 30, 2019. There was no tax expense (benefit) related to reclassification for the six months ended June 30, 2019 or for the three months and six months ended June 30, 2018.

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY — (UNAUDITED)

	For the three months ended June 30, 2019			
(Dollar in thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at March 31, 2019	$ 89,753	$ 66,049	$ 317	$ 156,119
Net income	—	3,555	—	3,555
Other comprehensive income	—	—	3,813	3,813
Redeemed stock (21,301 shares)	(516)	—	—	(516)
Common stock dividends declared ($0.04 per share)	—	(309)	—	(309)
Exercise of stock options (3,000 shares)	31	—	—	31
Stock-based compensation expense	174	—	—	174
Balance at June 30, 2019	$ 89,442	$ 69,295	$ 4,130	$ 162,867

	For the six months ended June 30, 2019			
(Dollar in thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at December 31, 2018	$ 90,621	$ 62,891	$ (1,752)	$ 151,760
Net income	—	7,022	—	7,022
Other comprehensive income	—	—	5,882	5,882
Redeemed stock (67,927 shares)	(1,620)	—	—	(1,620)
Common stock dividends declared ($0.08 per share)	—	(618)	—	(618)
Exercise of stock options (15,300 shares)	156	—	—	156
Stock-based compensation expense	285	—	—	285
Balance at June 30, 2019	$ 89,442	$ 69,295	$ 4,130	$ 162,867

(Dollar in thousands)	For the three months ended June 30, 2018 Common Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at March 31, 2018	$ 60,886	$ 52,568	$ (2,931)	$ 110,523
Net income	—	4,012	—	4,012
Other comprehensive loss	—	—	(208)	(208)
Initial public offering of 1,150,765 shares of common stock, net of issuance costs	29,030	—	—	29,030
Common stock dividend paid ($0.03 per share)	—	(197)	—	(197)
Exercise of stock options (6,450 shares)	65	—	—	65
Stock-based compensation expense	220	—	—	220
Balance at June 30, 2018	$ 90,201	$ 56,383	$ (3,139)	$ 143,445

(Dollar in thousands)	For the six months ended June 30, 2018 Common Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at December 31, 2017	$ 59,511	$ 49,232	$ (783)	$ 107,960
Net income	—	7,180	—	7,180
Other comprehensive loss	—	—	(2,188)	(2,188)
Reclass of tax reform adjustments due to early adoption of ASU 2018-02	—	168	(168)	—
Initial public offering of 1,150,765 shares of common stock, net of issuance costs	29,030	—	—	29,030
Common stock dividend paid ($0.03 per share)	—	(197)	—	(197)
Exercise of stock options (125,394 shares)	1,257	—	—	1,257
Stock-based compensation expense	403	—	—	403
Balance at June 30, 2018	$ 90,201	$ 56,383	$ (3,139)	$ 143,445

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS — (UNAUDITED)

(Dollars in thousands)	For the six months ended June 30, 2019	2018
Cash flows from operating activities		
Net income	**$ 7,022**	$ 7,180
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of fixed assets	**660**	663
Amortization of core deposit intangibles	**88**	110
Stock-based compensation expense	**328**	403
Provision expense (benefit) for loan losses	**851**	(156)
Net securities premium amortization	**837**	634
Originations of loans held for sale	**(108,134)**	(24,151)
Proceeds from sales of loans originated for sale	**92,942**	25,055
Net gain on sales of loans	**(3,436)**	(651)
Accretion on acquired purchase credit impaired loans	**(1,175)**	(1,909)
Gain on sale of other real estate owned and repossessed assets	**—**	(48)
Increase in cash surrender value of life insurance, net of 1035 exchange charge	**(126)**	(161)
Amortization of debt issuance costs	**29**	23
Net (increase) decrease in accrued interest receivable and other assets	**(2,949)**	4,827
Net increase in accrued interest payable and other liabilities	**5,356**	2,519
Net cash (used in) provided by operating activities	**(7,707)**	14,338
Cash flows from investing activities		
Net increase in loans	**(37,609)**	(8,745)
Principal payments on securities available-for-sale	**8,631**	4,295
Purchases of securities available-for-sale	**(51,373)**	(52,776)
Additions to premises and equipment	**(704)**	(391)
Proceeds from:		
Sale of securities available-for-sale	**35,465**	—
Sale of other real estate owned and repossessed assets	**—**	700
Net cash used in investing activities	**(45,590)**	(56,917)
Cash flows from financing activities		
Net increase (decrease) in deposits	**94,810**	(55,166)
Change in short-term borrowings	**(52,604)**	38,795
Issuances of long term FHLB advances	**30,000**	—
Change in secured borrowing	**(36)**	(34)
Net proceeds from issuance of common stock related to initial public offering	**—**	29,030
Share buyback - redeemed stock	**(1,620)**	—
Common stock dividends paid	**(542)**	(197)
Proceeds from exercised stock options	**156**	1,257
Payments related to tax-withholding for share based compensation awards	**(43)**	—
Net cash provided by financing activities	**70,121**	13,685
Net change in cash and cash equivalents	**16,824**	(28,894)
Beginning cash and cash equivalents	**33,296**	63,661
Ending cash and cash equivalents	**$ 50,120**	$ 34,767
Supplemental disclosure of cash flow information:		
Interest paid	**$ 9,569**	$ 5,726
Income taxes paid	**1,196**	100
Transfer from loans held for sale to loans held for investment	**1,429**	304
Transfer from loans to other real estate owned	**373**	—

Transfer from premises and equipment to other assets	—	20

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - (UNAUDITED)

JUNE 30, 2019

NOTE 1—BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations:

Level One Bancorp, Inc. (the "Company" “we,” “our,” or “us”) is a financial holding company headquartered in Farmington Hills, Michigan. Its wholly owned bank subsidiary, Level One Bank (the "Bank"), has 13 offices, including 9 banking centers (our full service branches) in Oakland County, one banking center in each of Detroit and Grand Rapids, Michigan’s two largest cities, one banking center in Sterling Heights, and one mortgage loan production office in Ann Arbor.

The Bank is a Michigan banking corporation with depository accounts insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the "FDIC"). The Bank provides a wide range of business and consumer financial services in the greater Farmington Hills, Novi, Northville, Birmingham, Ferndale, Sterling Heights, Bloomfield Township, Ann Arbor, Detroit and Grand Rapids areas. Its primary deposit products are checking, interest-bearing demand, money market and savings, and term certificate accounts, and its primary lending products are commercial real estate, commercial and industrial, residential real estate, and consumer loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Other financial instruments, which potentially represent concentrations of credit risk, include federal funds sold.

The Company's subsidiary, Hamilton Court Insurance Company ("Hamilton Court"), is a wholly owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and the Bank and reinsurance to ten other third party insurance captives for which insurance may not be currently available or economically feasible in the insurance marketplace. Hamilton Court was designed to insure the risks of the Company and the Bank by providing additional insurance coverage for deductibles, excess limits and uninsured exposures. Hamilton Court is domiciled in Nevada.

Initial Public Offering:

On April 24, 2018, the Company sold 1,150,765 shares of common stock in its initial public offering, including 180,000 shares of common stock pursuant to the exercise in full by the underwriters of their option to purchase additional shares. The aggregate offering price for the shares sold by the Company was $32.2 million, and after deducting $2.1 million of underwriting discounts and $1.1 million of offering expenses paid to third parties, the Company received total net proceeds of $29.0 million from the initial public offering. In addition, certain selling shareholders participated in the offering and sold an aggregate of 229,235 shares of our common stock at an aggregate offering price of $6.4 million. The Company did not receive any proceeds from the sales of shares by the selling shareholders.

Basis of Presentation and Principles of Consolidation:

The accompanying unaudited consolidated financial statements and notes thereto of the Company have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and conform to practices within the banking industry and include all of the information and disclosures required by generally accepted accounting principles in the United States of America (“GAAP”) for interim financial reporting. The accompanying unaudited consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for a fair presentation of financial results for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results for the full year or any other period. These interim unaudited financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto as of and for the year ended December 31, 2018, included in our Annual Form 10-K, filed with the SEC on March 22, 2019.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, the Bank and Hamilton Court, after elimination of significant intercompany transactions and accounts.

Use of Estimates:

To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided; therefore, future results could differ.

Change in Accounting Policy:

For fiscal years beginning after December 31, 2018, the Company has elected to evaluate goodwill for impairment as of October 1st as opposed to September 30th, as was done in the preceding years. The change will have no impact on the current year's or prior years' financial statements.

Emerging Growth Company Status:

The Company is an "emerging growth company," as defined in the Jumpstart Our Business Startups Act of 2012 (the JOBS Act). Section 107 of the JOBS Act provides that an emerging growth company can take advantage of an extended transition period when complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of this extended transition period, which means these financial statements, as well as financial statements we file in the future for as long as we remain an emerging growth company, will be subject to all new or revised accounting standards generally applicable to private companies.

Impact of Recently Issued Accounting Standards:

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 "Revenue from Contracts with Customers (Topic 606)," which provides a framework for revenue recognition that replaces the existing industry and transaction specific requirements under the existing standards. ASU 2014-09 requires an entity to apply a five-step model to determine when to recognize revenue and at what amount. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to a customer at the amount in which the entity expects to be entitled. Depending on whether certain criteria are met, revenue should be recognized either over time, in a manner that depicts the entity's performance, or at a point in time, when control of the goods or services are transferred to the customer.

The amendments of ASU 2014-09 may be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application. The guidance will be effective for the Company for the fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company plans to adopt these amendments within the time frames stated above.

The Company is continuing to evaluate the impact ASU 2014-09 will have on our consolidated financial statements. Based on this evaluation to date, management has determined that the majority of the revenues earned by the Company are not within the scope of ASU 2014-09, and that a few of the revenue streams that have been identified as being in scope would include service charges and interchange fees. Management will continue to evaluate the impact the adoption of ASU 2014-09 will have on our consolidated financial statements, focusing on noninterest income sources within the scope of ASU 2014-09 as well as new disclosures required by these amendments; however, the adoption of ASU 2014-09 is not expected to have a material impact on the Company's consolidated financial statements but is expected to result in additional disclosures.

Financial Instruments

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," to improve the accounting for financial instruments. This ASU requires equity investments with readily determinable fair values to be measured at fair value with changes recognized in net income regardless of classification. For equity investments without a readily determinable fair value, the value of the investment would be measured 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 instead of fair value, unless a qualitative assessment indicates impairment. Additionally, this ASU requires the separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements, as well as the required use of exit pricing when measuring the fair value of financial instruments for disclosure purposes. The guidance will be effective for the Company for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, and is to be applied prospectively with a cumulative effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. Management is currently developing processes and procedures to comply with the disclosures requirements of this ASU, which will impact the disclosures the Company makes related to fair value of its financial instruments. This standard is not expected to have a material impact on the Company's consolidated financial statements. The Company is planning to adopt this new guidance within the time frames stated above.

Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," to improve transparency and comparability across entities regarding leasing arrangements. This ASU requires the recognition of a separate lease liability representing the required discounted lease payments over the lease term and a separate lease asset representing the right to use the underlying asset during the same lease term. Additionally, this ASU provides clarification regarding the identification of certain components of contracts that would represent a lease as well as requires additional disclosures to the notes of the financial statements.

The guidance will be effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020, and is to be applied under an optional transition method. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements. Additionally, the Company does not expect to significantly change operating lease agreements prior to adoption. The Company is planning to adopt this new guidance within the time frames stated above.

Allowance for Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," to replace the current incurred loss methodology for recognizing credit losses, which delays recognition until it is probable a loss has been incurred, with a methodology that reflects an estimate of all expected credit losses and considers additional reasonable and supportable forecasted information when determining credit loss estimates. This impacts the calculation of the allowance for credit losses for all financial assets measured under the amortized cost basis, including PCI loans at the time of and subsequent to acquisition. Additionally, credit losses related to available-for-sale debt securities would be recorded through the allowance for credit losses and not as a direct adjustment to the amortized cost of the securities. Based on the ASU No. 2018-19, "Codification Improvements to Topic 326, Financial Instruments—Credit Losses," the guidance will be effective for the Company for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years, and is to be applied under a modified retrospective approach.

In July 2019, the FASB made a proposal to delay the effective date for the credit losses standard to January 2023 for certain entities, including certain SEC filers, public business entities, and private companies. As a smaller reporting company, the Company would be eligible for the proposed delay if it is effected. The Company is currently evaluating the impact of the proposed delay on its implementation project plan as well as the impact of adopting this new guidance on the consolidated financial statements, current systems and processes. At this time, the Company is reviewing potential methodologies for estimating expected credit losses using reasonable and supportable forecast information and has identified certain data and system requirements. Once adopted, we expect our allowance for loan losses to increase through a one-time adjustment to retained earnings; however, until our evaluation is complete, the estimated increase in allowance will be unknown. The Company is planning to adopt this new guidance within the time frames stated above but would delay the implementation to the delayed effective date if the proposed delay is effected.

Income Taxes - Tax Cuts and Jobs Act

In February 2018, the FASB issued ASU No. 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Topic 220)," which allows an entity to elect a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act ("TCJA"). The amount of that reclassification should include the effect of changes of tax rate on the deferred tax amount, any related valuation allowance and other income tax effects on the items in AOCI. In addition, the ASU requires that an entity state if an election to reclassify the tax effects to retained earnings is made, along with a description of other income tax effects that are reclassified from AOCI. This guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with early adoption permitted. The Company early adopted the ASU and reclassified $168 thousand from retained earnings to AOCI during the first quarter of 2018.

In May 2018, the FASB issued an update to ASU No. 2018-05, "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118," regarding the accounting implications of the recently issued TCJA. The update clarifies that in a company's financial statements that include the reporting period in which the TCJA was enacted, a company must first reflect the income tax effects of the TCJA in which the accounting under GAAP is complete. These amounts would not be provisional amounts. The Company would also report provisional amounts for those specific income tax effects for which the accounting under GAAP will be incomplete but for which a reasonable estimate can be determined. This accounting update is effective immediately. The Company believes its accounting for the income tax effects of the TCJA is complete. Technical corrections or other forthcoming guidance could change how we interpret provisions of the TCJA, which may impact our effective tax rate and could affect our deferred tax assets, tax positions and/or our tax liabilities.

NOTE 2—SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at June 30, 2019 and December 31, 2018 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss).

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2019				
U.S. government sponsored entities & agencies	**$ 1,420**	**$ 68**	**$ —**	**$ 1,488**
State and political subdivision	**88,350**	**3,777**	**(15)**	**92,112**
Mortgage-backed securities: residential	**13,221**	**193**	**(150)**	**13,264**
Mortgage-backed securities: commercial	**16,407**	**660**	**(9)**	**17,058**
Collateralized mortgage obligations: residential	**9,769**	**38**	**(121)**	**9,686**
Collateralized mortgage obligations: commercial	**32,013**	**724**	**(16)**	**32,721**
U.S. Treasury	**6,061**	**23**	**(77)**	**6,007**
SBA	**24,709**	**122**	**(127)**	**24,704**
Asset backed securities	**10,381**	**—**	**(106)**	**10,275**
Corporate bonds	**10,586**	**246**	**(2)**	**10,830**
Total available-for-sale	**$ 212,917**	**$ 5,851**	**$ (623)**	**$ 218,145**
December 31, 2018				
U.S. government sponsored entities & agencies	$ 2,404	$ 4	$ (11)	$ 2,397
State and political subdivision	75,093	657	(604)	75,146
Mortgage-backed securities: residential	10,114	4	(379)	9,739
Mortgage-backed securities: commercial	12,594	17	(229)	12,382
Collateralized mortgage obligations: residential	18,916	51	(296)	18,671
Collateralized mortgage obligations: commercial	32,390	98	(500)	31,988
U.S. Treasury	21,232	—	(751)	20,481
SBA	15,856	—	(168)	15,688
Asset backed securities	3,872	—	(30)	3,842
Corporate bonds	14,006	18	(100)	13,924
Total available-for-sale	$ 206,477	$ 849	$ (3,068)	$ 204,258

The proceeds from sales of securities and the associated gains and losses for the three and six months ended June 30, 2019 are summarized below. There were no sales of securities during the three and six months ended June 30, 2018.

(Dollars in thousands)	For the three months ended June 30, 2019	For the six months ended June 30, 2019
Proceeds	**$ 29,465**	**$ 35,465**
Gross gains	**277**	**341**
Gross losses	**(270)**	**(341)**

The amortized cost and fair value of securities are shown in the table below by contractual maturity. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2019	
(Dollars in thousands)	Amortized Cost	Fair Value
Within one year	$ 1,244	$ 1,246
One to five years	33,114	33,502
Five to ten years	54,097	55,976
Beyond ten years	124,462	127,421
Total	$ 212,917	$ 218,145

Securities pledged at June 30, 2019 and December 31, 2018 had a carrying amount of $33.6 million and $22.7 million, respectively, and were pledged to secure Federal Home Loan Bank ("FHLB") advances, a Federal Reserve Bank line of credit, repurchase agreements, deposits and mortgage derivatives.

As of June 30, 2019, the Bank held 57 tax-exempt state and local municipal securities totaling $42.6 million backed by the Michigan School Bond Loan Fund. Other than the aforementioned investments, at June 30, 2019 and December 31, 2018, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

The following table summarizes securities with unrealized losses at June 30, 2019 and December 31, 2018 aggregated by security type and length of time in a continuous unrealized loss position:

	Less than 12 Months		12 Months or Longer		Total	
(Dollars in thousands)	Fair value	Unrealized Losses	Fair value	Unrealized Losses	Fair value	Unrealized Losses
June 30, 2019						
Available-for-sale						
State and political subdivision	$ —	$ —	$ 2,243	$ (15)	$ 2,243	$ (15)
Mortgage-backed securities: residential	—	—	6,462	(150)	6,462	(150)
Mortgage-backed securities: commercial	—	—	1,338	(9)	1,338	(9)
Collateralized mortgage obligations: residential	—	—	7,089	(121)	7,089	(121)
Collateralized mortgage obligations: commercial	—	—	1,738	(16)	1,738	(16)
U.S. Treasury	—	—	4,013	(77)	4,013	(77)
SBA	4,147	(7)	14,003	(120)	18,150	(127)
Asset backed securities	10,275	(106)	—	—	10,275	(106)
Corporate bonds	—	—	1,005	(2)	1,005	(2)
Total available-for-sale	$ 14,422	$ (113)	$ 37,891	$ (510)	$ 52,313	$ (623)
December 31, 2018						
Available-for-sale						
U.S. government sponsored entities & agencies	$ 978	$ (11)	$ —	$ —	$ 978	$ (11)
State and political subdivision	5,121	(25)	27,667	(579)	32,788	(604)
Mortgage-backed securities: residential	2,595	(4)	6,393	(375)	8,988	(379)
Mortgage-backed securities: commercial	1,967	(8)	8,944	(221)	10,911	(229)
Collateralized mortgage obligations: residential	3,814	(27)	8,958	(269)	12,772	(296)
Collateralized mortgage obligations: commercial	—	—	17,939	(500)	17,939	(500)
U.S. Treasury	—	—	20,481	(751)	20,481	(751)
SBA	12,420	(91)	3,268	(77)	15,688	(168)
Asset backed securities	3,842	(30)	—	—	3,842	(30)
Corporate bonds	7,526	(28)	2,950	(72)	10,476	(100)
Total available-for-sale	$ 38,263	$ (224)	$ 96,600	$ (2,844)	$ 134,863	$ (3,068)

As of June 30, 2019, the Company's investment portfolio consisted of 251 securities, 54 of which were in an unrealized loss position. The unrealized losses for these securities resulted primarily from changes in interest rates since purchased. The Company expects full recovery of the carrying amount of these securities and does not intend to sell the securities in an unrealized loss position nor does it believe it will be required to sell securities in an unrealized loss position before the value is recovered. The Company does not consider these securities to be other-than-temporarily impaired at June 30, 2019.

