CITY HOLDING CO
Form 10-Q
August 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended June 30, 2015
OR
[ ] TRANSITION REPORT PURSANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Transition Period From ____________To_____________.

Commission File number 0-11733
CITY HOLDING COMPANY
(Exact name of registrant as specified in its charter)

West Virginia	55-0619957
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

25 Gatewater Road	
Charleston, West Virginia	25313
(Address of principal executive offices)	(Zip Code)

(304) 769-1100
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ]	Smaller reporting company [ ]

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.
Common stock, $2.50 Par Value – 15,316,700 shares as of August 4, 2015.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management’s Discussion and Analysis of Financial Condition and Result of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company's actual results differing materially from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to, (1) the Company may incur additional loan loss provision due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company could have adverse legal actions of a material nature; (4) the Company may face competitive loss of customers; (5) the Company may be unable to manage its expense levels; (6) the Company may have difficulty retaining key employees; (7) changes in the interest rate environment may have results on the Company’s operations materially different from those anticipated by the Company’s market risk management functions; (8) changes in general economic conditions and increased competition could adversely affect the Company’s operating results; (9) changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company’s operating results; (10) the Company may experience difficulties growing loan and deposit balances; (11) the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations; (12) deterioration in the financial condition of the U.S. banking system may impact the valuations of investments the Company has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; (13) the effects of the Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the regulations promulgated and to be promulgated thereunder, which may subject the Company and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses; (14) the impact of new minimum capital thresholds established as a part of the implementation of Basel III; and (15) other risk factors relating to the banking industry or the Company as detailed from time to time in the Company’s reports filed with the Securities and Exchange Commission, including those risk factors included in the disclosures under the heading “ITEM 1A Risk Factors” of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2014. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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City Holding Company and Subsidiaries

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Part I - Financial Information

Item 1 - Financial Statements

Consolidated Balance Sheets
City Holding Company and Subsidiaries
(in thousands)

Assets	June 30, 2015 (Unaudited)	December 31, 2014
Cash and due from banks	$142,335	$138,503
Interest-bearing deposits in depository institutions	11,089	9,725
Cash and Cash Equivalents	153,424	148,228
Investment securities available for sale, at fair value	287,609	254,043
Investment securities held-to-maturity, at amortized cost (approximate fair value at June 30, 2015 and December 31, 2014, - $86,561 and $94,191, respectively)	84,082	90,786
Other securities	9,926	9,857
Total Investment Securities	381,617	354,686
Gross loans	2,684,457	2,652,066
Allowance for loan losses	(20,809)	(20,150)
Net Loans	2,663,648	2,631,916
Bank owned life insurance	96,663	95,116
Premises and equipment, net	75,900	77,988
Accrued interest receivable	7,838	6,826
Net deferred tax asset	32,674	36,766
Goodwill and other intangible assets, net	70,779	74,198
Other assets	30,080	35,909
Total Assets	$3,512,623	$3,461,633
Liabilities		
Deposits:		
Noninterest-bearing	$563,715	$545,465
Interest-bearing:		
Demand deposits	646,198	639,932
Savings deposits	695,383	660,727
Time deposits	997,387	1,026,663
Total Deposits	2,902,683	2,872,787
Short-term borrowings	153,171	134,931
Long-term debt	16,495	16,495
Other liabilities	29,034	46,567
Total Liabilities	3,101,383	3,070,780
Shareholders’ Equity		
Preferred stock, par value $25 per share: 500,000 shares authorized; none issued	—	—

Common stock, par value $2.50 per share: 50,000,000 shares authorized; 18,499,282 shares issued at June 30, 2015 and December 31, 2014, less 3,222,332 and 3,345,590 shares in treasury, respectively	46,249	46,249

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Capital surplus	105,891	107,370
Retained earnings	379,379	362,211
Cost of common stock in treasury	(115,387)	(120,818)
Accumulated other comprehensive income (loss):		
Unrealized loss on securities available-for-sale	457	1,190
Underfunded pension liability	(5,349)	(5,349)
Total Accumulated Other Comprehensive Loss	(4,892)	(4,159)
Total Shareholders' Equity	411,240	390,853
Total Liabilities and Shareholders' Equity	$3,512,623	$3,461,633

See notes to consolidated financial statements.

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Consolidated Statements of Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands, except earnings per share data)

	Three months ended June 30,		Six months ended June 30,	
Interest Income	2015	2014	2015	2014
Interest and fees on loans	$28,812	$28,621	$58,200	$58,355
Interest and dividends on investment securities:				
Taxable	2,641	2,930	5,353	5,933
Tax-exempt	267	277	531	558
Total Interest Income	31,720	31,828	64,084	64,846
Interest Expense				
Interest on deposits	2,699	2,737	5,440	5,490
Interest on short-term borrowings	85	85	167	160
Interest on long-term debt	153	151	303	301
Total Interest Expense	2,937	2,973	5,910	5,951
Net Interest Income	28,783	28,855	58,174	58,895
Provision for loan losses	2,836	435	3,724	1,798
Net Interest Income After Provision for Loan Losses	25,947	28,420	54,450	57,097
Non-interest Income				
Gains on sale of investment securities	2,116	818	2,130	901
Service charges	6,589	6,739	12,516	12,899
Bankcard revenue	4,002	3,838	8,076	7,523
Insurance commissions	—	1,319	—	3,344
Trust and investment management fee income	1,201	1,111	2,401	2,148
Bank owned life insurance	783	765	1,547	1,521
Gain on sale of insurance division	—	—	11,084	—
Other income	714	549	1,672	1,108
Total Non-interest Income	15,405	15,139	39,426	29,444
Non-interest Expense				
Salaries and employee benefits	12,193	12,977	24,372	26,116
Occupancy and equipment	2,529	2,395	5,119	5,010
Depreciation	1,516	1,533	3,027	3,011
FDIC insurance expense	445	357	895	767
Advertising	701	925	1,405	1,749
Bankcard expenses	797	833	1,615	1,639
Postage, delivery, and statement mailings	507	530	1,068	1,105
Office supplies	347	420	693	830
Legal and professional fees	542	612	1,109	1,021
Telecommunications	463	506	938	844
Repossessed asset losses, net of expenses	335	142	555	521
Merger related expenses	108	—	108	—
Other expenses	2,761	3,075	5,505	5,068
Total Non-interest Expense	23,244	24,305	46,409	47,681
Income Before Income Taxes	18,108	19,254	47,467	38,860

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Income tax expense	6,125	6,497	17,492	12,300
Net Income Available to Common Shareholders	$11,983	$12,757	$29,975	$26,560
Total comprehensive income	$10,344	$14,462	$29,242	$29,041
Average common shares outstanding	15,104	15,556	15,079	15,583
Effect of dilutive securities:				
Employee stock awards and warrant outstanding	23	150	22	155
Shares for diluted earnings per share	15,127	15,706	15,101	15,738
				\
Basic earnings per common share	$0.78	$0.81	$1.97	$1.69
Diluted earnings per common share	$0.78	$0.80	$1.96	$1.67
Dividends declared per common share	$0.42	$0.40	$0.84	$0.80

See notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	$11,983	$12,757	$29,975	$26,560
Unrealized gains (losses) on available-for-sale securities arising during the period	(482)	3,521	968	4,834
Reclassification adjustment for gains	(2,116)	(818)	(2,130)	(901)
Other comprehensive income (loss) before income taxes	(2,598)	2,703	(1,162)	3,933
Tax effect	959	(998)	429	(1,452)
Other comprehensive income (loss), net of tax	(1,639)	1,705	(733)	2,481
Comprehensive income, net of tax	$10,344	$14,462	$29,242	$29,041

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
City Holding Company and Subsidiaries
Six Months Ended June 30, 2015 and 2014
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2013	$46,249	$107,596	$333,970	$(95,202)	(4,990)	$387,623
Net income	—	—	26,560	—	—	26,560
Other comprehensive loss	—	—	—	—	2,481	2,481
Cash dividends declared ($0.80 per share)	—	—	(12,512)	—	—	(12,512)
Stock-based compensation expense, net	—	(494)	—	1,383	—	889
Exercise of 19,000 stock options	—	(272)	—	825	—	553
Purchase of 194,651 treasury shares	—	—	—	(8,363)	—	(8,363)
Balance at June 30, 2014	$46,249	$106,830	$348,018	$(101,357)	$ (2,509)	$397,231