NOTE 3—LOANS

The following table presents the recorded investment in loans at June 30, 2019 and December 31, 2018. The recorded investment in loans excludes accrued interest receivable.

(Dollars in thousands)	Originated	Acquired	Total
June 30, 2019			
Commercial real estate	**$ 500,593**	**$ 57,411**	**$ 558,004**
Commercial and industrial	**412,065**	**8,747**	**420,812**
Residential real estate	**174,824**	**11,913**	**186,737**
Consumer	**913**	**35**	**948**
Total	**$ 1,088,395**	**$ 78,106**	**$ 1,166,501**
December 31, 2018			
Commercial real estate	$ 500,809	$ 61,284	$ 562,093
Commercial and industrial	375,130	8,325	383,455
Residential real estate	165,015	15,003	180,018
Consumer	944	55	999
Total	$ 1,041,898	$ 84,667	$ 1,126,565

At June 30, 2019 and December 31, 2018, the Company had residential loans held for sale, which were originated with the intent to sell, totaling $22.8 million and $5.6 million, respectively. During the three months ended June 30, 2019 and 2018, the Company sold residential real estate loans with proceeds totaling $63.8 million and $11.0 million, respectively and $92.9 million and $25.1 million, during the six months ended June 30, 2019 and 2018, respectively.

Information as to nonperforming assets was as follows:

(Dollars in thousands)	June 30, 2019	December 31, 2018
Nonaccrual loans:		
Commercial real estate	**$ 2,979**	$ 5,927
Commercial and industrial	**9,559**	9,605
Residential real estate	**2,006**	2,915
Total nonaccrual loans	**14,544**	18,447
Other real estate owned	**373**	—
Total nonperforming assets	**$ 14,917**	$ 18,447
Loans 90 days or more past due and still accruing	**$ 331**	$ 243

At June 30, 2019 and December 31, 2018, all of the loans 90 days or more past due and still accruing were PCI loans.

Loan delinquency as of the dates presented below was as follows:

(Dollars in thousands)	Current	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total
June 30, 2019					
Commercial real estate	**$ 556,554**	**$ 726**	**$ 293**	**$ 431**	**$ 558,004**
Commercial and industrial	**420,502**	**180**	**23**	**107**	**420,812**
Residential real estate	**181,317**	**3,878**	**703**	**839**	**186,737**
Consumer	**940**	**8**	**—**	**—**	**948**
Total	**$ 1,159,313**	**$ 4,792**	**$ 1,019**	**$ 1,377**	**$ 1,166,501**
December 31, 2018					
Commercial real estate	$ 559,523	$ 497	$ —	$ 2,073	$ 562,093
Commercial and industrial	381,424	664	82	1,285	383,455
Residential real estate	174,831	2,499	1,314	1,374	180,018
Consumer	998	—	1	—	999
Total	$ 1,116,776	$ 3,660	$ 1,397	$ 4,732	$ 1,126,565

Impaired Loans:

Information as to impaired loans, excluding purchased credit impaired loans, was as follows:

(Dollars in thousands)	June 30, 2019	December 31, 2018
Nonaccrual loans	**$ 14,544**	$ 18,447
Performing troubled debt restructurings:		
Commercial and industrial	**558**	568
Residential real estate	**363**	363
Total performing troubled debt restructurings	**921**	931
Total impaired loans, excluding purchase credit impaired loans	**$ 15,465**	$ 19,378

Troubled Debt Restructurings:

The Company assesses loan modifications to determine whether a modification constitutes a troubled debt restructuring ("TDR"). This applies to all loan modifications except for modifications to loans accounted for in pools under ASC 310-30, which are not subject to TDR accounting/classification. For loans excluded from ASC 310-30 accounting, a modification is considered a TDR when a borrower is experiencing financial difficulties and the Company grants a concession to the borrower. For loans accounted for individually under ASC 310-30, a modification is considered a TDR when a borrower is experiencing financial difficulties and the effective yield after the modification is less than the effective yield at the time the loan was acquired or less than the effective yield of any re-estimation of cash flows subsequent to acquisition in association with consideration of qualitative factors included within ASC 310-40. All TDRs are considered impaired loans. The nature and extent of impairment of TDRs, including those which have experienced a subsequent default, are considered in the determination of an appropriate level of allowance for loan losses.

As of June 30, 2019 and December 31, 2018, the Company had a recorded investment in troubled debt restructurings of $5.7 million and $5.9 million, respectively. The Company allocated a specific reserve of $414 thousand for those loans at June 30, 2019 and a specific reserve of $258 thousand for those loans at December 31, 2018. The Company has not committed to lend additional amounts to borrowers whose loans have been modified. As of June 30, 2019, there were $4.8 million of nonperforming TDRs and $921 thousand of performing TDRs included in impaired loans. As of December 31, 2018, there were $5.0 million of nonperforming TDRs and $931 thousand of performing TDRs included in impaired loans.

All TDRs are considered impaired loans in the calendar year of their restructuring. A loan that has been modified can return to performing status if it satisfies a six-month performance requirement; however, it will continue to be reported as a TDR and considered impaired.

The following table presents the recorded investment of loans modified as TDRs during the three and six months ended June 30, 2019 and 2018, by type of concession granted. In cases where more than one type of concession was granted, the loans were categorized based on the most significant concession.

	Concession type					Financial effects of modification	
(Dollars in thousands)	Principal deferral	Interest rate	Forbearance agreement	Total number of loans	Total recorded investment	Net charge-offs	Provision for loan losses
Three months ended June 30, 2019							
Commercial and industrial	**—**	**—**	**47**	**1**	**$ 47**	**—**	**16**
Total	**$ —**	**$ —**	**$ 47**	**1**	**$ 47**	**$ —**	**$ 16**
Six months ended June 30, 2019							
Commercial and industrial	**—**	**—**	**369**	**2**	**369**	**—**	**174**
Total	**$ —**	**$ —**	**$ 369**	**2**	**$ 369**	**$ —**	**$ 174**
Three months ended June 30, 2018							
Commercial real estate	$ —	$ —	$ 691	1	$ 691	$ 101	$ —
Commercial and industrial	138	—	93	2	231	—	—
Residential real estate	—	—	110	2	110	—	5
Total	$ 138	$ —	$ 894	5	$ 1,032	$ 101	$ 5
Six months ended June 30, 2018							
Commercial real estate	$ —	$ —	$ 2,793	4	$ 2,793	$ 101	$ —
Commercial and industrial	138	—	1,004	3	1,142	—	—
Residential real estate	—	—	110	2	110	—	5
Total	$ 138	$ —	$ 3,907	9	$ 4,045	$ 101	$ 5

On an ongoing basis, the Company monitors the performance of TDRs to their modified terms. The following table presents the number of loans modified as TDRs during the twelve months ending June 30, 2018 for which there was a subsequent payment default, including the recorded investment as of the period end. There were no loans modified as TDRs during the twelve months ending June 30, 2019 for which there was a subsequent default. A payment on a TDR is considered to be in default once it is greater than 30 days past due.

	Three months ended June 30, 2018			Six months ended June 30, 2018		
(Dollars in thousands)	Total number of loans	Total recorded investment	Provision for loan losses following a subsequent default	Total number of loans	Total recorded investment	Provision for loan losses following a subsequent default
Commercial real estate	—	$ —	$ —	1	$ 1,149	$ 11
Total	—	$ —	$ —	1	$ 1,149	$ 11

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes commercial and industrial and commercial real estate loans and is performed on an annual basis. The Company uses the following definitions for risk ratings:

Pass. Loans classified as pass are higher quality loans that do not fit any of the other categories described below. This category includes loans risk rated with the following ratings: cash/stock secured, excellent credit risk, superior credit risk, good credit risk, satisfactory credit risk, and marginal credit risk.

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Based on the most recent analysis performed, the risk category of loans by class of loans was as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2019					
Commercial real estate	**$ 544,576**	**$ 10,364**	**$ 2,589**	**$ 475**	**$ 558,004**
Commercial and industrial	**403,991**	**4,816**	**11,964**	**41**	**420,812**
Total	**$ 948,567**	**$ 15,180**	**$ 14,553**	**$ 516**	**$ 978,816**
December 31, 2018					
Commercial real estate	$ 545,843	$ 10,240	$ 5,966	$ 44	$ 562,093
Commercial and industrial	368,189	2,841	12,425	—	383,455
Total	$ 914,032	$ 13,081	$ 18,391	$ 44	$ 945,548

For residential real estate loans and consumer loans, the Company evaluates credit quality based on the aging status of the loan and by payment activity. Residential real estate loans and consumer loans are considered nonperforming if they are 90 days or more past due. Consumer loan types are continuously monitored for changes in delinquency trends and other asset quality indicators.

The following presents residential real estate and consumer loans by credit quality:

(Dollars in thousands)	Performing	Nonperforming	Total
June 30, 2019			
Residential real estate	**$ 184,731**	**$ 2,006**	**$ 186,737**
Consumer	**948**	**—**	**948**
Total	**$ 185,679**	**$ 2,006**	**$ 187,685**
December 31, 2018			
Residential real estate	$ 177,103	$ 2,915	$ 180,018
Consumer	999	—	999
Total	$ 178,102	$ 2,915	$ 181,017

Purchased Credit Impaired Loans:

As part of the Company's previous four acquisitions, the Company acquired purchase credit impaired ("PCI") loans for which there was evidence of credit quality deterioration since origination, and we determined that it was probable that the Company would be unable to collect all contractually required principal and interest payments. The total balance of all PCI loans from these acquisitions was as follows:

(Dollars in thousand)	Unpaid Principal Balance	Recorded Investment
June 30, 2019		
Commercial real estate	**$ 6,560**	**$ 3,868**
Commercial and industrial	**301**	**173**
Residential real estate	**4,354**	**3,099**
Total PCI loans	**$ 11,215**	**$ 7,140**
December 31, 2018		
Commercial real estate	$ 7,406	$ 4,344
Commercial and industrial	177	122
Residential real estate	4,974	3,409
Total PCI loans	$ 12,557	$ 7,875

The following table reflects the activity in the accretable yield of PCI loans from past acquisitions, which includes total expected cash flows, including interest, in excess of the recorded investment.

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	2019	2018	2019	2018
Accretable yield at beginning of period	**$ 10,363**	$ 13,534	**$ 10,947**	$ 14,452
Accretion of income	**(591)**	(991)	**(1,175)**	(1,909)
Adjustments to accretable yield	**422**	(159)	**422**	(159)
Other activity, net	**—**	6	**—**	6
Accretable yield at end of period	**$ 10,194**	$ 12,390	**$ 10,194**	$ 12,390

"Accretion of income" represents the income earned on these loans for the year. "Adjustments to accretable yield" represents the net amount of accretable yield added or removed as a result of the semi-annual re-estimation of expected cash flows.

NOTE 4—ALLOWANCE FOR LOAN LOSSES

An allowance for loan losses is maintained to absorb probable incurred losses from the loan portfolio. The allowance for loan losses is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of nonaccrual loans.

The Company established an allowance for loan losses associated with PCI loans (accounted for under ASC 310-30) based on credit deterioration subsequent to the acquisition date. As of June 30, 2019, the Company had six PCI loan pools and 11 non-pooled PCI loans. The Company re-estimates cash flows expected to be collected for PCI loans on a semi-annual basis, with any decline in expected cash flows recorded as provision for loan losses on a discounted basis during the period. For any increases in cash flows expected to be collected, the Company adjusts the amount of accretable yield to be recognized on a prospective basis over the loan's remaining life.

For loans not accounted for under ASC 310-30, the Company individually evaluates certain impaired loans on a quarterly basis and establishes specific allowances for such loans, if required. A loan is considered impaired when it is probable that interest or principal payments will not be made in accordance with the contractual terms of the loan agreement. Consistent with this definition, all loans for which the accrual of interest has been discontinued (nonaccrual loans) and all TDRs are considered impaired. The Company individually evaluates nonaccrual loans with book balances of $250 thousand or more, all loans whose terms have been modified in a TDR, and certain other loans. The threshold for individual evaluation is revised on an infrequent basis, generally when economic circumstances significantly change. Specific allowances for impaired loans are estimated using one of several methods, including the estimated fair value of underlying collateral, observable market value of similar debt or discounted expected future cash flows. All other impaired loans are individually evaluated by identifying its risk characteristics and applying the standard reserve factor for the corresponding loan pool.

Loans which do not meet the criteria to be individually evaluated are evaluated in pools of loans with similar risk characteristics. Business loans are assigned to pools based on the Company's internal risk rating system. Internal risk ratings are assigned to each business loan at the time of approval and are subjected to subsequent periodic reviews by the Company's senior management, generally at least annually or more frequently upon the occurrence of a circumstance that affects the credit risk of the loan. For business loans not individually evaluated, losses inherent to the pool are estimated by applying standard reserve factors to outstanding principal balances.

The allowance for loans not individually evaluated is determined by applying estimated loss rates to various pools of loans within the portfolios with similar risk characteristics. Estimated loss rates for all pools are updated quarterly, incorporating quantitative and qualitative factors such as recent charge-off experience, current economic conditions and trends, changes in collateral values of properties securing loans (using index-based estimates), and trends with respect to past due and nonaccrual amounts.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for loan losses is recorded for these loans at acquisition. Methods utilized to estimate any subsequently required allowance for loan losses for acquired loans not deemed credit-impaired at acquisition are similar to originated loans; however, the estimate of loss is based on the unpaid principal balance less any remaining purchase discount.

Loans individually evaluated for impairment are presented below.

(Dollars in thousands)	Recorded investment with no related allowance	Recorded investment with related allowance [1]	Total recorded investment	Contractual principal balance	Related allowance [1]
June 30, 2019					
Individually evaluated impaired loans:					
Commercial real estate	**$ 2,979**	**$ —**	**$ 2,979**	**$ 3,136**	**$ —**
Commercial and industrial	**6,006**	**3,813**	**9,819**	**10,229**	**758**
Residential real estate	**1,255**	**189**	**1,444**	**1,582**	**19**
Total	**$ 10,240**	**$ 4,002**	**$ 14,242**	**$ 14,947**	**$ 777**
December 31, 2018					
Individually evaluated impaired loans:					
Commercial real estate	$ 5,898	$ 3,991	$ 9,889	$ 13,076	$ 815
Commercial and industrial	5,892	4,059	9,951	10,411	526
Residential real estate	1,666	3,255	4,921	6,604	101
Total	$ 13,456	$ 11,305	$ 24,761	$ 30,091	$ 1,442

[1] December 31, 2018 individually evaluated impaired loans included $7.2 million of PCI loans with a related allowance of $920 thousand. June 30, 2019 individually evaluated impaired loans do not include PCI loans with a related allowance.

(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
For the three months ended June 30, 2019			
Individually evaluated impaired loans [1]:			
Commercial real estate	**$ 2,927**	**$ —**	**$ 1**
Commercial and industrial	**10,220**	**10**	**—**
Residential real estate	**2,111**	**7**	**10**
Total	**$ 15,258**	**$ 17**	**$ 11**
For the six months ended June 30, 2019			
Individually evaluated impaired loans [1]:			
Commercial real estate	**$ 4,675**	**$ —**	**$ 174**
Commercial and industrial	**10,535**	**19**	**224**
Residential real estate	**2,476**	**14**	**10**
Total	**$ 17,686**	**$ 33**	**$ 408**
For the three months ended June 30, 2018			
Individually evaluated impaired loans [1]:			
Commercial real estate	$ 9,571	$ 434	$ —
Commercial and industrial	6,829	23	112
Residential real estate	5,375	93	—
Total	$ 21,775	$ 550	$ 112
For the six months ended June 30, 2018			
Individually evaluated impaired loans [1]:			
Commercial real estate	$ 9,650	$ 846	$ —
Commercial and industrial	9,335	48	112
Residential real estate	5,309	181	—
Total	$ 24,294	$ 1,075	$ 112

[1] June 30, 2018 individually evaluated impaired loans included PCI loans, whereas June 30, 2019 individually evaluated impaired loans excluded PCI loans.

Activity in the allowance for loan losses and the allocation of the allowance for loans was as follows:

(Dollars in thousands)	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Consumer	Total
For the three months ended June 30, 2019					
Allowance for loan losses:					
Beginning balance	**$ 5,181**	**$ 5,606**	**$ 1,170**	**$ 3**	**$ 11,960**
Provision (benefit) for loan losses	**111**	**363**	**(50)**	**5**	**429**
Gross chargeoffs	**(74)**	**(20)**	**—**	**(8)**	**(102)**
Recoveries	**1**	**41**	**22**	**2**	**66**
Net (chargeoffs) recoveries	**(73)**	**21**	**22**	**(6)**	**(36)**
Ending allowance for loan losses	**$ 5,219**	**$ 5,990**	**$ 1,142**	**$ 2**	**$ 12,353**
For the six months ended June 30, 2019					
Allowance for loan losses:					
Beginning balance	**$ 5,227**	**$ 5,174**	**$ 1,164**	**$ 1**	**$ 11,566**
Provision (benefit) for loan losses	**65**	**840**	**(65)**	**11**	**851**
Gross chargeoffs	**(74)**	**(115)**	**—**	**(14)**	**(203)**
Recoveries	**1**	**91**	**43**	**4**	**139**
Net (chargeoffs) recoveries	**(73)**	**(24)**	**43**	**(10)**	**(64)**
Ending allowance for loan losses	**$ 5,219**	**$ 5,990**	**$ 1,142**	**$ 2**	**$ 12,353**
For the three months ended June 30, 2018					
Allowance for loan losses:					
Beginning balance	$ 5,076	$ 5,458	$ 967	$ 5	$ 11,506
Provision (benefit) for loan losses	85	(799)	(4)	8	(710)
Gross chargeoffs	(101)	(5)	—	(8)	(114)
Recoveries	—	769	14	—	783
Net (chargeoffs) recoveries	(101)	764	14	(8)	669
Ending allowance for loan losses	$ 5,060	$ 5,423	$ 977	$ 5	$ 11,465
For the six months ended June 30, 2018					
Allowance for loan losses:					
Beginning balance	$ 4,852	$ 5,903	$ 950	$ 8	$ 11,713
Provision (benefit) for loan losses	318	(528)	42	12	(156)
Gross chargeoffs	(112)	(758)	(47)	(15)	(932)
Recoveries	2	806	32	—	840
Net (chargeoffs) recoveries	(110)	48	(15)	(15)	(92)
Ending allowance for loan losses	$ 5,060	$ 5,423	$ 977	$ 5	$ 11,465

(Dollars in thousands)	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Consumer	Total
June 30, 2019					
Allowance for loan losses:					
Individually evaluated for impairment	**$ —**	**$ 758**	**$ 19**	**$ —**	**$ 777**
Collectively evaluated for impairment	**4,467**	**5,193**	**1,110**	**2**	**10,772**
Acquired with deteriorated credit quality	**752**	**39**	**13**	**—**	**804**
Ending allowance for loan losses	**$ 5,219**	**$ 5,990**	**$ 1,142**	**$ 2**	**$ 12,353**
Balance of loans:					
Individually evaluated for impairment	**$ 2,979**	**$ 9,819**	**$ 1,444**	**$ —**	**$ 14,242**
Collectively evaluated for impairment	**551,157**	**410,820**	**182,194**	**948**	**1,145,119**
Acquired with deteriorated credit quality	**3,868**	**173**	**3,099**	**—**	**7,140**
Total loans	**$ 558,004**	**$ 420,812**	**$ 186,737**	**$ 948**	**$ 1,166,501**
December 31, 2018					
Allowance for loan losses:					
Individually evaluated for impairment	$ —	$ 504	$ 18	$ —	$ 522
Collectively evaluated for impairment	4,412	4,648	1,063	1	10,124
Acquired with deteriorated credit quality	815	22	83	—	920
Ending allowance for loan losses	$ 5,227	$ 5,174	$ 1,164	$ 1	$ 11,566
Balance of loans:					
Individually evaluated for impairment	$ 5,898	$ 9,829	$ 1,854	$ —	$ 17,581
Collectively evaluated for impairment	551,851	373,504	174,755	999	1,101,109
Acquired with deteriorated credit quality	4,344	122	3,409	—	7,875
Total loans	$ 562,093	$ 383,455	$ 180,018	$ 999	$ 1,126,565

NOTE 5—PREMISES AND EQUIPMENT

Premises and equipment were as follows at June 30, 2019 and December 31, 2018:

(Dollars in thousands)	June 30, 2019	December 31, 2018
Land	**$ 2,225**	$ 2,197
Buildings	**9,825**	9,746
Leasehold improvements	**1,957**	1,708
Furniture, fixtures and equipment	**6,090**	6,024
Total premises and equipment	**$ 20,097**	$ 19,675
Less: Accumulated depreciation	**6,909**	6,433
Net premises and equipment	**$ 13,188**	$ 13,242

Depreciation expense was $333 thousand and $331 thousand for the three months ended June 30, 2019 and 2018, and $660 thousand and $663 thousand for the six months ended June 30, 2019 and 2018, respectively.