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2014	46,249	$107,370	$362,211	(120,818)	$ (4,159)	$390,853
Net income	—	—	29,975	—	—	29,975
Other comprehensive income	—	—	—	—	(733)	(733)
Cash dividends declared ($0.84 per share)	—	—	(12,807)	—	—	(12,807)
Stock-based compensation expense, net	—	(408)	—	1,468	—	1,060
Exercise of 29,250 stock options	—	(306)	—	1,302	—	996
Exercise of 61,796 warrants	—	(765)	—	2,661	—	1,896
Balance at June 30, 2015	46,249	$105,891	$379,379	(115,387)	$ (4,892)	$411,240

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Six months ended June 30,	
	2015	2014
Net income	$29,975	$26,560
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion and amortization	(2,976)	(2,599)
Provision for loan losses	3,724	1,798
Depreciation of premises and equipment	3,027	3,011
Deferred income tax expense	4,549	2,615
Net periodic employee benefit cost	413	286
Realized investment securities gains	(2,130)	(901)
Stock-compensation expense	1,060	889
Increase in value of bank-owned life insurance	(1,547)	(1,520)
Loans originated for sale	(9,191)	(2,454)
Proceeds from the sale of loans originated for sale	9,327	3,129
Gain on sale of loans	(167)	(84)
Gain on sale of insurance division	(11,084)	—
Change in accrued interest receivable	(1,012)	(861)
Change in other assets	5,703	(5,986)
Change in other liabilities	(19,307)	(9,919)
Net Cash Provided by Operating Activities	10,364	13,964
Proceeds from sales of securities available-for-sale	290	1,660
Proceeds from maturities and calls of securities available-for-sale	33,323	26,237
Proceeds from maturities and calls of securities held-to-maturity	7,648	1,254
Purchases of securities available-for-sale	(67,911)	(13,530)
Purchases of securities held-to-maturity	—	(10,226)
Net (increase) decrease in loans	(31,705)	29,225
Purchases of premises and equipment	(978)	(664)
Proceeds from sale of insurance division	15,250	—
Net Cash (Used In) Provided by Investing Activities	(44,083)	33,956
Net increase in noninterest-bearing deposits	18,250	7,163
Net increase (decrease) in interest-bearing deposits	11,985	(5,638)
Net increase (decrease) in short-term borrowings	18,240	(4,656)
Purchases of treasury stock	—	(8,363)
Proceeds from exercise of stock options, net of tax benefit	996	553
Proceeds from exercise of warrants	1,896	—
Dividends paid	(12,452)	(12,115)
Net Cash Provided by (Used in) Financing Activities	38,915	(23,056)
Increase in Cash and Cash Equivalents	5,196	24,864
Cash and cash equivalents at beginning of period	148,228	85,876
Cash and Cash Equivalents at End of Period	$153,424	$110,740

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)
June 30, 2015

Note A –Background and Basis of Presentation

City Holding Company is a financial holding company headquartered in Charleston, West Virginia and conducts its principal activities through its wholly-owned subsidiary, City National Bank of West Virginia ("City National"). City National operates a network of 82 branch offices primarily along the I-64 corridor from Grayson, Kentucky through Lexington, Virginia; and along the I-81 corridor through the Shenandoah Valley from Staunton, Virginia to Martinsburg, West Virginia. City National's branch network includes 57 offices in West Virginia, 14 offices in Virginia, 8 offices in Kentucky and 3 offices in Ohio. City National provides credit, deposit, and investment advisory services to a broad geographical area that includes many rural and small community markets in addition to larger cities such as Charleston (WV), Huntington (WV), Winchester (VA), Staunton (VA), Virginia Beach (VA), Ashland (KY) and Martinsburg (WV). In addition to its branch network, the bank's delivery channels include ATMs, mobile banking, on-line banking, debit cards, cash management tools and telephone banking systems.