Most of the Company's branch facilities are rented under non-cancelable operating lease agreements. Total rent expense was $236 thousand and $253 thousand for the three months ended June 30, 2019 and 2018, and $533 thousand and $505 thousand for the six months ended June 30, 2019 and 2018, respectively.

NOTE 6—GOODWILL AND INTANGIBLE ASSETS

Goodwill: The Company acquired two banks, Lotus Bank in March 2015 and Bank of Michigan in March 2016, which resulted in the recognition of $4.6 million and $4.8 million of goodwill, respectively. Goodwill was $9.4 million at both June 30, 2019 and December 31, 2018.

Goodwill is not amortized but is evaluated at least annually for impairment. The Company's most recent annual goodwill impairment review performed as of September 30, 2018 did not indicate that an impairment of goodwill existed. The Company also determined that no triggering events have occurred that indicated impairment from the most recent valuation date through June 30, 2019 and that the Company's goodwill was not impaired at June 30, 2019.

Beginning with fiscal year 2019, the Company has elected to evaluate goodwill for impairment as of October 1st rather than September 30th as was done in the preceding years. The change will have no impact on the current year's or prior year's financial statements.

Acquired Intangible Assets: The Company has recorded core deposit intangibles ("CDIs") associated with each of its acquisitions. CDIs are amortized on an accelerated basis over their estimated useful lives.

The table below presents the Company's net carrying amount of CDIs:

(Dollars in thousands)	June 30, 2019	December 31, 2018
Gross carrying amount	**$ 2,045**	$ 2,045
Accumulated amortization	**(1,686)**	(1,598)
Net Intangible	**$ 359**	$ 447

Amortization expense for the CDIs was $36 thousand and $55 thousand for the three months ended June 30, 2019 and 2018 and $88 thousand and $110 thousand for the six months ended June 30, 2019 and 2018, respectively.

NOTE 7 —BORROWINGS AND SUBORDINATED DEBT

The following table presents the components of our short-term borrowings and long-term debt.

(Dollars in thousands)	June 30, 2019 Amount	June 30, 2019 Weighted Average Rate[(1)]	December 31, 2018 Amount	December 31, 2018 Weighted Average Rate[(1)]
Short-term borrowings:				
FHLB Advances	**$ 45,000**	**2.51%**	$ 90,000	2.54%
Securities sold under agreements to repurchase	**525**	**0.30**	609	0.30
FHLB line of credit	**—**	**—**	2,520	2.87
Federal funds purchased	**—**	**—**	5,000	2.50
Total short-term borrowings	**45,525**	**2.49**	98,129	2.53
Long-term debt:				
Secured borrowing due in 2022	**1,409**	**1.00**	1,445	1.00
FHLB advances due in 2022 to 2029[(2)]	**30,000**	**2.05**	—	—
Subordinated notes due in 2025[(3)]	**14,920**	**6.38**	14,891	6.38
Total long-term debt	**46,329**	**3.41**	16,336	5.90
Total short-term and long-term borrowings	**$ 91,854**	**2.95%**	$ 114,465	3.01%

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(1) Weighted average rate presented is the contractual rate which excludes premiums and discounts related to purchase accounting.
(2) At June 30, 2019, the long-term FHLB advances consisted of 1.80% - 2.35% fixed rate notes.
(3) The June 30, 2019 balance includes subordinated notes of $15.0 million and debt issuance costs of $80 thousand. The December 31, 2018 balance includes subordinated notes of $15.0 million and debt issuance costs of $109 thousand.

The Bank is a member of the FHLB of Indianapolis, which provides short- and long-term funding collateralized by mortgage-related assets to its members. FHLB short-term borrowings bear interest at variable rates based on LIBOR. The advances were secured by a blanket lien on $400.4 million of real estate-related loans as of June 30, 2019. Based on this collateral and the Company's holdings of FHLB stock, the Company was eligible to borrow up to an additional $167.0 million from the FHLB at June 30, 2019. In addition, the Bank can borrow up to $117.0 million through the unsecured lines of credit it has established with other correspondent banks, as well as $4.9 million through a secured line with the Federal Reserve Bank. The Bank had no outstanding federal funds purchased as of June 30, 2019 and $5.0 million outstanding as of December 31, 2018.

At June 30, 2019, the Company had $525 thousand of securities sold under agreements to repurchase with customers, which mature overnight. These borrowings were secured by residential collateralized mortgage obligation securities with a fair value of $838 thousand at June 30, 2019.

The Company had a secured borrowing of $1.4 million as of June 30, 2019 relating to certain loan participations sold by the Company that did not qualify for sales treatment. The secured borrowing bears a fixed rate of 1.00% and matures on September 15, 2022.

As of June 30, 2019, the Company had outstanding $15.0 million of subordinated notes. The notes bear a fixed interest rate of 6.375% per annum, payable semiannually through December 15, 2020. The notes will bear a floating interest rate of three-month LIBOR plus 477 basis points payable quarterly after December 15, 2020 through maturity. The notes mature no later than December 15, 2025, and the Company has the option to redeem or prepay any or all of the subordinated notes without premium or penalty any time after December 15, 2020 or upon an occurrence of a Tier 2 capital event or tax event. The notes are subordinated to all other borrowings. At June 30, 2019, there was $80 thousand of debt issuance costs remaining, which are netted against the balance of the subordinated notes and recognized as expense over the expected term of the notes.

NOTE 8—INCOME TAXES

The Company records its federal income tax expense using its estimate of the effective income tax rate expected for the full year and applies that rate on a year-to-date basis. The fluctuations in the Company's effective federal income tax rate reflect changes related to interest income exempt from federal taxation and other nondeductible expenses relative to income tax credits.

A reconciliation of expected income tax expense using the federal corporate tax rate of 21% and the actual income tax expense recorded in our consolidated financial statements was as follows:

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	**2019**	**2018**	**2019**	**2018**
Income tax expense based on federal corporate tax rate	**$ 908**	$ 1,023	**$ 1,793**	$ 1,823
Changes resulting from:				
Tax-exempt income	**(135)**	(97)	**(256)**	(185)
Other, net	**(6)**	(66)	**(23)**	(136)
Income tax expense	**$ 767**	$ 860	**$ 1,514**	$ 1,502

NOTE 9—STOCK BASED COMPENSATION

2018 Equity Incentive Plan

On March 15, 2018, the Company’s Board of Directors approved the 2018 Equity Incentive Compensation Plan ("2018 Plan"). The 2018 Plan became effective upon shareholder approval at the annual shareholders meeting held on April 17, 2018. Under the 2018 Plan, the Company can grant incentive and non-qualified stock options, stock awards, stock appreciation rights, and other incentive awards to directors and employees of, and certain service providers to, the Company and its subsidiaries. Once the 2018 Plan became effective, no further awards could be granted from the 2007 Stock Option Plan ("Stock Option Plan") or the 2014 Equity Incentive Plan ("2014 Plan"). However, any outstanding equity awards granted under the Stock Option Plan or the 2014 Plan will remain subject to the terms of such plans until the time it is no longer outstanding. For further discussion on the Stock Option Plan and 2014 Plan, refer to the disclosures included within the Annual Form 10-K, filed with the SEC on March 22, 2019.

The Company has reserved 250,000 shares of common stock for issuance under the 2018 Plan. During the six months ended June 30, 2019, the Company granted no stock options and issued 35,633 restricted stock awards under the 2018 Plan, resulting in 207,617 shares available to be granted as of June 30, 2019. During the six months ended June 30, 2018, the Company granted 30,000 stock options under the Stock Option Plan and 30,271 restricted stock awards under the 2014 Plan.

Stock Options

As of June 30, 2019, all of the Company's outstanding options were granted under the Stock Option Plan. The term of these options is ten years, and they vest one-third each year, over a three year period. The Company will use authorized, but unissued shares to satisfy share option exercises. The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model.

Expected volatilities are based on historical volatilities of the Company's common stock. The Company assumes all awards will vest. The expected term of options granted represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The fair value of the stock options granted in the six months ended June 30, 2018 was determined using the following weighted-average assumptions as of grant date:

	June 30, 2018
Risk Free Interest Rate	2.83%
Expected Term (years)	7.0
Expected Volatility	0.04%
Weighted average fair value of options granted	$4.46

The summary of our stock option activity for the three months ended June 30, 2019 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Options outstanding at January 1, 2019	376,768	$ 16.26	5.8	$ 2,685
Exercised	(15,300)	10.14		
Options outstanding at June 30, 2019	361,468	16.52	5.4	3,063
Options exercisable at June 30, 2019	341,464	$ 16.03	5.2	$ 3,059

The aggregate intrinsic value was $3.1 million for both options outstanding and exercisable as of June 30, 2019. As of June 30, 2019, there was $73 thousand of total unrecognized compensation cost related to stock options granted under the Stock Option Plan. The cost is expected to be recognized over a weighted-average period of 1.3 years.

Share-based compensation expense charged against income was $11 thousand and $48 thousand for the three months ended June 30, 2019 and 2018, and $31 thousand and $90 thousand for the six months ended June 30, 2019 and 2018, respectively.

Restricted Stock Awards

A summary of changes in the Company's nonvested shares for the six months ended June 30, 2019 is as follows:

Nonvested Shares	Shares	Weighted Average Grant-Date Fair Value
Nonvested at January 1, 2019	**53,770**	**$ 24.14**
Granted	**35,633**	**23.76**
Vested	**(6,700)**	**20.75**
Forfeited	**(3,150)**	**23.99**
Nonvested at June 30, 2019	**79,553**	**$ 24.26**

As of June 30, 2019, there was $1.2 million of total unrecognized compensation cost related to nonvested shares granted under the 2014 Plan and 2018 Plan. The cost is expected to be recognized over a weighted average period of 2.1 years. The total fair value of shares vested during the six months ended June 30, 2019 was $139 thousand.

Total expense for restricted stock awards totaled $163 thousand and $172 thousand for the three months ended June 30, 2019 and 2018, and $297 thousand and $313 thousand for the six months ended June 30, 2019 and 2018, respectively. For the six months ended June 30, 2019, there was $43 thousand of restricted stock redeemed to cover the payroll taxes due at the time of vesting.

NOTE 10—OFF-BALANCE SHEET ACTIVITIES

In the normal course of business, the Company offers a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include outstanding commitments to extend credit, credit lines, commercial letters of credit and standby letters of credit. These are agreements to provide credit, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies used for loans are used to make such commitments, including obtaining collateral at exercise of the commitment.

A summary of the contractual amounts of the Company's exposure to off-balance sheet risk is as follows:

	June 30, 2019		December 31, 2018	
(Dollars in thousands)	Fixed	Variable	Fixed	Variable
Commitments to make loans	**$ 7,111**	**$ 7,995**	$ 8,608	$ 10,900
Unused lines of credit	**26,536**	**281,619**	18,672	229,490
Unused standby letters of credit and commercial letters of credit	**4,446**	**—**	3,861	232

Commitments to make loans are generally made for periods of 90 days or less. The fixed rate loan commitments of $7.1 million as of June 30, 2019, have interest rates ranging from 4.37% to 6.5% and maturities ranging from 6 months to 10 years.

NOTE 11—REGULATORY CAPITAL MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believed as of June 30, 2019, the Company and Bank met all capital adequacy requirements to which they were subject.

The Basel III rules require the Company to maintain a capital conservation buffer of common equity capital of 2.5% above the minimum risk-weighted assets ratios, which is the fully phased-in amount of the capital conservation buffer. The capital conservation buffer was 2.5% at June 30, 2019 and 1.875% at December 31, 2018.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

At June 30, 2019 and December 31, 2018, the Bank was classified as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events that management believes have changed the Bank's category.

Actual and required capital amounts and ratios are presented below:

	Actual		For Capital Adequacy Purposes		For Capital Adequacy Purposes + Capital Conservation Buffer(1)		Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
June 30, 2019								
Common equity tier 1 to risk-weighted assets:								
Consolidated	**$ 149,274**	**11.49%**	**$ 58,458**	**4.50%**	**$ 90,935**	**7.00%**		
Bank	**155,148**	**11.94%**	**58,454**	**4.50%**	**90,929**	**7.00%**	**$ 84,434**	**6.50%**
Tier 1 capital to risk-weighted assets:								
Consolidated	**$ 149,274**	**11.49%**	**$ 77,944**	**6.00%**	**$ 110,421**	**8.50%**		
Bank	**155,148**	**11.94%**	**77,939**	**6.00%**	**110,413**	**8.50%**	**$ 103,918**	**8.00%**
Total capital to risk-weighted assets:								
Consolidated	**$ 176,882**	**13.62%**	**$ 103,926**	**8.00%**	**$ 136,402**	**10.50%**		
Bank	**167,837**	**12.92%**	**103,918**	**8.00%**	**136,393**	**10.50%**	**$ 129,898**	**10.00%**
Tier 1 capital to average assets (leverage ratio):								
Consolidated	**$ 149,274**	**10.01%**	**$ 59,661**	**4.00%**	**$ 59,661**	**4.00%**		
Bank	**155,148**	**10.43%**	**59,521**	**4.00%**	**59,521**	**4.00%**	**$ 74,401**	**5.00%**
December 31, 2018								
Common equity tier 1 to risk-weighted assets:								
Consolidated	$ 144,008	11.82%	$ 54,803	4.50%	$ 77,699	6.38%		
Bank	147,495	12.12%	54,780	4.50%	77,666	6.38%	$ 79,126	6.50%
Tier 1 capital to risk-weighted assets:								
Consolidated	$ 144,008	11.82%	$ 73,071	6.00%	$ 95,967	7.88%		
Bank	147,495	12.12%	73,040	6.00%	95,926	7.88%	$ 97,386	8.00%
Total capital to risk-weighted assets:								
Consolidated	$ 170,503	14.00%	$ 97,428	8.00%	$ 120,324	9.88%		
Bank	159,100	13.07%	97,386	8.00%	120,272	9.88%	$ 121,733	10.00%
Tier 1 capital to average assets (leverage ratio):								
Consolidated	$ 144,008	10.21%	$ 56,411	4.00%	$ 56,411	4.00%		
Bank	147,495	10.48%	56,309	4.00%	56,309	4.00%	$ 70,386	5.00%

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(1) Reflects the capital conservation buffer of 2.5% and 1.875% applicable during 2019 and 2018, respectively.

Dividend Restrictions - The Company's primary source of cash is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. As of June 30, 2019, the Bank had the capacity to pay the Company a dividend of up to $31.4 million without the need to obtain prior regulatory approval.

NOTE 12—FAIR VALUE

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

Level 1—Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

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

Level 3—Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: Securities available for sale are recorded at fair value on a recurring basis as follows: the fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). No securities are valued using a Level 3 approach.

Loans Held for Sale, at Fair Value: The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

Loans Measured at Fair Value: During the normal course of business, loans originated with the initial intention to sell but not ultimately sold, are transferred from held for sale to our portfolio of loans held for investment at fair value as the Company adopted the fair value option at origination. The fair value of these loans is determined by obtaining fair value pricing from a third-party software, and then layering an additional adjustment, ranging from 5 to 75 basis points, as determined by management, depending on the reason for the transfer. Due to the adjustments made, the Company classifies the loans transferred from loans held for sale as recurring Level 3.

Impaired Loans: Impaired loans are measured and recorded at fair value on a non-recurring basis. All of our nonaccrual loans and trouble debt restructured loans are considered impaired and are reviewed individually for the amount of impairment, if any. The fair value of impaired loans is estimated using one of several methods, including the fair value of the collateral or the present value of the expected future cash flows discounted at the loan's effective interest rate. For loans that are collateral dependent, the fair value of each loan’s collateral is generally based on estimated market prices from an independently prepared appraisal. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. Such adjustments are considered unobservable and the fair value measurement is categorized as a Level 3 measurement.

Other Real Estate Owned: Other real estate owned assets are recorded at the lower of cost or fair value upon the transfer of a loan to other real estate owned and, subsequently, continue to be measured and carried at the lower of cost or fair value. The fair value of other real estate owned is based on recent real estate appraisals which are generally updated annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales, cost, and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Other real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by either the Company or the Company's appraisal services vendor. Once received, management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Management monitors the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Derivatives: Customer-initiated derivatives are traded in over-the counter markets where quoted market prices are not readily available. Fair value of customer-initiated derivatives is measured on a recurring basis using valuation models that use market observable inputs (Level 2).

Mortgage banking related derivatives including commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are recorded at fair value on a recurring basis. The fair value of these commitments is based on the fair value of related mortgage loans determined using observable market data (Level 2). Interest rate lock commitments are adjusted for expectations of exercise and funding. This adjustment is not considered to be material input.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

(Dollars in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2019				
Securities available for sale:				
U.S. government sponsored entities and agencies	$ 1,488	$ —	$ 1,488	$ —
State and political subdivision	92,112	—	92,112	—
Mortgage-backed securities: residential	13,264	—	13,264	—
Mortgage-backed securities: commercial	17,058	—	17,058	—
Collateralized mortgage obligations: residential	9,686	—	9,686	—
Collateralized mortgage obligations: commercial	32,721	—	32,721	—
U.S. Treasury	6,007	—	6,007	—
SBA	24,704	—	24,704	—
Asset backed securities	10,275	—	10,275	—
Corporate bonds	10,830	—	10,830	—
Total securities available for sale	218,145	—	218,145	—
Loans held for sale	22,822	—	22,822	—
Loans measured at fair value:				
Residential real estate	5,624	—	—	5,624
Derivative assets:				
Customer-initiated derivatives	4,041	—	4,041	—
Forward contracts related to mortgage loans to be delivered for sale	52	—	52	—
Interest rate lock commitments	403	—	403	—
Total assets at fair value	$ 251,087	$ —	$ 245,463	$ 5,624
Derivative liabilities:				
Customer-initiated derivatives	4,041	—	4,041	—
Forward contracts related to mortgage loans to be delivered for sale	127	—	127	—
Interest rate lock commitments	1	—	1	—
Total liabilities at fair value	$ 4,169	$ —	$ 4,169	$ —

(Dollars in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Securities available for sale:				
U.S. government sponsored entities and agencies	$ 2,397	$ —	$ 2,397	$ —
State and political subdivision	75,146	—	75,146	—
Mortgage-backed securities: residential	9,739	—	9,739	—
Mortgage-backed securities: commercial	12,382	—	12,382	—
Collateralized mortgage obligations: residential	18,671	—	18,671	—
Collateralized mortgage obligations: commercial	31,988	—	31,988	—
U.S. Treasury	20,481	—	20,481	—
SBA	15,688	—	15,688	—
Asset backed securities	3,842	—	3,842	—
Corporate bonds	13,924	—	13,924	—
Total securities available for sale	$ 204,258	$ —	$ 204,258	$ —
Loans held for sale	5,595	—	5,595	—
Loans measured at fair value:				
Residential real estate	4,571	—	—	4,571
Derivative assets:				
Customer-initiated derivatives	1,126	—	1,126	—
Forward contracts related to mortgage loans to be delivered for sale	22	—	22	—
Interest rate lock commitments	198	—	198	—
Total assets at fair value	$ 215,770	$ —	$ 211,199	$ 4,571
Derivative liabilities:				
Customer-initiated derivatives	1,126	—	1,126	—
Forward contracts related to mortgage loans to be delivered for sale	43	—	43	—
Total liabilities at fair value	$ 1,169	$ —	$ 1,169	$ —

There were no transfers between levels within the fair value hierarchy, within a specific category, during the six months ended June 30, 2019 or during the year ended December 31, 2018.

The following table summarizes the changes in Level 3 assets measured at fair value on a recurring basis.

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	2019	2018	2019	2018
Loans held for investment				
Beginning balance	**$ 4,650**	$ 4,159	**$ 4,571**	$ 4,291
Transfers from loans held for sale	**1,190**	304	**1,429**	304
Gains (losses):				
Recorded in "Mortgage banking activities"	**72**	(16)	**160**	(112)
Repayments	**(288)**	(33)	**(536)**	(69)
Ending balance	**$ 5,624**	$ 4,414	**$ 5,624**	$ 4,414

The Company has elected the fair value option for loans held for sale. These loans are intended for sale and the Company believes that the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Company's policy on loans held for investment. There were no loans held for sale that were on nonaccrual status or 90 days past due as of June 30, 2019 or December 31, 2018.

As of June 30, 2019 and December 31, 2018, the aggregate fair value, contractual balance (including accrued interest), and gain or loss for loans held for sale carried at fair value was as follows:

(Dollars in thousands)	June 30, 2019	December 31, 2018
Aggregate fair value	$ 22,822	$ 5,595
Contractual balance	22,289	5,512
Unrealized gain	533	83

The total amount of gains as a result of changes in fair value of loans held for sale included in "Mortgage banking activities" for the three and six months ended June 30, 2019 and 2018 were as follows:

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	2019	2018	2019	2018
Change in fair value	$ 367	$ 77	$ 450	$ 31

Assets measured at fair value on a non-recurring basis are summarized below:

(Dollars in thousands)	Total	Significant Unobservable Inputs (Level 3)
June 30, 2019		
Impaired loans:		
Commercial real estate	$ 371	$ 371
Commercial and industrial	2,736	2,736
Other real estate owned	373	373
Total	$ 3,480	$ 3,480
December 31, 2018		
Impaired loans:		
Commercial and industrial	$ 3,337	$ 3,337
Total	$ 3,337	$ 3,337

The Company recorded specific reserves of $518 thousand and $278 thousand to reduce the value of these loans at June 30, 2019 and December 31, 2018, respectively, based on the estimated fair value of the underlying collateral. The Company also recorded chargeoffs of $74 thousand during the six months ended June 30, 2019 related to the impaired loans at fair value. There were no charge-offs related to impaired loans at fair value during the year ended December 31, 2018.

There were no write downs recorded in other real estate owned during the three and six months ended June 30, 2019. There were no other real estate owned assets at fair value at December 31, 2018.

The table below presents quantitative information about the significant unobservable inputs for assets measured at fair value on a nonrecurring basis at June 30, 2019 and December 31, 2018:

(Dollars in thousands)	Fair value at June 30, 2019	Valuation Technique(s)	Significant Unobservable Input(s)	Discount %
Impaired loans	$ 3,107	Discounted appraisals; estimated net realizable value of collateral	Collateral discounts	0-80%
Other real estate owned	373	Redemption value of collateral	Collateral discounts	—

(Dollars in thousands)	Fair value at December 31, 2018	Valuation Technique(s)	Significant Unobservable Input(s)	Discount % Range
Impaired loans	$ 3,337	Discounted appraisals	Collateral discounts	17-50%

The carrying amounts and estimated fair values of financial instruments, excluding those previously presented unless otherwise noted, at June 30, 2019 and December 31, 2018 were as follows:

		Estimated Fair Value			
(Dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
June 30, 2019					
Financial assets:					
Cash and cash equivalents	**$ 50,120**	**$ 29,239**	**$ 20,881**	**$ —**	**$ 50,120**
Federal Home Loan Bank stock	**8,325**	**NA**	**NA**	**NA**	**NA**
Net loans	**1,154,148**	**—**	**—**	**1,157,910**	**1,157,910**
Accrued interest receivable	**4,984**	**—**	**1,493**	**3,491**	**4,984**
Financial liabilities:					
Deposits	**1,229,445**	**—**	**1,233,327**	**—**	**1,233,327**
Borrowings	**76,934**	**—**	**77,385**	**—**	**77,385**
Subordinated notes	**14,920**	**—**	**15,300**	**—**	**15,300**
Accrued interest payable	**2,045**	**—**	**2,045**	**—**	**2,045**
December 31, 2018					
Financial assets:					
Cash and cash equivalents	$ 33,296	$ 27,072	$ 6,224	$ —	$ 33,296
Federal Home Loan Bank stock	8,325	NA	NA	NA	NA
Net loans	1,114,999	—	—	1,113,648	1,113,648
Accrued interest receivable	4,207	—	1,210	2,997	4,207
Financial liabilities:					
Deposits	1,134,635	—	1,137,575	—	1,137,575
Borrowings	99,574	—	100,602	—	100,602
Subordinated notes	14,891	—	15,450	—	15,450
Accrued interest payable	1,674	—	1,674	—	1,674

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

(a) ***Cash and Cash Equivalents***

The carrying amounts of cash on hand and non-interest due from bank accounts approximate fair values and are classified as Level 1. The carrying amounts of fed funds sold and interest bearing due from bank accounts approximate fair values and are classified as Level 2.

(b) ***FHLB Stock***

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

(c) ***Loans***

Fair value of loans, excluding loans held for sale, are estimated as follows: Fair values for all loans are estimated using present value of future estimated cash flows, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality, resulting in a Level 3 classification. Impaired loans are values at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(d) ***Deposits***

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2 classification. Fair values for fixed and variable rate certificates of deposit are estimated using a present value of future estimated cash flows calculation that applies interest rates currently being offered on certificates of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

(e) ***Borrowings***

The fair values of the Company's short-term and long-term borrowings are estimated using present value of future estimated cash flows using current interest rates offered to the Company for similar types of borrowing arrangements, resulting in a Level 2 classification.

(f) ***Subordinated notes***

The fair value of the Company's subordinated notes is calculated based on present value of future estimated cash flows using current interest rates offered to the Company for similar types of borrowing arrangements, resulting in a Level 2 classification.

(g) ***Accrued Interest Receivable/Payable***

The carrying amounts of accrued interest approximate fair value resulting in a Level 3 classification for receivable and a Level 2 classification for payable, consistent with their associated assets/liabilities.

NOTE 13—DERIVATIVES

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered standalone derivatives, and changes in the fair value of derivatives are reported in earnings as non-interest income.

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. The Company's exposure is limited to the replacement value of the contracts rather than the notional, principal or contract amounts. There are provisions in the agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from its commitments to fund the loans. These mortgage banking derivatives are not designated in hedge relationships. Fair values were estimated based on changes in mortgage interest rates from the date of the commitments. Changes in the fair values of these mortgage-banking derivatives are included in mortgage banking activities.

The following table presents the notional amount and fair value of the Company's derivative instruments held or issued in connection with customer initiated and mortgage banking activities:

	June 30, 2019		December 31, 2018	
(Dollars in thousands)	**Notional Amount**	**Fair Value**	**Notional Amount**	**Fair Value**
Included in other assets:				
Customer-initiated and mortgage banking derivatives:				
Customer-initiated derivatives	**$ 55,351**	**$ 4,041**	$ 35,733	$ 1,126
Forward contracts related to mortgage loans to be delivered for sale	**18,344**	**52**	5,241	22
Interest rate lock commitments	**46,840**	**403**	18,375	198
Total derivatives included in other assets	**$ 120,535**	**$ 4,496**	$ 59,349	$ 1,346
Included in other liabilities:				
Customer-initiated and mortgage banking derivatives:				
Customer-initiated derivatives	**$ 55,351**	**$ 4,041**	$ 35,733	$ 1,126
Forward contracts related to mortgage loans to be delivered for sale	**25,658**	**127**	11,195	43
Interest rate lock commitments	**1,063**	**1**	—	—
Total derivatives included in other liabilities	**$ 82,072**	**$ 4,169**	$ 46,928	$ 1,169

In the normal course of business, the Company may decide to settle a forward contract rather than fulfill the contract. Cash received or paid in this settlement manner is included in "Mortgage banking activities" in the consolidated statements of income and is considered a cost of executing a forward contract. The following table presents the gains (losses) related to derivative instruments reflecting the changes in fair value:

		For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	**Location of Gain (Loss)**	**2019**	**2018**	**2019**	**2018**
Forward contracts related to mortgage loans to be delivered for sale	Mortgage Banking Activities	**$ (217)**	**$ (5)**	**$ (391)**	**$ (6)**
Interest rate lock commitments	Mortgage Banking Activities	**82**	**74**	**204**	**84**
Total gain (loss) recognized in income		**$ (135)**	**$ 69**	**$ (187)**	**$ 78**

Balance Sheet Offsetting:

Certain financial instruments, including customer-initiated derivatives and interest rate swaps, may be eligible for offset in the consolidated balance sheets and/or subject to master netting arrangements or similar agreements. The Company is a party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes based on an accounting policy election. The table below presents information about the Company's financial instruments that are eligible for offset.

				Gross amounts not offset in the statements of financial position		
(Dollars in thousands)	Gross amounts recognized	Gross amounts offset in the statements of financial condition	Net amounts presented in the statements of financial condition	Financial instruments	Collateral (received)/posted	Net amount
June 30, 2019						
Offsetting derivative assets:						
Customer initiated derivatives	**$ 4,041**	**$ —**	**$ 4,041**	**$ —**	**$ —**	**$ 4,041**
Offsetting derivative liabilities:						
Customer initiated derivatives	**4,041**	**—**	**4,041**	**—**	**4,180**	**(139)**
December 31, 2018						
Offsetting derivative assets:						
Customer initiated derivatives	$ 1,126	$ —	$ 1,126	$ —	$ —	$ 1,126
Offsetting derivative liabilities:						
Customer initiated derivatives	1,126	—	1,126	—	1,020	106

NOTE 14—PARENT COMPANY FINANCIAL STATEMENTS

Balance Sheets—Parent Company

(Dollars in thousands)	June 30, 2019	December 31, 2018
Assets		
Cash and cash equivalents	**$ 7,001**	$ 9,690
Investment in banking subsidiary	**168,741**	155,248
Investment in captive insurance subsidiary	**2,085**	1,622
Income tax benefit	**358**	393
Other assets	**42**	21
Total assets	**$ 178,227**	$ 166,974
Liabilities		
Subordinated notes	**$ 14,920**	$ 14,891
Accrued expenses and other liabilities	**440**	323
Total liabilities	**15,360**	15,214
Shareholders' equity	**162,867**	151,760
Total liabilities and shareholders' equity	**$ 178,227**	$ 166,974

Statements of Income and Comprehensive Income—Parent Company

(Dollars in thousands)	For the three months ended June 30, 2019	For the three months ended June 30, 2018	For the six months ended June 30, 2019	For the six months ended June 30, 2018
Expenses				
Interest on subordinated notes	**$ 253**	$ 253	**$ 503**	$ 503
Other expenses	**186**	265	**386**	329
Total expenses	**439**	518	**889**	832
Loss before income taxes and equity in undistributed net earnings of subsidiaries	**(439)**	(518)	**(889)**	(832)
Income tax benefit	**39**	106	**91**	203
Equity in undistributed earnings of subsidiaries	**3,955**	4,424	**7,820**	7,809
Net income	**$ 3,555**	$ 4,012	**$ 7,022**	$ 7,180
Other comprehensive income (loss)	**3,813**	(208)	**5,882**	(2,188)
Total comprehensive income, net of tax	**$ 7,368**	$ 3,804	**$ 12,904**	$ 4,992

Statements of Cash Flows—Parent Company

(Dollars in thousands)	For the six months ended June 30, 2019	For the six months ended June 30, 2018
Cash flows from operating activities		
Net income	**$ 7,022**	$ 7,180
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiaries	**(7,820)**	(7,809)
Stock based compensation expense	**31**	164
(Increase) decrease in other assets, net	**14**	(200)
Decrease in other liabilities, net	**70**	(115)
Net cash used in operating activities	**(683)**	(780)
Cash flows from investing activities		
Capital infusion to subsidiaries	**—**	(20,000)
Net cash used in investing activities	**—**	(20,000)
Cash flows from financing activities		
Net proceeds from issuance of common stock related to initial public offering	**—**	29,030
Share buyback - redeemed stock	**(1,620)**	—
Common stock dividends paid	**(542)**	(197)
Proceeds from exercised stock options	**156**	1,257
Net cash provided by (used in) financing activities	**(2,006)**	30,090
Net increase (decrease) in cash and cash equivalents	**(2,689)**	9,310
Beginning cash and cash equivalents	**9,690**	1,158
Ending cash and cash equivalents	**$ 7,001**	$ 10,468

NOTE 15—EARNINGS PER SHARE

Beginning in the second quarter of 2019, the Company has elected to prospectively use the two-class method in calculating earnings per share due to the restricted stock awards qualifying as participating securities. The two-class method is used in the calculation of basic and diluted earnings per share. Under the two-class method, earnings available to common shareholders for the period are allocated between common shareholders and participating securities according to dividends declared (or accumulated) and participating rights in undistributed earnings.

Average shares of common stock for diluted net income per common share include shares to be issued upon the exercise of stock options granted under the Company's share-based compensation plans and restricted stock awards.

The calculation of basic and diluted earnings per share using the two-class method for each period noted below was as follows:

(Dollars in thousands, except per share data)	For the three months ended June 30, 2019	For the six months ended June 30, 2019
Net income	$ 3,555	$ 7,022
Net income allocated to participating securities	37	66
Net income allocated to common shareholders [1]	$ 3,518	$ 6,956
Weighted average common shares - issued	7,739	7,746
Average unvested restricted share awards	(81)	(74)
Weighted average common shares outstanding - basic	7,658	7,672
Effect of dilutive securities		
Weighted average common stock equivalents	114	116
Weighted average common shares outstanding - diluted	7,772	7,788
EPS available to common shareholders		
Basic earnings per common share	$ 0.46	$ 0.91
Diluted earnings per common share	$ 0.45	$ 0.89

[1] Net income allocated to common shareholders for basic and diluted earnings per share may differ under the two-class method as a result of adding common share equivalents for options to dilutive shares outstanding, which alters the ratio used to allocate net income to common shareholders and participating securities for the purposes of calculating diluted earnings per share.

For the three and six months ended June 30, 2018, the basic and diluted earnings per share were calculated using the treasury stock method, as disclosed in the table below. The Company determined that there would be no impact to diluted earnings per share for the three and six months ended June 30, 2018, if calculated under the two-class method.

(Dollars in thousands, except per share data)	For the three months ended June 30, 2018	For the six months ended June 30, 2018
Basic:		
Net Income attributable to common shareholders	$ 4,012	$ 7,180
Weighted average common shares outstanding	7,456,212	7,050,487
Basic earnings per share	$ 0.54	$ 1.02
Diluted:		
Net Income attributable to common shareholders	$ 4,012	$ 7,180
Weighted average common shares outstanding	7,456,212	7,050,487
Add: Dilutive effects of assumed exercises of stock options	156,672	160,977
Weighted average common and dilutive potential common shares outstanding	7,612,884	7,211,464
Diluted earnings per common share	$ 0.53	$ 1.00

Stock options for 30,000 shares of common stock were not considered in computing diluted earnings per common share for the three months ended June 30, 2019 and 2018, and stock options for 30,000 shares and 22,541 shares of common stock were not considered in computing diluted earnings per common share for the six months ended June 30, 2019 and 2018, respectively, because they were antidilutive.

NOTE 16—SUBSEQUENT EVENTS

On August 1, 2019, the Company received a $6.9 million payoff on one of its large, nonaccrual loan relationships. The net book balance of the loan relationship as of August 1, 2019 was $6.5 million, which resulted in a $6.5 million decrease in our nonaccrual loans. The payoff of the nonaccrual loan also resulted in an income statement impact of $771 thousand, consisting of $408 thousand in loan interest and fee income and $363 thousand of provision benefit.

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

The following discussion explains our financial condition and results of operations as of and for the three and six months ended June 30, 2019. The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes presented elsewhere in this report and our Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on March 22, 2019. Annualized results for these interim periods may not be indicative of results for the full year or future periods.

In addition to the historical information contained herein, this Form 10-Q includes "forward-looking statements." These statements are subject to many risks and uncertainties, including changes in interest rates and other general economic, business and political conditions, including changes in the financial markets; changes in business plans as circumstances warrant; and other risks detailed from time to time in filings made by the Company with the SEC. Readers should note that the forward-looking statements included herein are not a guarantee of future events, and that actual events may differ materially from those made in or suggested by the forward-looking statements. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "will," "propose," "may," "plan," "seek," "expect," "intend," "estimate," "anticipate," "believe," "continue," or similar terminology. Any forward-looking statements presented herein are made only as of the date of this document, and we do not undertake any obligation to update or revise any forward-looking statements to reflect changes in assumptions, the occurrence of unanticipated events, or otherwise.