On May 29, 2015, City National Bank of West Virginia (“City National”), a wholly-owned subsidiary of City Holding Company, entered into a Branch Purchase and Assumption Agreement (the “Purchase Agreement”) with American Founders Bank, Inc. (“AFB”), a wholly-owned subsidiary of Financial Holdings, Inc., pursuant to which City National will purchase AFB’s three Lexington, Kentucky branch locations (the “Acquisition”). Under the terms of the Purchase Agreement, City National will acquire $125 million in performing loans and will assume deposit liabilities of approximately $164 million. City National will pay AFB a deposit premium of 5.5% on non-time deposits, and 1.0% on premium loan balances acquired.

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of the City Holding Company and its wholly-owned subsidiaries (collectively, the "Company”). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for six months ended June 30, 2015 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2015. The Company’s accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management’s estimates.

The consolidated balance sheet as of December 31, 2014 has been derived from audited financial statements included in the Company’s 2014 Annual Report to Shareholders. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2014 Annual Report of the Company.

Certain amounts in the financial statements have been reclassified. Such reclassifications had no impact on shareholders’ equity or net income for any period.

Note B - Recent Accounting Pronouncements

In January 2014, the FASB issued ASU No. 2014-01, "Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects." This ASU permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment. The ASU also requires reporting entities to disclose information that enable users of its financial statements to understand the nature of its investments in qualified affordable housing projects, and the effect of the measurement of its investments in qualified affordable housing projects and the related tax credits on its financial position and results of operations. This ASU became effective for the Company on January 1, 2015. The adoption of ASU 2014-01 did not have a material impact on the Company's financial statements.

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In January 2014, the FASB issued ASU No. 2014-04, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." This ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through similar legal agreement. Additionally, the amendments require interim and annual disclosures of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. This ASU became effective for the Company on January 1, 2015. The adoption of ASU 2014-04 did not have a material impact on the Company's financial statements.

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." This ASU changes the requirements for reporting discontinued operations. A disposal of a component or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity’s operations when certain criteria are met. Additional disclosures are also required for disposals that meet the criteria to be reported in discontinued operations. The Company elected to early adopt this ASU for the year ended December
31, 2014 relating to the sale of CityInsurance. The adoption of ASU 2014-08 did not have a material impact on the Company's financial statements.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-09, "Revenue from Contracts with Customers (Topic 606)." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The core principle will be achieved using a five step process. This ASU will become effective for the Company on January 1, 2018. The adoption of ASU 2014-09 is not expected to have a material impact on the Company's financial statements.

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The amendments in this update require two accounting changes. First, the amendments in this update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counter-party, which will result in secured borrowing accounting for the repurchase agreement. This update also requires certain disclosures for these types of transactions. This ASU became effective for the Company on January 1, 2015. The adoption of ASU 2014-11 did not have a material impact on the Company's financial statements.

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-12, "Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." The amendments in this update require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Performance targets should not be reflected in estimating the grant date fair value of the award, but compensation cost should be recognized in the period for which the requisite service has already been rendered. This ASU will become effective for the Company on January 1, 2016, with early adoption permitted. The adoption of ASU 2014-12 is not expected to have a material impact on the

Company's financial statements.

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-14, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure." The amendments in this update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if certain conditions are met. This ASU became effective for the Company on January 1, 2015. The adoption of ASU 2014-14 did not have a material impact on the Company's financial statements.

In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2015-02, "Consolidation (Topic 810) - Amendments to the Consolidation Analysis". ASU 2015-02 eliminates the deferral of FAS 167 and makes changes to both the variable interest model and the voting model. This ASU will become effective for the

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Company on January 1, 2016. The adoption of ASU 2015-02 is not expected to have a material impact on the Company's financial statements.

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This ASU will become effective for the Company on January 1, 2016. The adoption of ASU 2015-03 is not expected to have a material impact on the Company's financial statements.

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement." ASU 2015-05 provides guidance to clarify the customer’s accounting for fees paid in a cloud computing arrangement. This ASU will become effective for the Company on January 1, 2016. The adoption of ASU 2015-05 is not expected to have a material impact on the Company's financial statements.