Critical Accounting Policies

Our consolidated financial statements are prepared based on the application of accounting policies generally accepted in the United States. Our critical accounting policies require reliance on estimates and assumptions, which are based upon historical experience and on various other assumptions that management believes are reasonable under current circumstances, but may prove to be inaccurate or can be subject to variations. Changes in underlying factors, assumptions, or estimates could have a material impact on our future financial condition and results of operations.

The most critical of these significant accounting policies are set forth in *"Note 1 – Summary of Significant Accounting Policies"* of the Notes to Consolidated Financial Statements, included in our Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the SEC on March 22, 2019. There have been no significant changes in critical accounting policies or the assumptions and judgments utilized in applying these policies since December 31, 2018.

Overview

Level One Bancorp, Inc. is a bank holding company headquartered in Farmington Hills, Michigan, with its primary branch operations in southeastern Michigan and Grand Rapids, Michigan. Through our wholly owned subsidiary, Level One Bank, we offer a broad range of loan products to the residential and commercial markets, as well as retail and business banking services. Hamilton Court Insurance Company, a wholly owned subsidiary of the Company, provides property and casualty insurance to the Company and the Bank and reinsurance to ten other third-party insurance captives for which insurance may not be currently available or economically feasible in the insurance marketplace.

Since 2007, we have grown substantially through organic growth and a series of four acquisitions, all of which have been fully integrated into our operations. We have made significant investments over the last several years in hiring additional staff and upgrading technology and system security. In 2016, we opened our first branch in the Grand Rapids, Michigan market. In the third quarter of 2017, we opened our second location in Bloomfield Township located in Oakland County. In the third quarter of 2018, we doubled the size of our mortgage division with the addition of new mortgage officers and support staff. As of June 30, 2019, the Company had total consolidated assets of $1.51 billion, total consolidated deposits of $1.23 billion and total consolidated shareholders' equity of $162.9 million.

Our principal business activity has been lending to and accepting deposits from individuals, businesses, municipalities and other entities. We derive income principally from interest charged on loans and leases and, to a lesser extent, from interest and dividends earned on investment securities. We have also derived income from noninterest sources, such as fees received in connection with various lending and deposit services and originations and sales of residential mortgage loans. Our principal expenses include interest expense on deposits and borrowings, operating expenses, such as salaries and employee benefits, occupancy and equipment expenses, data processing costs, professional fees and other noninterest expenses, provisions for loan losses and income tax expense.

Recent Developments

Second Quarter Dividend. On June 20, 2019, the Company declared a second quarter 2019 cash dividend of $0.04 per share, payable on July 15, 2019 to shareholders of record on June 30, 2019.

Nonaccrual Loan Relationship Payoff. On August 1, 2019, the Company received a $6.9 million payoff on one of its large, nonaccrual loan relationships. The net book balance of the loan relationship as of August 1, 2019 was $6.5 million, which resulted in a $6.5 million decrease in our nonaccrual loans. The payoff of the nonaccrual loan also resulted in an income statement impact of $771 thousand, consisting of $408 thousand in loan interest and fee income and $363 thousand of provision benefit.

Selected Financial Data - Unaudited

(Dollars in thousands, except per share data)	As of and for the three months ended June 30, 2019	As of and for the three months ended March 31, 2019	As of and for the three months ended June 30, 2018	As of and for the six months ended June 30, 2019	As of and for the six months ended June 30, 2018
Earnings Summary					
Interest income	**$ 17,657**	$ 17,442	$ 15,380	**$ 35,099**	$ 30,154
Interest expense	**5,216**	4,724	2,965	**9,940**	5,612
Net interest income	**12,441**	12,718	12,415	**25,159**	24,542
Provision expense (benefit) for loan losses	**429**	422	(710)	**851**	(156)
Noninterest income	**3,477**	2,286	1,452	**5,763**	2,824
Noninterest expense	**11,167**	10,368	9,705	**21,535**	18,840
Income before income taxes	**4,322**	4,214	4,872	**8,536**	8,682
Income tax provision	**767**	747	860	**1,514**	1,502
Net income	**3,555**	3,467	4,012	**7,022**	7,180
Per Share Data					
Basic earnings per common share	**$ 0.46**	$ 0.45	$ 0.54	**$ 0.91**	$ 1.02
Diluted earnings per common share	**0.45**	0.44	0.53	**0.89**	1.00
Book value per common share	**21.07**	20.15	18.51	**21.07**	18.51
Tangible book value per share [1]	**19.81**	18.88	17.23	**19.81**	17.23
Shares outstanding (in thousands)	**7,728**	7,749	7,749	**7,728**	7,749
Average basic common shares (in thousands)	**7,741**	7,752	7,456	**7,746**	7,050
Average diluted common shares (in thousands)	**7,856**	7,869	7,613	**7,862**	7,211
Selected Period End Balances					
Total assets	**$ 1,505,376**	$ 1,456,552	$ 1,322,913	**$ 1,505,376**	$ 1,322,913
Securities available-for-sale	**218,145**	226,874	196,047	**218,145**	196,047
Total loans	**1,166,501**	1,131,097	1,045,789	**1,166,501**	1,045,789
Total deposits	**1,229,445**	1,151,463	1,065,216	**1,229,445**	1,065,216
Total liabilities	**1,342,509**	1,300,433	1,179,468	**1,342,509**	1,179,468
Total shareholders' equity	**162,867**	156,119	143,445	**162,867**	143,445
Tangible shareholders' equity [1]	**153,121**	146,337	133,501	**153,121**	133,501
Performance and Capital Ratios					
Return on average assets	**0.95%**	0.96%	1.23 %	**0.95%**	1.11%
Return on average equity	**8.92**	8.99	11.97	**8.95**	11.72
Net interest margin (fully taxable equivalent) [2]	**3.50**	3.76	3.99	**3.63**	4.01
Efficiency ratio (noninterest expense/net interest income plus noninterest income)	**70.15**	69.10	69.99	**69.64**	68.84
Dividend payout ratio	**8.69**	6.72	5.78	**7.72**	2.74
Total shareholders' equity to total assets	**10.82**	10.72	10.84	**10.82**	10.84
Tangible equity to tangible assets [1]	**10.24**	10.11	10.17	**10.24**	10.17
Common equity tier 1 to risk-weighted assets	**11.49**	11.78	12.11	**11.49**	12.11
Tier 1 capital to risk-weighted assets	**11.49**	11.78	12.11	**11.49**	12.11
Total capital to risk-weighted assets	**13.62**	13.95	14.44	**13.62**	14.44
Tier 1 capital to average assets (leverage ratio)	**10.01**	10.19	10.60	**10.01**	10.60
Asset Quality Ratios:					
Net charge-offs (recoveries) to average loans	**0.01%**	0.01%	(0.26)%	**0.02%**	0.02%
Nonperforming assets as a percentage of total assets	**0.99**	1.17	0.85	**0.99**	0.85
Nonaccrual loans as a percent of total loans	**1.25**	1.47	1.08	**1.25**	1.08
Allowance for loan losses as a percentage of period-end loans	**1.06**	1.06	1.10	**1.06**	1.10
Allowance for loan losses as a percentage of nonaccrual loans	**84.94**	71.85	101.67	**84.94**	101.67
Allowance for loan losses as a percentage of nonaccrual loans, excluding allowance allocated to loans accounted for under ASC 310-30	**79.41**	66.33	92.93	**79.41**	92.93

(1) See section entitled "GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures" below.
(2) Presented on a tax equivalent basis using a 21% tax rate.

GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures

Some of the financial measures included in this report are not measures of financial condition or performance recognized by GAAP. These non-GAAP financial measures include tangible shareholders' equity, tangible book value per share and the ratio of tangible equity to tangible assets. Our management uses these non-GAAP financial measures in its analysis of our performance, and we believe that providing this information to financial analysts and investors allows them to evaluate capital adequacy, as well as better understand and evaluate the Company’s core financial results for the periods in question.

We calculate: (i) tangible shareholders' equity as total shareholders' equity less core deposit intangibles and goodwill; (ii) tangible book value per share as tangible shareholders' equity divided by shares of common stock outstanding; and (iii) tangible assets as total assets, less core deposit intangibles and goodwill.

The following presents these non-GAAP financial measures along with their most directly comparable financial measures calculated in accordance with GAAP:

(Dollars in thousands, except per share data)	June 30, 2019	December 31, 2018	June 30, 2018
	(Unaudited)		*(Unaudited)*
Total shareholders' equity	**$ 162,867**	$ 151,760	$ 143,445
Less:			
Goodwill	**9,387**	9,387	9,387
Core deposit intangibles	**359**	447	557
Tangible shareholders' equity	**$ 153,121**	$ 141,926	$ 133,501
Shares outstanding (in thousands)	**7,728**	7,750	7,749
Tangible book value per share	**$ 19.81**	$ 18.31	$ 17.23
Total assets	**$ 1,505,376**	$ 1,416,215	$ 1,322,913
Less:			
Goodwill	**9,387**	9,387	9,387
Core deposit intangibles	**359**	447	557
Tangible assets	**$ 1,495,630**	$ 1,406,381	$ 1,312,969
Tangible equity to tangible assets	**10.24%**	10.09%	10.17%

Results of Operations

Net Income

We had net income of $3.6 million, or $0.45 per diluted common share, for the three months ended June 30, 2019, compared to $4.0 million, or $0.53 per diluted common share, for the three months ended June 30, 2018. The decrease of $457 thousand in net income in the second quarter of 2019 primarily reflected an increase of $1.5 million in noninterest expense and an increase an increase in provision for loan losses of $1.1 million. This was partially offset by an increase of $2.0 million in noninterest income.

We had net income of $7.0 million, or $0.89 per diluted common share, for the six months ended June 30, 2019, compared to $7.2 million, or $1.00 per diluted common share, for the six months ended June 30, 2018. The decrease of $158 thousand in net income year over year primarily reflected an increase of $2.7 million in noninterest expense and an increase in provision for loan losses of $1.0 million. This was partially offset by an increase of $2.9 million in noninterest income and an increase of $617 thousand in net interest income.

Net Interest Income

Our primary source of revenue is net interest income, which is the difference between interest income from interest-earning assets (primarily loans and securities) and interest expense of funding sources (primarily interest-bearing deposits and borrowings).

Net interest income was $12.4 million for both the three months ended June 30, 2019 and 2018, respectively. Increases of $1.6 million in interest and fees on loans and $528 thousand in interest income from investment securities were partially offset by the increase in deposit interest expense of $2.3 million.

The increases in interest and fees on loans and interest income from investment securities for the three months ended June 30, 2019 compared to the same period in 2018, were mainly attributable to increases in the average balance of loans of $119.2 million and average balance of investments securities portfolio of $57.2 million.

The increase in deposit interest expense during three months ended June 30, 2019 was primarily due to a higher average rate paid on deposits of 1.48% compared to 0.91% for the same period in 2018, which was mainly as a result of the increase in the target federal fund rate as well as increased competition. In addition, the increase in deposit expense was impacted by an increase in average balance of deposits of $156.9 million compared to the same period in 2018.

Net interest income was $25.2 million and $24.5 million for the six months ended June 30, 2019 and 2018, respectively. The $0.7 million increase in net interest income was primarily driven by a $3.7 million increase in interest and fees on loans and a $1.1 million increase in interest income from investment securities, partially offset by a $4.1 million increase in deposit interest expense.

The changes in interest and fees on loans and interest income from investment securities for the six months ended June 30, 2019 compared to the same period in 2018 was primarily driven by increases in the average balance of loans of $103.7 million and average balance of investments securities portfolio of $61.0 million.

The increase in deposit interest expense during six months ended June 30, 2019 was primarily due to a higher average rate paid on total deposits of 1.44% compared to 0.86% for the same period in 2018, which was mainly as a result of the increase in the target federal fund rate as well as increased competition. In addition, the increase in deposit expense was impacted by increase in average balance of deposits of $134.6 million compared to the same period in 2018.

Our net interest margin (on a fully tax equivalent basis ("FTE")) for the three months ended June 30, 2019 was 3.50%, compared to 3.99% for the same period in 2018. The decrease of 49 basis points in net interest margin as compared to the same period in 2018 was primarily a result of higher cost of funds as the federal funds rate rose 50 basis points during the second half of 2018. Our net interest margin benefits from discount accretion on our purchased credit impaired loan portfolios, a component of our accretable yield. The accretable yield represents the excess of the net present value of expected future cash flows over the acquisition date fair value and includes both the expected coupon of the loan and the discount accretion. The accretable yield is recognized as interest income over the expected remaining life of the purchased credit impaired loan. The difference between the actual yield earned on total loans and the yield generated based on the contractual coupon (not including any interest income for loans in nonaccrual status) represents excess accretable yield. The contractual coupon of the loan considers the contractual coupon rates of the loan and does not include any interest income for loans in nonaccrual status. For the three months ended June 30, 2019 and 2018, the average yield on total loans was 5.43% and 5.42%, respectively. The yield on total loans was impacted by 14 basis points and 28 basis points, respectively, due to the accretable yield on purchased credit impaired loans. Our net interest margin for the three months ended June 30, 2019 and 2018, benefited by 11 basis points and 23

basis points, respectively, as a result of the excess accretable yield. As of June 30, 2019 and December 31, 2018, our remaining accretable yield was

$10.2 million and $10.9 million, respectively, and our nonaccretable difference was $4.4 million and $5.6 million, respectively.

Our net interest margin (FTE) for the six months ended June 30, 2019 was 3.63%, compared to 4.01% for the same period in 2018. The decrease of 38 basis points reflected the higher cost of funds rate that is described in the three month analysis above. For the six months ended June 30, 2019 and 2018, the average yield on total loans was 5.53% and 5.37%, respectively. The yield on total loans was impacted by 15 basis points and 29 basis points, respectively, due to the accretable yield on purchased credit impaired loans. Our net interest margin for the six months ended June 30, 2019 and 2018, benefited by 13 basis points and 24 basis points, respectively, as a result of the excess accretable yield.

The following tables set forth information related to our average balance sheet, average yields on assets, and average rates of liabilities for the periods indicated. We derived these yields by dividing income or expense by the average daily balance of the corresponding assets or liabilities. In this table, adjustments are made to the yields on tax-exempt assets in order to present tax-exempt income and fully taxable income on a comparable basis.

Analysis of Net Interest Income—Fully Taxable Equivalent

	For the three months ended June 30,					
	2019			2018		
(Dollars in thousands)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)
Interest-earning assets:						
Gross loans[3]	**$ 1,164,871**	**$ 15,762**	**5.43%**	$ 1,045,715	$ 14,126	5.42%
Investment securities[4]:						
Taxable	**143,841**	**980**	**2.73**	114,957	667	2.33
Tax-exempt	**87,287**	**595**	**3.26**	58,976	380	3.10
Interest-earning cash balances	**32,606**	**206**	**2.53**	25,828	119	1.85
Federal Home Loan Bank stock	**8,325**	**114**	**5.49**	8,303	88	4.25
Total interest-earning assets	**$ 1,436,930**	**$ 17,657**	**4.96%**	$ 1,253,779	$ 15,380	4.94%
Non-earning assets:						
Cash and due from banks	**24,347**			17,800		
Premises and equipment	**13,239**			12,621		
Goodwill	**9,387**			9,387		
Other intangible assets, net	**376**			589		
Bank-owned life insurance	**11,948**			11,650		
Allowance for loan losses	**(12,039)**			(11,473)		
Other non-earning assets	**16,804**			7,839		
Total assets	**$ 1,500,992**			$ 1,302,192		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand deposits	**$ 56,434**	**$ 69**	**0.49%**	$ 64,394	$ 48	0.30%
Money market and savings deposits	**295,371**	**1,125**	**1.53**	276,496	678	0.98
Time deposits	**582,874**	**3,423**	**2.36**	445,894	1,761	1.58
Borrowings	**59,272**	**346**	**2.33**	48,604	225	1.86
Subordinated notes	**14,910**	**253**	**6.78**	14,859	253	6.83
Total interest-bearing liabilities	**$ 1,008,861**	**$ 5,216**	**2.07%**	$ 850,247	$ 2,965	1.40%
Noninterest-bearing liabilities and shareholders' equity:						
Noninterest-bearing demand deposits	**315,530**			306,547		
Other liabilities	**17,144**			10,923		
Shareholders' equity	**159,457**			134,475		
Total liabilities and shareholders' equity	**$ 1,500,992**			$ 1,302,192		
Net interest income		**$ 12,441**			$ 12,415	
Interest spread			**2.89%**			3.54%
Net interest margin[5]			**3.47**			3.97
Tax equivalent effect			**0.03**			0.02
Net interest margin on a fully tax equivalent basis			**3.50%**			3.99%

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(1) Interest income is shown on actual basis and does not include taxable equivalent adjustments.
(2) Average rates and yields are presented on an annual basis and include a taxable equivalent adjustment to interest income of $115 thousand and $76 thousand on tax-exempt securities for the three months ended June 30, 2019 and 2018, respectively, using the federal corporate tax rate of 21%.
(3) Includes nonaccrual loans
(4) For presentation in this table, average balances and the corresponding average rates for investment securities are based upon historical cost, adjusted for amortization of premiums and accretion of discounts.
(5) Net interest margin represents net interest income divided by average total interest-earning assets.

	For the six months ended June 30,					
	2019			2018		
(Dollars in thousands)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)
Interest-earning assets:						
Gross loans(3)	**$ 1,145,151**	**$ 31,413**	**5.53%**	$ 1,041,404	$ 27,730	5.37%
Investment securities(4):						
Taxable	**142,569**	**1,916**	**2.71**	108,581	1,241	2.31
Tax-exempt	**84,041**	**1,140**	**3.28**	56,997	731	3.12
Interest-earning cash balances	**30,353**	**382**	**2.54**	26,455	225	1.71
Federal Home Loan Bank stock	**8,325**	**248**	**6.01**	8,303	227	5.51
Total interest-earning assets	**$ 1,410,439**	**$ 35,099**	**5.05%**	$ 1,241,740	$ 30,154	4.92%
Non-earning assets:						
Cash and due from banks	**24,570**			18,163		
Premises and equipment	**13,264**			12,990		
Goodwill	**9,387**			9,387		
Other intangible assets, net	**401**			616		
Bank-owned life insurance	**11,921**			11,610		
Allowance for loan losses	**(11,802)**			(11,646)		
Other non-earning assets	**14,335**			10,006		
Total assets	**$ 1,472,515**			$ 1,292,866		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand deposits	**$ 54,875**	**$ 117**	**0.43%**	$ 63,950	$ 99	0.31%
Money market and savings deposits	**300,903**	**2,219**	**1.49**	275,105	1,226	0.90
Time deposits	**563,609**	**6,402**	**2.29**	451,195	3,340	1.49
Borrowings	**57,553**	**699**	**2.45**	52,689	444	1.70
Subordinated notes	**14,903**	**503**	**6.79**	14,852	503	6.83
Total interest-bearing liabilities	**$ 991,843**	**$ 9,940**	**2.02%**	$ 857,791	$ 5,612	1.32%
Noninterest-bearing liabilities and shareholders' equity:						
Noninterest-bearing demand deposits	**308,146**			302,635		
Other liabilities	**15,648**			9,933		
Shareholders' equity	**156,878**			122,507		
Total liabilities and shareholders' equity	**$ 1,472,515**			$ 1,292,866		
Net interest income		**$ 25,159**			$ 24,542	
Interest spread			**3.03%**			3.60%
Net interest margin(5)			**3.60**			3.99
Tax equivalent effect			**0.03**			0.02
Net interest margin on a fully tax equivalent basis			**3.63%**			4.01%

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(1) Interest income is shown on actual basis and does not include taxable equivalent adjustments.
(2) Average rates and yields are presented on an annual basis and include a taxable equivalent adjustment to interest income of $226 thousand and $150 thousand on tax-exempt securities for the six months ended June 30, 2019 and 2018, respectively, using the federal corporate tax rate of 21%.
(3) Includes nonaccrual loans
(4) For presentation in this table, average balances and the corresponding average rates for investment securities are based upon historical cost, adjusted for amortization of premiums and accretion of discounts.
(5) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

The table below presents the effect of volume and rate changes on interest income and expense for the periods indicated. Changes in volume are changes in the average balance multiplied by the previous year's average rate. Changes in rate are changes in the average rate multiplied by the average balance from the previous year. The net changes attributable to the combined impact of both rate and volume have been allocated proportionately to the changes due to volume and the changes due to rate. The average rate for tax-exempt securities is reported on a fully taxable equivalent basis.