In May 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2015-07, "Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)." ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. the ASU also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. This ASU will become effective for the Company on January 1, 2016. The adoption of ASU 2015-07 is not expected to have a material impact on the Company's financial statements.

Note C –Investments

The amortized cost and estimated fair values of the Company's securities are shown in the following table (in thousands):

	June 30, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:								
U.S. Treasuries and U.S. government agencies	$5	$—	$—	$5	$1,816	$11	$—	$1,827
Obligations of states and political subdivisions	38,556	470	131	38,895	41,382	722	8	42,096
Mortgage-backed securities:								
U.S. government agencies	227,636	2,459	2,393	227,702	185,831	3,470	1,973	187,328

Private label	1,442	5	4	1,443	1,700	8	4	1,704
Trust preferred securities	7,714	498	1,087	7,125	9,763	425	1,152	9,036
Corporate securities	7,753	229	515	7,467	7,806	204	693	7,317
Total Debt Securities	283,106	3,661	4,130	282,637	248,298	4,840	3,830	249,308
Marketable equity securities	2,131	1,326	—	3,457	2,131	1,082	—	3,213
Investment funds	1,525	—	10	1,515	1,525	—	3	1,522
Total Securities Available-for-Sale	$286,762	$4,987	$4,140	$287,609	$251,954	$5,922	$3,833	$254,043

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	June 30, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities held-to-maturity								
Mortgage-backed securities								
US government agencies	$80,081	$ 1,770	$ —	$81,851	$86,742	$ 2,733	$ —	$89,475
Trust preferred securities	4,001	709	—	4,710	4,044	672	—	4,716
Total Securities Held-to-Maturity	$84,082	$ 2,479	$ —	$86,561	$90,786	$ 3,405	$ —	$94,191
Other investment securities:								
Non-marketable equity securities	$9,926	$ —	$ —	$9,926	$9,857	$ —	$ —	$9,857
Total Other Investment Securities	$9,926	$ —	$ —	$9,926	$9,857	$ —	$ —	$9,857

Securities with limited marketability, such as stock in the Federal Reserve Bank or the Federal Home Loan Bank, are carried at cost and are reported as non-marketable equity securities in the table above.

Certain investment securities owned by the Company were in an unrealized loss position (i.e., amortized cost basis exceeded the estimated fair value of the securities). The following table shows the gross unrealized losses and fair value of the Company's investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	June 30, 2015					
	Less Than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	$9,115	$122	$121	$9	$9,236	$131
Mortgage-backed securities:						
U.S. Government agencies	99,641	772	37,734	1,621	137,375	2,393
Private label	1,124	4	—	—	1,124	4
Trust preferred securities	1,015	17	4,848	1,070	5,863	1,087
Corporate securities	—	—	4,238	515	4,238	515
Investment funds	1,490	10	—	—	1,490	10
Total	$112,385	$925	$46,941	$3,215	$159,326	$4,140

	December 31, 2014					
	Less Than Twelve Months		Twelve Months or Greater		Total	

	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	$1,559	$3	$125	$5	$1,684	$8
Mortgage-backed securities:						
U.S. Government agencies	—	—	60,122	1,973	60,122	1,973
Private label	1,277	4	—	—	1,277	4
Trust preferred securities	—	—	4,760	1,152	4,760	1,152
Corporate securities	—	—	4,049	693	4,049	693
Investment funds	$—	$—	$1,496	$3	1,496	3
Total	$2,836	$7	$70,552	$3,826	$73,388	$3,833

Marketable equity securities consist of investments made by the Company in equity positions of various regional community bank holding companies, with ownership positions ranging from nominal to a 4% ownership position in First National Corporation (FXNC).

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During the six months ended June 30, 2015 and 2014, the Company had no credit-related net investment impairment losses. Also, for the year ended December 31, 2014, the Company had no credit-related net investment impairment losses.
Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary would be reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost; (ii) the financial condition, capital strength, and near-term (12 months) prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; (iii) the historical volatility in the market value of the investment and/or the liquidity or illiquidity of the investment; (iv) adverse conditions specifically related to the security, an industry, or a geographic area; or (v) the intent to sell the investment security and if it’s more likely than not that the Company will not have to sell the security before recovery of its cost basis. In addition, management also employs a continuous monitoring process in regards to its marketable equity securities, specifically its portfolio of regional community bank holding company stocks. Although the regional community bank holding company stocks that are owned by the Company are publicly traded, the trading activity for these stocks is minimal, with trading volumes of less than 0.7% of each respective company being traded on a daily basis. As part of management’s review process for these securities, management reviews the financial condition of each respective regional community bank for any indications of financial weakness.