	For the three months ended June 30, 2019 vs. 2018		
	Increase (Decrease) Due to:		
(Dollars in thousands)	**Rate**	**Volume**	**Net Increase (Decrease)**
Interest-earning assets			
Gross loans	$ 23	$ 1,613	$ 1,636
Investment securities:			
Taxable	128	185	313
Tax-exempt	(14)	229	215
Interest-earning cash balances	51	36	87
FHLB Stock	26	—	26
Total interest income	214	2,063	2,277
Interest-bearing liabilities			
Interest-bearing demand deposits	28	(7)	21
Money market and savings deposits	398	49	447
Time deposits	1,020	642	1,662
Borrowings	66	55	121
Subordinated debt	(1)	1	—
Total interest expense	1,511	740	2,251
Change in net interest income	$ (1,297)	$ 1,323	$ 26

	For the six months ended June 30, 2019 vs. 2018		
	Increase (Decrease) Due to:		
(Dollars in thousands)	**Rate**	**Volume**	**Net Increase (Decrease)**
Interest-earning assets			
Gross loans	$ 857	$ 2,826	$ 3,683
Investment securities:			
Taxable	242	433	675
Tax-exempt	(29)	438	409
Interest-earning cash balances	120	37	157
FHLB Stock	20	1	21
Total interest income	1,210	3,735	4,945
Interest-bearing liabilities			
Interest-bearing demand deposits	33	(15)	18
Money market and savings deposits	868	125	993
Time deposits	2,090	972	3,062
Borrowings	211	44	255
Subordinated debt	(2)	2	—
Total interest expense	3,200	1,128	4,328
Change in net interest income	$ (1,990)	$ 2,607	$ 617

Provision for Loan Losses

We established an allowance for loan losses through a provision for loan losses charged as an expense in our consolidated statements of income. Management reviews the loan portfolio, consisting of originated loans and purchased loans, on a quarterly basis to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses.

Loans acquired in connection with acquisitions that have evidence of credit deterioration since origination and for which it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, or ASC 310-30. These credit-impaired loans have been recorded at their estimated fair value on the respective acquisition date, based on subjective determinations regarding risk ratings, expected future cash flows and fair value of the underlying collateral, without a carryover of the related allowance for loan losses. At the acquisition date, the Company recognizes the expected shortfall of expected future cash flows, as compared to the contractual amount due, as a nonaccretable discount. Any excess of the net present value of expected future cash flows over the acquisition date fair value is recognized as the accretable discount, or accretable yield. We evaluate these loans semi-annually to assess expected cash flows. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from nonaccretable to accretable with a positive impact on interest income. As of June 30, 2019, and December 31, 2018, our remaining accretable yield was $10.2 million and $10.9 million, respectively, and our nonaccretable difference was $4.4 million and $5.6 million, respectively.

The provision for loan losses was a provision expense of $429 thousand for the three months ended June 30, 2019, compared to a $710 thousand provision benefit for the same period in 2018. The increase in the provision for loan losses was primarily due to a $700 thousand recovery in the second quarter of 2018, as well as increases of $232 thousand in specific reserves on impaired loans and $217 thousand in general reserves on originated loans as a result of continued growth.

The provision for loan losses was a provision expense of $851 thousand for the six months ended June 30, 2019, compared to $156 thousand provision benefit for the six months ended June 30, 2018. The increase in the provision for loan losses year over year was primarily attributable to a $591 thousand increase in general reserves on originated loans as a result of continued growth and $457 thousand in specific reserves on impaired loans. Our total nonaccrual loans decreased by $3.9 million to $14.5 million at June 30, 2019 compared to $18.4 million at December 31, 2018. The decrease in nonaccrual loans was primarily a result of pay-downs on three commercial loan relationships totaling $4.9 million, partially offset by four commercial loan relationships totaling $2.1 million moving to nonaccrual during the six months ending June 30, 2019.

Noninterest Income

The following table presents noninterest income for the three and six months ended June 30, 2019 and 2018.

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	**2019**	**2018**	**2019**	**2018**
Noninterest income				
Service charges on deposits	**$ 662**	$ 618	**$ 1,287**	$ 1,260
Net gain on sales of securities	**7**	—	**—**	—
Mortgage banking activities	**2,316**	404	**3,436**	640
Net gain on sale of commercial loans	**—**	11	**—**	11
Other charges and fees	**492**	419	**1,040**	913
Total noninterest income	**$ 3,477**	$ 1,452	**$ 5,763**	$ 2,824

Noninterest income increased $2.0 million to $3.5 million for the three months ended June 30, 2019, compared to $1.5 million for the same period in 2018. The increase in noninterest income was primarily due to an increase in mortgage banking activities of $1.9 million, which was attributable to increased volumes of mortgage loans sold, loans held for sale and mortgage banking derivatives. The increase in the mortgage banking activities income year over year was predominantly as a result of the doubling of our mortgage team during the third quarter of 2018.

Noninterest income increased $2.9 million to $5.8 million for the six months ended June 30, 2019, compared to $2.8 million for the same period in 2018. The increase in noninterest income was primarily due to an increase in mortgage banking activities of $2.8 million, which was attributable to the same factors mentioned above.

Noninterest Expense

The following table presents noninterest expense for the three and six months ended June 30, 2019 and 2018.

(Dollars in thousands)	For the three months ended June 30, 2019	For the three months ended June 30, 2018	For the six months ended June 30, 2019	For the six months ended June 30, 2018
Noninterest expense				
Salary and employee benefits	**$ 7,193**	$ 6,169	**$ 14,106**	$ 12,125
Occupancy and equipment expense	**1,168**	1,074	**2,372**	2,120
Professional service fees	**385**	471	**747**	737
Marketing expense	**288**	291	**464**	433
Printing and supplies expense	**104**	112	**172**	216
Data processing expense	**606**	511	**1,201**	947
Other expense	**1,423**	1,077	**2,473**	2,262
Total noninterest expense	**$ 11,167**	$ 9,705	**$ 21,535**	$ 18,840

Noninterest expense increased $1.5 million to $11.2 million for the three months ended June 30, 2019, as compared to $9.7 million for the same period in 2018. The increase in noninterest expense was primarily attributable to increases in salary and employee benefits of $1.0 million, other expense of $346 thousand, data processing expense of $95 thousand and occupancy and equipment expense of $94 thousand. These increases were partially offset by a decrease in professional service fees of $86 thousand. The increase in salary and employee benefits between the periods was primarily due to an increase of $776 thousand in commissions expense as a result of higher mortgage volumes, as well as an increase in headcount of 14 full-time employees. The increase in other expense year over year was primarily due to a $310 thousand increase in the provision for unfunded commitments as a result of a change in the assumptions within the calculation, which resulted in a better representation of our line of credit utilization. The increase in data processing expense as well as the increase in occupancy and equipment expense were due to the incremental increases in software costs and building expenses to sustain the growth of the Company.

Noninterest expense increased $2.7 million to $21.5 million for the six months ended June 30, 2019, as compared to $18.8 million for the same period in 2018. The increase in noninterest expense was primarily due to an increase in salary and employee benefits of $2.0 million, an increase in data processing expense of $254 thousand, an increase in occupancy and equipment expense of $252 thousand, and an increase in other expense of $211 thousand. The increase in salary and employee benefits between the periods was primarily due to an increase of $1.1 million in commissions expense as a result of higher mortgage volumes, as well as an increase in headcount of 20 full-time employees. The increases in the data processing, occupancy and equipment and other expense categories were primarily attributable to the same factors mentioned above.

Income Taxes and Tax-Related Items

During the three months ended June 30, 2019, we recognized income tax expense of $767 thousand on $4.3 million of pre-tax income resulting in an effective tax rate of 17.7%, compared to the same period in 2018, in which we recognized an income tax expense of $860 thousand on $4.9 million of pre-tax income, resulting in an effective tax rate of 17.7%.

During the six months ended June 30, 2019, we recognized income tax expense of $1.5 million on $8.5 million of pre-tax income resulting in an effective tax rate of 17.7%, compared to the same period in 2018, in which we recognized an income tax expense of $1.5 million on $8.7 million of pre-tax income, resulting in an effective tax rate of 17.3%.

Refer to Note 8 - Income Taxes in the notes to the consolidated financial statements for a reconciliation between expected and actual income tax expense for the three and six months ended June 30, 2019 and 2018.

Financial Condition

Total assets increased $89.2 million to $1.51 billion at June 30, 2019 as compared to $1.42 billion at December 31, 2018. The increase in total assets was primarily due to increases of $39.9 million in gross loans, $17.2 million in mortgage loans held for sale, $16.8 million in cash and cash equivalents, and $13.9 million in securities available-for-sale. The year to date increase in loans was primarily driven by the growth in our commercial and industrial as well as our residential real estate loan portfolios. The increase in mortgage loans held for sale was attributable to the increase in volumes of loans held for sale as a result of the doubling of our mortgage team during the third quarter of 2018. Cash and cash equivalents increased as a result of an $11.5 million increase in cash balances held with the Federal Reserve Bank. The Company maintains a cash balance at the Federal Reserve and manages this liquidity balance on a daily basis as required, and may have significant cash balance fluctuations in the ordinary course of business based on inflows and outflows from changing loan totals, investment activity, and deposit flows. Lastly, the increase in securities available-for-sale reflects management's plan to increase the investment securities portfolio in line with total assets.

Investment Securities

The following table presents the fair value of the Company's investment securities portfolio, all of which were classified as available-for-sale as of June 30, 2019 and December 31, 2018.

(Dollars in thousands)	June 30, 2019	December 31, 2018
Securities available-for-sale:		
U.S. government sponsored entities and agencies	**$ 1,488**	$ 2,397
State and political subdivision	**92,112**	75,146
Mortgage-backed securities: residential	**13,264**	9,739
Mortgage-backed securities: commercial	**17,058**	12,382
Collateralized mortgage obligations: residential	**9,686**	18,671
Collateralized mortgage obligations: commercial	**32,721**	31,988
U.S. Treasury	**6,007**	20,481
SBA	**24,704**	15,688
Asset backed securities	**10,275**	3,842
Corporate bonds	**10,830**	13,924
Total securities available-for-sale	**$ 218,145**	$ 204,258

The composition of our investment securities portfolio reflects our investment strategy of maintaining an appropriate level of liquidity for both normal operations and potential acquisitions, while providing an additional source of revenue. The investment portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet, while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as collateral. At June 30, 2019, total investment securities were $218.1 million, or 14.5% of total assets, compared to $204.3 million, or 14.4% of total assets, at December 31, 2018. The $13.8 million increase in securities available-for-sale from December 31, 2018 to June 30, 2019, primarily reflected increases in obligations of state and political subdivisions, SBA securities, asset backed securities, mortgage backed securities: commercial, and mortgage backed securities: residential. Securities with a carrying value of $33.6 million and $22.7 million were pledged at June 30, 2019 and December 31, 2018, respectively, to secure borrowings, deposits and mortgage derivatives.

As of June 30, 2019, the Company held 57 tax-exempt state and local municipal securities totaling $42.6 million backed by the Michigan School Bond Loan Fund. Other than the aforementioned investments, at June 30, 2019 and December 31, 2018, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

The securities available-for-sale presented in the following tables are reported at amortized cost and by contractual maturity as of June 30, 2019 and December 31, 2018. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Additionally, residential mortgage-backed securities and collateralized mortgage obligations receive monthly principal payments, which are not reflected below. The yields below are calculated on a tax equivalent basis.

(Dollars in thousands)	June 30, 2019 One year or less Amortized Cost	Average Yield	One to five years Amortized Cost	Average Yield	Five to ten years Amortized Cost	Average Yield	After ten years Amortized Cost	Average Yield
Securities available-for-sale:								
U.S. government sponsored agency obligations	$ —	—%	$ —	—%	$ 1,420	3.22%	$ —	—%
State and political subdivision	743	2.22	4,419	2.31	20,555	3.13	62,633	3.54
Mortgage-backed securities: residential	—	—	195	0.95	3,824	2.91	9,202	2.80
Mortgage-backed securities: commercial	—	—	4,571	2.00	8,586	2.91	3,250	3.54
Collateralized mortgage obligations: residential	—	—	—	—	787	2.13	8,982	2.35
Collateralized mortgage obligations: commercial	—	—	9,274	2.83	11,677	3.06	11,062	2.36
U.S. Treasury	—	—	6,061	1.43	—	—	—	—
SBA	—	—	—	—	5,757	3.23	18,952	2.89
Asset backed securities	—	—	—	—	—	—	10,381	3.09
Corporate bonds	501	1.80	8,594	3.36	1,491	3.69	—	—
Total securities available-for-sale	$ 1,244	2.05%	$ 33,114	2.52%	$ 54,097	3.08%	$ 124,462	3.16%

(Dollars in thousands)	December 31, 2018 One year or less Amortized Cost	Average Yield	One to five years Amortized Cost	Average Yield	Five to ten years Amortized Cost	Average Yield	After ten years Amortized Cost	Average Yield
Securities available-for-sale:								
U.S. government sponsored agency obligations	$ —	—%	$ —	—%	$ 2,404	3.09%	$ —	—%
State and political subdivision	181	2.02	6,273	2.16	16,329	2.91	52,310	3.41
Mortgage-backed securities: residential	—	—	235	1.21	183	2.33	9,696	2.84
Mortgage-backed securities: commercial	—	—	6,124	2.30	5,016	2.91	1,454	3.46
Collateralized mortgage obligations: residential	—	—	—	—	837	2.09	18,079	3.22
Collateralized mortgage obligations: commercial	—	—	9,772	2.90	10,047	3.27	12,571	2.49
U.S. Treasury	—	—	21,232	1.53	—	—	—	—
SBA	—	—	—	—	1,664	3.17	14,192	3.21
Asset backed securities	—	—	—	—	—	—	3,872	3.04
Corporate bonds	1,501	2.04	10,034	3.43	2,471	3.75	—	—
Total securities available-for-sale	$ 1,682	2.04%	$ 53,670	2.29%	$ 38,951	3.06%	$ 112,174	3.19%

Loans

Our loan portfolio represents a broad range of borrowers comprised of commercial real estate, commercial and industrial, residential real estate, and consumer financing loans.

Commercial real estate loans consist of term loans secured by a mortgage lien on the real property, such as office and industrial buildings, retail shopping centers and apartment buildings, as well as commercial real estate construction loans that are offered to builders and developers. Commercial real estate loans are then segregated into two classes: non-owner occupied and owner occupied commercial real estate loans. Non-owner occupied loans, which include loans secured by non-owner occupied and nonresidential properties, generally have a greater risk profile than owner-occupied loans, which include loans secured by multifamily structures and owner-occupied commercial structures.

Commercial and industrial loans include financing for commercial purposes in various lines of businesses, including manufacturing, service industry and professional service areas. Commercial and industrial loans are generally secured with the assets of the company and/or the personal guarantee of the business owners.

Residential real estate loans represent loans to consumers for the purchase or refinance of a residence. These loans are generally financed over a 15- to 30-year term and, in most cases, are extended to borrowers to finance their primary residence with both fixed-rate and adjustable-rate terms. Real estate construction loans are also offered to consumers who wish to build their own homes and are often structured to be converted to permanent loans at the end of the construction phase, which is typically twelve months. Residential real estate loans also include home equity loans and lines of credit that are secured by a first- or second-lien on the borrower's residence. Home equity lines of credit consist mainly of revolving lines of credit secured by residential real estate.

Consumer loans include loans made to individuals not secured by real estate, including loans secured by automobiles or watercraft, and personal unsecured loans.

The following table details our loan portfolio by loan type at the dates presented:

	As of June 30,	As of December 31,			
(Dollars in thousands)	**2019**	**2018**	**2017**	**2016**	**2015**
Commercial real estate:					
Non-owner occupied	**$ 364,504**	$ 367,671	$ 343,420	$ 322,354	$ 240,161
Owner occupied	**193,500**	194,422	168,342	169,348	146,487
Total commercial real estate	**558,004**	562,093	511,762	491,702	386,648
Commercial and industrial	**420,812**	383,455	377,686	342,069	254,808
Residential real estate	**186,737**	180,018	144,439	118,730	116,734
Consumer	**948**	999	1,036	892	1,528
Total loans	**$ 1,166,501**	$ 1,126,565	$ 1,034,923	$ 953,393	$ 759,718

Total loans were $1.17 billion at June 30, 2019, an increase of $39.9 million from December 31, 2018. The total increase in loans from December 31, 2018 was primarily due to an increase in commercial and industrial loans of $37.4 million and residential real estate of $6.7 million, partially offset by a decrease in commercial real estate loans of $4.1 million. In general, we target a loan portfolio mix of approximately one-half commercial real estate, approximately one-third commercial and industrial loans and one-sixth a mix of residential real estate and consumer loans. As of June 30, 2019, approximately 47.8% of our loans were commercial real estate, 36.1% were commercial and industrial, and 16.1% were residential real estate and consumer loans.

We originate both fixed and adjustable rate residential real estate loans conforming to the underwriting guidelines of the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation, as well as home equity loans and lines of credit that are secured by first or junior liens. Most of our fixed rate residential loans, along with some of our adjustable rate mortgages, are sold to other financial institutions with which we have established a correspondent lending relationship. The Company is in the process of establishing a direct relationship with FNMA and hopes to begin locking and selling loans to FNMA during the third quarter of 2019.

Loan Maturity/Rate Sensitivity

The following table shows the contractual maturities of our loans as of June 30, 2019.

(Dollars in thousands)	**One year or less**	**After one but within five years**	**After five years**	**Total**
June 30, 2019				
Commercial real estate	**$ 63,344**	**$ 349,574**	**$ 145,086**	**$ 558,004**
Commercial and industrial	**152,922**	**166,554**	**101,336**	**420,812**
Residential real estate	**2,561**	**4,244**	**179,932**	**186,737**
Consumer	**135**	**530**	**283**	**948**
Total loans	**$ 218,962**	**$ 520,902**	**$ 426,637**	**$ 1,166,501**
Sensitivity of loans to changes in interest rates:				
Fixed interest rates		**$ 406,697**	**$ 159,830**	
Floating interest rates		**114,205**	**266,807**	
Total		**$ 520,902**	**$ 426,637**	

Summary of Impaired Assets and Past Due Loans

Nonperforming assets consist of nonaccrual loans and other real estate owned. We do not consider performing troubled debt restructurings (TDRs) to be nonperforming assets, but they are included as part of impaired assets. The level of nonaccrual loans is an important element in assessing asset quality. Loans are classified as nonaccrual when, in the opinion of management, collection of principal or interest is not expected according to the terms of the agreement. Generally, loans are placed on nonaccrual status due to the continued failure by the borrower to adhere to contractual payment terms coupled with other pertinent factors, such as insufficient collateral value.

A loan is categorized as a troubled debt restructuring if a concession is granted, such as to provide for the reduction of either interest or principal, due to deterioration in the financial condition of the borrower. Typical concessions include reduction of the interest rate on the loan to a rate considered lower than the current market rate, forgiveness of a portion of the loan balance, extension of the maturity date, and/or modifications from principal and interest payments to interest-only payments for a certain period. Loans are not classified as TDRs when the modification is short-term or results in only an insignificant delay or shortfall in the payments to be received.

***Credit Quality Indicators*:**

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes commercial and industrial and commercial real estate loans and is performed on an annual basis. The Company uses the following definitions for risk ratings:

Pass. Loans classified as pass are higher quality loans that do not fit any of the other categories described below. This category includes loans risk rated with the following ratings: cash/stock secured, excellent credit risk, superior credit risk, good credit risk, satisfactory credit risk, and marginal credit risk.

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

For residential real estate loans and consumer loans, the Company evaluates credit quality based on the aging status of the loan and by payment activity. Residential real estate loans and consumer loans are considered nonperforming if they are 90 days or more past due. Consumer loan types are continuously monitored for changes in delinquency trends and other asset quality indicators.

Purchased credit impaired loans accounted for under ASC 310-30 are classified as performing, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the semi-annual re-estimation of expected cash flows and is included in the resulting recognition of current period loan loss provision or future period yield adjustments.

Total classified and criticized loans as of June 30, 2019 compared to December 31, 2018 were as follows:

(Dollars in thousands)	June 30, 2019	December 31, 2018
Classified loans:		
Substandard	**$ 14,553**	$ 18,391
Doubtful	**516**	44
Total classified loans	**$ 15,069**	$ 18,435
Special mention	**15,180**	13,081
Total classified and criticized loans	**$ 30,249**	$ 31,516

A summary of nonperforming assets (defined as nonaccrual loans and other real estate owned), performing troubled debt restructurings and loans 90 days or more past due and still accruing, as of the dates indicated, are presented below.

	As of June 30,	As of December 31,			
(Dollars in thousands)	2019	2018	2017	2016	2015
Nonaccrual loans					
Commercial real estate	**$ 2,979**	$ 5,927	$ 2,257	$ 147	$ 141
Commercial and industrial	**9,559**	9,605	9,024	13,389	309
Residential real estate	**2,006**	2,915	2,767	1,498	1,177
Total nonaccrual loans[1]	**14,544**	18,447	14,048	15,034	1,627
Other real estate owned	**373**	—	652	258	81
Total nonperforming assets	**14,917**	18,447	14,700	15,292	1,708
Performing troubled debt restructurings					
Commercial real estate	**—**	—	—	290	—
Commercial and industrial	**558**	568	961	1,018	1,069
Residential real estate	**363**	363	261	207	279
Total performing troubled debt restructurings	**921**	931	1,222	1,515	1,348
Total impaired assets, excluding ASC 310-30 loans	**$ 15,838**	$ 19,378	$ 15,922	$ 16,807	$ 3,056
Loans 90 days or more past due and still accruing	**$ 331**	$ 243	$ 440	$ 377	$ 883

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[1] Nonaccrual loans include nonperforming troubled debt restructurings of $4.8 million, $5.0 million, $6.4 million, $5.8 million, and $564 thousand at the respective dates indicated above.

During the six months ended June 30, 2019 and 2018, the Company recorded $441 thousand and $190 thousand, respectively, of interest income on nonaccrual loans and performing TDRs excluding PCI loans.

In addition to nonperforming and impaired assets, the Company had purchased credit impaired loans accounted for under ASC 310-30 which amounted to $7.1 million, $7.9 million, $9.7 million, $11.6 million, and $17.6 million at the respective dates indicated in the table above.

Allowance for Loan Losses

We maintain the allowance for loan losses at a level we believe is sufficient to absorb probable incurred losses in our loan portfolio given the conditions at the time. Management determines the adequacy of the allowance based on periodic evaluations of the loan portfolio and other factors. These evaluations are inherently subjective as they require management to make material estimates, all of which may be susceptible to significant change. The allowance is increased by provisions charged to expense and decreased by actual charge-offs, net of recoveries.

Purchased Loans

The allowance for loan losses on purchased loans is based on credit deterioration subsequent to the acquisition date. In accordance with the accounting guidance for business combinations, there was no allowance brought forward on any of the acquired loans as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. For purchased credit impaired loans, accounted for under ASC 310-30, management establishes an allowance for credit deterioration subsequent to the date of acquisition by re-estimating expected cash flows on a semi-annual basis with any decline in expected cash flows recorded as provision for loan losses. Impairment is measured as the excess of the recorded investment in a loan over the present value of expected future cash flows discounted at the pre-impairment accounting yield of the loan. For increases in cash flows expected to be collected, we first reverse any previously recorded allowance for loan losses, then adjust the amount of accretable yield recognized on a prospective basis over the loan's remaining life. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change. For non-purchased credit impaired loans acquired in our acquisitions that are accounted for under ASC 310-20, the historical loss estimates are based on the historical losses experienced since acquisition. We record an allowance for loan losses only when the calculated amount exceeds the discount remaining from acquisition that was established for the similar period covered in the allowance for loan loss calculation. For all other purchased loans, the allowance is calculated in accordance with the methods used to calculate the allowance for loan losses for originated loans, as described below.

Originated Loans

The allowance for loan losses represents management's assessment of probable credit losses inherent in the loan portfolio. The allowance for loan losses consists of specific components, based on individual evaluation of certain loans, and general components for homogeneous pools of loans with similar risk characteristics.

Impaired loans include loans placed on nonaccrual status and troubled debt restructurings. Loans are considered impaired when based on current information and events it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreements. When determining if we will be unable to collect all principal and interest payments due in accordance with the original contractual terms of the loan agreement, we consider the borrower's overall financial condition, resources and payment record, support from guarantors, and the realizable value of any collateral. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All impaired loans are identified to be individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the discounted expected future cash flows or at the fair value of collateral if repayment is collateral dependent.

The allowance for our nonimpaired loans, which includes commercial real estate, commercial and industrial, residential, and consumer loans that are not individually evaluated for impairment, begins with a process of estimating the probable incurred losses in the portfolio. These estimates are established based on our historical loss data. Additional allowance estimates for commercial and industrial and commercial real estate loans are based on internal credit risk ratings. Internal credit risk ratings are assigned to each business loan at the time of approval and are subjected to subsequent periodic reviews by senior management, at least annually or more frequently upon the occurrence of a circumstance that affects the credit risk of the loan.

The Company's current methodology on historical loss analysis incorporates and fully relies on the Company's own historical loss data. The historical loss estimates are established by loan type including commercial real estate, commercial and industrial, residential, and consumer. In addition, consideration is given to borrower’s rating for commercial and industrial and commercial real estate loans.

The following table presents, by loan type, the changes in the allowance for loan losses for the periods presented.

(Dollars in thousands)	For the three months ended June 30, 2019	For the three months ended June 30, 2018	For the six months ended June 30, 2019	For the six months ended June 30, 2018
Balance at beginning of period	**$ 11,960**	$ 11,506	**$ 11,566**	$ 11,713
Loan charge-offs:				
Commercial real estate	**(74)**	(101)	**(74)**	(112)
Commercial and industrial	**(20)**	(5)	**(115)**	(758)
Residential real estate	**—**	—	**—**	(47)
Consumer	**(8)**	(8)	**(14)**	(15)
Total loan charge-offs	**(102)**	(114)	**(203)**	(932)
Recoveries of loans previously charged-off:				
Commercial real estate	**1**	—	**1**	2
Commercial and industrial	**41**	769	**91**	806
Residential real estate	**22**	14	**43**	32
Consumer	**2**	—	**4**	—
Total loan recoveries	**66**	783	**139**	840
Net charge-offs (recoveries)	**(36)**	669	**(64)**	(92)
Provision for loan losses	**429**	(710)	**851**	(156)
Balance at end of period	**$ 12,353**	$ 11,465	**$ 12,353**	$ 11,465
Allowance for loan losses as a percentage of period-end loans	**1.06**	1.10	**1.06**	0.01
Net charge-offs (recoveries) to average loans	**0.01**	(0.26)	**0.02**	0.02

Our allowance for loan losses was $12.4 million, or 1.06% of loans, at June 30, 2019 compared to $11.6 million, or 1.03% of loans, at December 31, 2018. The $787 thousand increase in the allowance for loan losses during the six months ended June 30, 2019 was primarily due to a $229 thousand increase in specific reserves related to impaired loans as well as an increase in general reserves related to organic loan growth.

The following table presents, by loan type, the allocation of the allowance for loan losses at the dates presented.

(Dollars in thousands)	Allocated Allowance	Percentage of loans in each category to total loans
June 30, 2019		
Balance at end of period applicable to:		
Commercial real estate	**$ 5,219**	**47.8%**
Commercial and industrial	**5,990**	**36.1**
Residential real estate	**1,142**	**16.0**
Consumer	**2**	**0.1**
Total loans	**$ 12,353**	**100.0%**
December 31, 2018		
Balance at end of period applicable to:		
Commercial real estate	$ 5,227	49.9%
Commercial and industrial	5,174	34.0
Residential real estate	1,164	16.0
Consumer	1	0.1
Total loans	$ 11,566	100.0%
December 31, 2017		
Balance at end of period applicable to:		
Commercial real estate	$ 4,852	49.4%
Commercial and industrial	5,903	36.5
Residential real estate	950	14.0
Consumer	8	0.1
Total loans	$ 11,713	100.0%
December 31, 2016		
Balance at end of period applicable to:		
Commercial real estate	$ 4,124	51.5%
Commercial and industrial	5,932	35.9
Residential real estate	1,030	12.5
Consumer	3	0.1
Total loans	$ 11,089	100.0%
December 31, 2015		
Balance at end of period applicable to:		
Commercial real estate	$ 3,299	50.9%
Commercial and industrial	3,256	33.5
Residential real estate	1,307	15.4
Consumer	28	0.2
Total loans	$ 7,890	100.0%

Deposits

Total deposits were $1.23 billion at June 30, 2019 and $1.13 billion at December 31, 2018, representing 91.6% and 89.7% of total liabilities, respectively. The increase in deposits of $94.8 million was due to an increase of $60.7 million in time deposits, $27.9 million in money market and savings deposits, and $6.2 million in demand deposits. Our average interest-bearing deposit costs were 1.92% and 1.19% for the six months ended June 30, 2019 and 2018, respectively. The increase in interest-bearing deposit costs between the two periods was impacted by the changing mix of deposit types, as well as by the increase in overnight market rates, as measured by the target federal funds rate. The target federal funds rate rose 1.00% during 2018 but did not rise during the six months ended June 30, 2019.

Brokered deposits. Brokered deposits are marketed through national brokerage firms to their customers in $1,000 increments. For these brokered deposits, detailed records of owners are maintained by the Depository Trust Company under the name of CEDE & Co. This relationship provides a large source of deposits for the Company. Due to the competitive nature of the brokered deposit market, brokered deposits tend to bear higher rates of interest than non-brokered deposits. At June 30, 2019 and December 31, 2018, the Company had approximately $115.5 million and $110.3 million in brokered deposits, respectively. The Company's ability to accept, roll-over or renew brokered deposits is contingent upon the Bank maintaining a capital level of "well-capitalized."

For periods prior to September 30, 2018, Certificate of Deposit Account Registry Service (CDARS) and reciprocal money market accounts were considered to be brokered deposits by regulatory authorities and were reported as such on quarterly Call Reports. With the passage of The Economic Growth, Regulatory Relief and Consumer Protection Act in May 2018, these items are no longer considered brokered deposits. Included in the brokered deposits total at June 30, 2019 and December 31, 2018 were $514 thousand and $1.8 million in CDARS customer deposit accounts, respectively. The $514 thousand at June 30, 2019 was due to an early withdrawal from a CDARS customer deposit account in the first quarter of 2018 that will be paid at maturity.

Management understands the importance of core deposits as a stable source of funding and may periodically implement various deposit promotion strategies to encourage core deposit growth, including recent promotions for time deposits and money market deposits. For periods of rising interest rates, management has modeled the aggregate yields for non-maturity deposits and time deposits to increase at a slower pace than the increase in underlying market rates, which is intended to result in net interest margin expansion and an increase in net interest income.

The following table sets forth the distribution of average deposits by account type for the periods indicated below.

	Three Months Ended June 30, 2019		
(Dollars in thousands)	**Average Balance**	**Percent**	**Average Rate**
Noninterest-bearing demand deposits	$ 315,530	25.2%	—%
Interest-bearing demand deposits	56,434	4.5	0.49
Money market and savings deposits	295,371	23.6	1.53
Time deposits	582,874	46.7	2.36
Total deposits	$ 1,250,209	100.0%	1.48%

	Six Months Ended June 30, 2019		
(Dollars in thousands)	**Average Balance**	**Percent**	**Average Rate**
Noninterest-bearing demand deposits	$ 308,146	25.1%	—%
Interest-bearing demand deposits	54,875	4.5	0.43
Money market and savings deposits	300,903	24.5	1.49
Time deposits	563,609	45.9	2.29
Total deposits	$ 1,227,533	100.0%	1.44%

The following table shows the contractual maturity of time deposits, including CDARs and IRA deposits and other brokered funds, of $100 thousand and over that were outstanding as of the date presented.

(Dollars in thousands)	**June 30, 2019**
Maturing in:	
3 months or less	$ 500
3 months to 6 months	83,286
6 months to 1 year	118,729
1 year or greater	170,401
Total	$ 372,916

Borrowings

Total debt outstanding at June 30, 2019 was $91.9 million, a decrease of $22.6 million from $114.5 million at December 31, 2018. The decrease in total borrowings was primarily due to a decrease of $45.0 million in short-term FHLB advances, a $5.0 million payoff in our federal funds purchased and $2.5 million decrease in our FHLB line of credit, partially offset by a $30.0 million increase in long-term FHLB advances. The decrease in total borrowings was a result of less short-term borrowings needed to fund the liquidity needs of the Company.

At June 30, 2019, FHLB advances were secured by a blanket lien on $400.4 million of real estate-related loans, and repurchase agreements were secured by securities with a fair value of $838 thousand. At December 31, 2018, FHLB advances were secured by a blanket lien on $372.5 million of real estate-related loans, and repurchase agreements were secured by securities with a fair value of $1.0 million.

As of June 30, 2019 and December 31, 2018, the Company had $15.0 million of subordinated notes outstanding at each date, and debt issuance costs of $80 thousand and $109 thousand, respectively, related to these subordinated notes. The notes bear a fixed interest rate of 6.375% per annum, payable semi-annually through December 15, 2020. The notes will bear a floating interest rate of three-month LIBOR plus 477 basis points payable quarterly after December 15, 2020 through maturity. The notes mature December 15, 2025, and the Company has the option to redeem or prepay any or all of the subordinated notes without premium or penalty any time after December 15, 2020 or at any time in the event of certain changes that affect the deductibility of interest for tax purposes or the treatment of the notes as Tier 2 Capital.

Selected financial information pertaining to the components of our short-term borrowings for the periods and as of the dates indicated is as follows:

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	**2019**	**2018**	**2019**	**2018**
FHLB Line of Credit				
Average daily balance	**$ 16**	$ 3,866	**$ 167**	$ 4,624
Weighted-average rate during period	**2.87%**	1.95%	**2.92%**	2.13%
Amount outstanding at period end	**$ —**	$ 41	**$ —**	$ 41
Weighted-average rate at period end	**—%**	2.26%	**—%**	2.26%
Maximum month-end balance	**$ —**	$ 29,827	**$ 895**	$ 29,827
Securities sold under agreements to repurchase				
Average daily balance	**$ 515**	$ 2,121	**$ 524**	$ 1,662
Weighted-average rate during period	**0.30%**	1.46%	**0.30%**	1.05%
Amount outstanding at period end	**$ 525**	$ 10,073	**$ 525**	$ 10,073
Weighted-average rate at period end	**0.30%**	2.07%	**0.30%**	2.07%
Maximum month-end balance	**$ 525**	$ 10,507	**$ 682**	$ 10,934
FHLB Advances				
Average daily balance	**$ 29,505**	$ 31,099	**$ 38,716**	$ 34,889
Weighted-average rate during period	**2.24%**	1.83%	**2.48%**	1.67%
Amount outstanding at period end	**$ 45,000**	$ 65,000	**$ 45,000**	$ 65,000
Weighted-average rate at period end	**2.51%**	1.94%	**2.51%**	1.94%
Maximum month-end balance	**$ 45,000**	$ 65,000	**$ 95,000**	$ 65,000
Federal funds purchased				
Average daily balance	**$ 2,780**	$ —	**$ 3,028**	$ —
Weighted-average rate during period	**2.54%**	—%	**2.79%**	—%
Amount outstanding at period end	**$ —**	$ —	**$ —**	$ —
Weighted-average rate at period end	**—%**	—%	**—%**	—%
Maximum month-end balance	**$ 15,000**	$ —	**$ 15,000**	$ —

Capital Resources

Shareholders' equity is influenced primarily by earnings, dividends, the Company's sales and repurchases of its common stock and changes in accumulated other comprehensive income caused primarily by fluctuations in unrealized gains or losses, net of taxes, on available for sale securities.

Shareholders' equity increased $11.0 million to $162.9 million at June 30, 2019 as compared to $151.8 million at December 31, 2018. The increase in shareholders' equity was primarily impacted by $7.0 million of net income generated during the six months ended June 30, 2019 as well as an increase of $5.8 million of other comprehensive income, partially offset by $1.6 million of stock repurchased through the share buyback program and $618 thousand of dividends declared on our common stock during the six months ended June 30, 2019.

The following table summarizes the changes in our shareholders' equity for the periods indicated below:

	For the three months ended June 30,		For the six months ended June 30,	
(Dollars in thousands)	**2019**	**2018**	**2019**	**2018**
Balance at beginning of period	**$ 156,119**	$ 110,523	**$ 151,760**	$ 107,960
Net income	**3,555**	4,012	**7,022**	7,180
Other comprehensive income (loss)	**3,813**	(208)	**5,882**	(2,188)
Initial public offering of 1,150,765 shares of common stock, net of issuance costs	**—**	29,030	**—**	29,030
Redeemed stock	**(516)**	—	**(1,620)**	—
Dividends declared	**(309)**	(197)	**(618)**	(197)
Exercise of stock options	**31**	65	**156**	1,257
Stock-based compensation expense	**174**	220	**285**	403
Balance at end of period	**$ 162,867**	$ 143,445	**$ 162,867**	$ 143,445

We strive to maintain an adequate capital base to support our activities in a safe and sound manner while at the same time attempting to maximize shareholder value. We assess capital adequacy against the risk inherent in our balance sheet, recognizing that unexpected loss is the common denominator of risk and that common equity has the greatest capacity to absorb unexpected loss.

We are subject to various regulatory capital requirements both at the Company and at the Bank level. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting policies. We have consistently maintained regulatory capital ratios at or above the well-capitalized standards.

The Basel III rules require the Company to maintain a capital conservation buffer of common equity capital of 2.5% above the minimum risk-weighted assets ratios, which is the fully phased-in amount of the capital conservation buffer. The capital conservation buffer requirement was 2.5% as of June 30, 2019 and 1.875% as of December 31, 2018, which is reflected in the table below.

At June 30, 2019, the Company and the Bank met all the capital adequacy requirements to which they were subject.

The summary below compares the actual capital ratios with the minimum quantitative measures established by regulation to ensure capital adequacy:

	Actual Capital Ratio	Capital Adequacy Regulatory Requirement	Capital Adequacy Regulatory Requirement + Capital Conservation Buffer(1)	Well Capitalized Regulatory Requirement
June 30, 2019				
Common equity tier 1 to risk-weighted assets:				
Consolidated	**11.49%**	**4.50%**	**7.00%**	
Bank	**11.94%**	**4.50%**	**7.00%**	**6.50%**
Tier 1 capital to risk-weighted assets:				
Consolidated	**11.49%**	**6.00%**	**8.50%**	
Bank	**11.94%**	**6.00%**	**8.50%**	**8.00%**
Total capital to risk-weighted assets:				
Consolidated	**13.62%**	**8.00%**	**10.50%**	
Bank	**12.92%**	**8.00%**	**10.50%**	**10.00%**
Tier 1 capital to average assets (leverage ratio):				
Consolidated	**10.01%**	**4.00%**	**4.00%**	
Bank	**10.43%**	**4.00%**	**4.00%**	**5.00%**
December 31, 2018				
Common equity tier 1 to risk-weighted assets:				
Consolidated	11.82%	4.50%	6.38%	
Bank	12.12%	4.50%	6.38%	6.50%
Tier 1 capital to risk-weighted assets:				
Consolidated	11.82%	6.00%	7.88%	
Bank	12.12%	6.00%	7.88%	8.00%
Total capital to risk-weighted assets:				
Consolidated	14.00%	8.00%	9.88%	
Bank	13.07%	8.00%	9.88%	10.00%
Tier 1 capital to average assets (leverage ratio):				
Consolidated	10.21%	4.00%	4.00%	
Bank	10.48%	4.00%	4.00%	5.00%

(1) Reflects the capital conservation buffer of 2.5% and 1.875% applicable during 2019 and 2018, respectively.

Contractual Obligations

In the ordinary course of our operations, we enter into certain contractual obligations. Total contractual obligations at June 30, 2019 were $646.9 million, an increase of $39.7 million, from $607.2 million at December 31, 2018. The increase of $39.7 million was due to increases of $60.7 million in time deposits, $30.0 million in long-term borrowings and $1.6 million in operating lease obligations, partially offset by a decrease of $52.6 million in short-term borrowings.

The following tables present our contractual obligations as of June 30, 2019 and December 31, 2018.

	Contractual Maturities as of June 30, 2019				
(Dollars in thousands)	**Less Than One Year**	**One to Three Years**	**Three to Five Years**	**Over Five Years**	**Total**
Operating lease obligations	**$ 1,211**	**$ 2,079**	**$ 1,885**	**$ 4,263**	**$ 9,438**
Short-term borrowings	**45,525**	**—**	**—**	**—**	**45,525**
Long-term borrowings	**—**	**—**	**31,409**	**—**	**31,409**
Subordinated notes	**—**	**—**	**—**	**14,920**	**14,920**
Time deposits	**468,871**	**74,240**	**2,505**	**—**	**545,616**
Total	**$ 515,607**	**$ 76,319**	**$ 35,799**	**$ 19,183**	**$ 646,908**

	Contractual Maturities as of December 31, 2018				
(Dollars in thousands)	**Less Than One Year**	**One to Three Years**	**Three to Five Years**	**Over Five Years**	**Total**
Operating lease obligations	$ 1,160	$ 1,849	$ 1,628	$ 3,235	$ 7,872
Short-term borrowings	98,129	—	—	—	98,129
Long-term borrowings	—	—	1,445	—	1,445
Subordinated notes	—	—	—	14,891	14,891
Time deposits	408,408	74,055	2,409	—	484,872
Total	$ 507,697	$ 75,904	$ 5,482	$ 18,126	$ 607,209

Off-Balance Sheet Arrangements

In the normal course of business, the Company offers a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include outstanding commitments to extend credit, credit lines, commercial letters of credit and standby letters of credit. These are agreements to provide credit, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies used for loans are used to make such commitments, including obtaining collateral at exercise of the commitment.

We maintain an allowance to cover probable losses inherent in our financial instruments with off-balance sheet risk. At June 30, 2019, the allowance for off-balance sheet risk was $336 thousand, compared to $38 thousand at December 31, 2018, and was included in "Other liabilities" on our consolidated balance sheets. The increase in the allowance for off-balance sheet risk as compared to December 31, 2018 was due to a change in the assumptions within the calculation for provision of unfunded commitments, which resulted in a better representation of our line of credit utilization.

A summary of the contractual amounts of our exposure to off-balance sheet risk is as follows.

	June 30, 2019		December 31, 2018	
(Dollars in thousands)	**Fixed Rate**	**Variable Rate**	**Fixed Rate**	**Variable Rate**
Commitments to make loans	**$ 7,111**	**$ 7,995**	$ 8,608	$ 10,900
Unused lines of credit	**26,536**	**281,619**	18,672	229,490
Unused standby letters of credit and commercial letters of credit	**4,446**	**—**	3,861	232

Of the total unused lines of credit of $308.2 million at June 30, 2019, $49.7 million was comprised of undisbursed construction loan commitments. The Company expects to have sufficient access to liquidity to fund its off-balance sheet commitments.

Liquidity

Liquidity management is the process by which we manage the flow of funds necessary to meet our financial commitments on a timely basis and at a reasonable cost and to take advantage of earnings enhancement opportunities. These financial commitments include withdrawals by depositors, credit commitments to borrowers, expenses of our operations, and capital expenditures. Liquidity is monitored and closely managed by the Bank's Asset and Liability Committee (ALCO), a group of senior officers from the finance, enterprise risk management, treasury, and lending areas, as well as two board members. It is ALCO's responsibility to ensure we have the necessary level of funds available for normal operations as well as maintain a contingency funding policy to ensure that potential liquidity stress events are planned for and quickly identified, and management has plans in place to respond. ALCO has created policies which establish limits and require measurements to monitor liquidity trends, including modeling and management reporting that identifies the amounts and costs of all available funding sources. In addition, we have implemented modeling software that projects cash flows from the balance sheet under a broad range of potential scenarios, including severe changes in the economic environment.

At June 30, 2019, we had liquid assets of $218.2 million, compared to $213.7 million at December 31, 2018. Liquid assets include cash and due from banks, federal funds sold, interest-bearing deposits with banks and unencumbered securities available-for-sale.

The Bank is a member of the FHLB, which provides short- and long-term funding to its members through advances collateralized by real estate-related assets and other select collateral, most typically in the form of debt securities. The actual borrowing capacity is contingent on the amount of collateral available to be pledged to the FHLB. As of June 30, 2019, we had $75.0 million of outstanding borrowings from the FHLB and these advances were secured by a blanket lien on $400.4 million of real estate-related loans. Based on this collateral and the approved policy limits, the Company is eligible to borrow up to an additional $167.0 million with the FHLB. Additionally, the Bank can borrow up to $117.0 million through the unsecured lines of credit it has established with nine other banks, as well as $4.9 million through a secured line with the Federal Reserve Bank.

Further, because the Bank is "well capitalized," it can accept wholesale funding up to 40% of total assets, or approximately $601.2 million, based on current policy limits at June 30, 2019. Management believed that as of June 30, 2019, we had adequate resources to fund all of our commitments

The following liquidity ratios compare certain assets and liabilities to total deposits or total assets.

	June 30, 2019	December 31, 2018
Investment securities available-for-sale to total assets	**14.49%**	14.42%
Loans to total deposits	**94.88**	99.29
Interest-earning assets to total assets	**95.17**	95.31
Interest-bearing deposits to total deposits	**74.16**	72.73

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates. Interest-rate risk is the risk to earnings and equity value arising from changes in market interest rates and arises in the normal course of business to the extent that there is a divergence between the amount of our interest-earning assets and the amount of interest-bearing liabilities that are prepaid/withdrawn, re-price, or mature in specified periods. We seek to achieve consistent growth in net interest income and equity while managing volatility arising from shifts in market interest rates. ALCO oversees market risk management, monitoring risk measures, limits, and policy guidelines for managing the amount of interest-rate risk and its effect on net interest income and capital. Our Board of Directors approves policy limits with respect to interest rate risk.

Interest Rate Risk

Interest rate risk management is an active process that encompasses monitoring loan and deposit flows complemented by investment and funding activities. Effective interest rate risk management begins with understanding the dynamic characteristics of assets and liabilities and determining the appropriate interest rate risk position given business activities, management objectives, market expectations and ALCO policy limits and guidelines.

Interest rate risk can come in a variety of forms, including repricing risk, basis risk, yield curve risk and option risk. Repricing risk is the risk of adverse consequences from a change in interest rates that arises because of differences in the timing of when those interest rate changes impact our assets and liabilities. Basis risk is the risk of adverse consequence resulting from unequal change in the spread between two or more rates for different instruments with the same maturity. Yield curve risk is the risk of adverse consequence resulting from unequal changes in the spread between two or more rates for different maturities for the same or different instruments. Option risk in financial instruments arises from embedded options such as options provided to borrowers to make unscheduled loan prepayments, options provided to debt issuers to exercise call options prior to maturity, and depositor options to make withdrawals and early redemptions.

We regularly review our exposure to changes in interest rates. Among the factors we consider are changes in the mix of interest-earning assets and interest-bearing liabilities, interest rate spreads and repricing periods. ALCO reviews, on at least a quarterly basis, our interest rate risk position.

The interest rate risk position is measured and monitored at the Bank using net interest income simulation models and economic value of equity sensitivity analysis that capture both short-term and long-term interest-rate risk exposure.

Modeling the sensitivity of net interest income and the economic value of equity to changes in market interest rates is highly dependent on numerous assumptions incorporated into the modeling process. The models used for these measurements rely on estimates of the potential impact that changes in interest rates may have on the value and prepayment speeds on all components of our loan portfolio, investment portfolio, as well as embedded options and cash flows of other assets and liabilities. Balance sheet growth assumptions are also included in the simulation modeling process. The analysis provides a framework as to what our overall sensitivity position is as of our most recent reported position and the impact that potential changes in interest rates may have on net interest income and the economic value of our equity.

Net interest income simulation involves forecasting net interest income under a variety of interest rate scenarios including instantaneous shocks.

The estimated impact on our net interest income as of June 30, 2019 and December 31, 2018, assuming immediate parallel moves in interest rates is presented in the table below.

	June 30, 2019		**December 31, 2018**	
Change in rates	**Following 12 months**	**Following 24 months**	**Following 12 months**	**Following 24 months**
+400 basis points	**4.7 %**	**0.1 %**	1.8 %	(1.0)%
+300 basis points	**4.4**	**1.2**	1.8	(0.2)
+200 basis points	**3.5**	**1.6**	1.5	0.4
+100 basis points	**2.4**	**1.6**	1.3	0.8
-100 basis points	**(2.2)**	**(1.8)**	(0.9)	(0.8)

Management strategies may impact future reporting periods, as our actual results may differ from simulated results due to the timing, magnitude, and frequency of interest rate changes, the difference between actual experience and the characteristics assumed, as well as changes in market conditions. Market-based prepayment speeds are factored into the analysis for loan and securities portfolios. Rate sensitivity for transactional deposit accounts is modeled based on both historical experience and external industry studies.

We use economic value of equity sensitivity analysis to understand the impact of interest rate changes on long-term cash flows, income, and capital. Economic value of equity is based on discounting the cash flows for all balance sheet instruments under different interest rate scenarios. Deposit premiums are based on external industry studies and utilizing historical experience.

The table below presents the change in our economic value of equity as of June 30, 2019 and December 31, 2018, assuming immediate parallel shifts in interest rates.

Change in rates	**June 30, 2019**	**December 31, 2018**
+400 basis points	**(33.7)%**	(38.1)%
+300 basis points	**(24.0)**	(28.5)
+200 basis points	**(15.0)**	(18.3)
+100 basis points	**(6.8)**	(8.4)
-100 basis points	**6.8**	7.9

Item 4 – Controls and Procedures

Evaluation of disclosure controls and procedures. The Company’s management, including our President and Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of our “disclosure controls and procedures” (as defined in Rule 13a-15(e) under the Exchange Act), as of the end of the period covered by this report. Based on such evaluation, our President and Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of such period, the Company’s disclosure controls and procedures were effective as of that date to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company’s management, including its President and Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. There have not been any changes in the Company’s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1 – Legal Proceedings

In the normal course of business, we are named or threatened to be named as a defendant in various lawsuits, none of which we expect to have a material effect on the Company. However, given the nature, scope and complexity of the extensive legal and regulatory landscape applicable to our business (including laws and regulations governing consumer protection, fair lending, fair labor, privacy, information security, anti-money laundering and anti-terrorism), we, like all banking organizations, are subject to heightened legal and regulatory compliance and litigation risk. There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which we or any of our subsidiaries is a party or to which our property is the subject.

Item 1A – Risk Factors

There have been no material changes from the risk factors previously disclosed in the “Risk Factors” section included in our Annual Report on Form 10-K for the year ended December 31, 2018.

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

Unregistered Sales of Equity Securities

None.

Use of Proceeds from Registered Securities

On April 24, 2018, the Company sold 1,150,765 shares of common stock in its initial public offering, including 180,000 shares of common stock pursuant to the exercise in full by the underwriters of their option to purchase additional shares. All of the shares were sold pursuant to our Registration Statement on Form S-1, as amended (File No. 333-223866), which was declared effective by the SEC on April 19, 2018. Our common stock is currently traded on Nasdaq under the symbol “LEVL”.

There has been no material change in the planned use of proceeds from our initial public offering as described in our prospectus filed with the SEC on April 20, 2018 pursuant to Rule 424(b)(4) under the Securities Act. On April 25, 2018, the Company contributed $20.0 million of the net proceeds of the initial public offering to the Bank.

Issuer Purchases of Equity Securities

Share Buyback Program. On January 23, 2019, the Company announced that its Board of Directors approved a repurchase program under which the Company is authorized to repurchase, from time to time as the Company deems appropriate, shares of the Company’s common stock with an aggregate purchase price of up to $5 million. The repurchase program began on January 23, 2019, and expires on December 31, 2020. The repurchase program does not obligate the Company to repurchase any dollar amount or number of shares, and the program may be extended, modified, suspended or discontinued at any time.

The following table sets forth information regarding the Company’s repurchase of shares of its outstanding common stock during the three months ended June 30, 2019.

(Dollars in thousands, except per share amounts)	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased under the Plans or Programs
April 1-30, 2019	—	$ —	—	$ 3,896
May 1-31, 2019	11,505	24.45	11,505	3,615
June 1-30, 2019	9,796	24.03	9,796	3,380
Total	21,301	$ 24.26	21,301	

Under applicable state law, Michigan corporations are not permitted to retain treasury stock. As such, the price paid for the repurchased shares is recorded to common stock. As of June 30, 2019, the total shares repurchased in the amount of $1.6 million were redeemed but remain authorized, unissued shares.

Item 3 – Defaults Upon Senior Securities

None.

Item 4 – Mine Safety Disclosures

Not Applicable.

Item 5 – Other Information

None.

Item 6 – Exhibits

Exhibit No.	Description
31.1	Chief Executive Officer’s Certifications required by Rule 13(a)-14(a) – filed herewith.

31.2	Chief Financial Officer's Certifications required by Rule 13(a)-14(a) – filed herewith.
32.1	Chief Executive Officer Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.
32.2	Chief Financial Officer Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.
101	Financial information from the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2019, formatted in XBRL interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Changes in Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to the Consolidated Financial Statements – filed herewith.

SIGNATURES

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

Level One Bancorp, Inc.

Date: August 9, 2019	By:	/s/	Patrick J. Fehring
			Patrick J. Fehring
			President and Chief Executive Officer
			(principal executive officer)
Date: August 9, 2019	By:	/s/	David C. Walker
			David C. Walker
			Executive Vice President and Chief Financial Officer
			(principal financial officer)

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Section 2: EX-31.1 (EXHIBIT 31.1 - CEO CERTIFICATIONS)

Exhibit 31.1

CERTIFICATIONS REQUIRED BY

RULE 13a-14(a) OR RULE 15d-14(a)

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANSE-OXLEY ACT OF 2002

I, Patrick J. Fehring , certify that:

1. I have reviewed this Quarterly Report on Form 10-Q (the “Report”) of Level One Bancorp, Inc. (the “Registrant”);

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;

4. The Registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13 (a)-15(f) and 15(d)-15(f)) for the Registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adverse affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

	Level One Bancorp, Inc.		
Dated as of: August 9, 2019	By:	/s/	Patrick J. Fehring
			Patrick J. Fehring
			President and Chief Executive Officer
			(principal executive officer)

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Section 3: EX-31.2 (EXHIBIT 31.2 - CFO CERTIFICATIONS)

Exhibit 31.2

CERTIFICATIONS REQUIRED BY

RULE 13a-14(a) OR RULE 15d-14(a)

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANSE-OXLEY ACT OF 2002

I, David C. Walker, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q (the "Report") of Level One Bancorp, Inc. (the "Registrant");

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;

4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13 (a)-15(f) and 15(d)-15(f)) for the Registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adverse affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Level One Bancorp, Inc.

Dated as of: August 9, 2019	By:	/s/	David C. Walker
			David C. Walker
			Executive Vice President and Chief Financial Officer
			(principal financial officer)

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Section 4: EX-32.1 (EXHIBIT 32.1 - CEO CERTIFICATIONS)

Exhibit 32.1

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Patrick J. Fehring, President and Chief Executive Officer of Level One Bancorp, Inc. (the "Company") certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Quarterly Report on Form 10-Q of the Company for the quarterly period ended June 30, 2019 (the "Report") fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Level One Bancorp, Inc.

Dated as of: August 9, 2019	By:	/s/	Patrick J. Fehring
			Patrick J. Fehring
			President and Chief Executive Officer
			(principal executive officer)

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Section 5: EX-32.2 (EXHIBIT 32.2 - CFO CERTIFICATIONS)

Exhibit 32.2

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, David C. Walker, Executive Vice President and Chief Financial Officer of Level One Bancorp, Inc. (the "Company") certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Quarterly Report on Form 10-Q of the Company for the quarterly period ended June 30, 2019 (the "Report") fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Level One Bancorp, Inc.

Dated as of: August 9, 2019   By: /s/ David C. Walker

David C. Walker

Executive Vice President and Chief Financial Officer
(principal financial officer)

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