Management has the ability and intent to hold the securities classified as "held-to-maturity" until they mature, at which time the Company will receive full value for the securities. Furthermore, as of June 30, 2015, management does not intend to sell an impaired security and it is not more than likely that it will be required to sell the security before the recovery of its amortized cost basis. The unrealized losses on debt securities are primarily the result of interest rate changes, credit spread widening on agency-issued mortgage related securities, general financial market uncertainty and market volatility. These conditions will not prohibit the Company from receiving its contractual principal and interest payments on its debt securities. The fair value is expected to recover as the securities approach their maturity date or repricing date.   As of June 30, 2015, management believes the unrealized losses detailed in the table above are temporary and no impairment loss has been recognized in the Company’s consolidated income statement. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period where the other-than-temporary impairment is identified, while any noncredit loss will be recognized in other comprehensive income.

At June 30, 2015, the book value of the Company’s five pooled trust preferred securities totaled $1.0 million with an estimated fair value of $1.9 million. All of these securities are mezzanine tranches. Pooled trust preferred securities represent beneficial interests in securitized financial assets that the Company analyzes within the scope of ASC 320, “Investments-Debt and Equity Securities” and are evaluated quarterly for other-than-temporary-impairment (“OTTI”). Management performs an analysis of OTTI utilizing its internal methodology as described below to estimate expected cash flows to be received in the future. The Company reviews each of its pooled trust preferred securities to determine if an OTTI charge would be recognized in current earnings in accordance with ASC 320, “Investments-Debt and Equity Securities.” There is a risk that collateral deterioration could cause the Company to recognize additional OTTI charges in earnings in the future.

When evaluating pooled trust preferred securities for OTTI, the Company determines a credit related portion and a noncredit related portion. The credit related portion is recognized in earnings and represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. The noncredit related portion is recognized in other comprehensive income, and represents the difference between the book value and the fair value of the security less the amount of the credit related impairment. The determination of whether it is probable that an adverse change in estimated cash flows has occurred is evaluated by comparing estimated cash flows to those previously projected as further described below. The Company considers this process to be its primary evidence when determining whether credit related OTTI exists. The results of these analyses are significantly affected by other variables such as the estimate of future cash flows, credit worthiness of the underlying issuers and determination of the likelihood of defaults of the underlying collateral.

The Company utilizes a third party model to compute the present value of expected cash flows which considers the structure and term of each of the five respective pooled trust preferred securities and the financial condition of the underlying issuers. Specifically, the third party model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. For issuing banks that have defaulted, management generally assumes no recovery. For issuing banks that have deferred its interest payments, management excludes the collateral balance associated with these banks and assumes no recoveries of such collateral balance in the future unless otherwise noted. The exclusion of such issuing banks in a current deferral position is based on such bank experiencing a certain level of financial difficulty that raises doubt about its ability to satisfy its contractual debt obligation, and

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accordingly, the Company excludes the associated collateral balance from its estimate of expected cash flows. Other assumptions used in the estimate of expected cash flows include expected future default rates and prepayments. Specifically, the model assumes annual prepayments of 1.0% with 100% at maturity and assumes 150 basis points of additional annual defaults from banks that are currently not in default or deferral. In addition, the model assumes no recoveries except for one trust preferred security which assumes that one of the banks currently deferring will cure such positions. Management compares the present value of expected cash flows to those previously projected to determine if an adverse change in cash flows has occurred. If an adverse change in cash flows has occurred, management determines the credit loss to be recognized in the current period and the portion related to noncredit factors to be recognized in other comprehensive income.

The following table presents a progression of the credit loss component of OTTI on debt and equity securities recognized in earnings during the six months ended June 30, 2015 and for the year ended December 31, 2014 (in thousands). The credit loss component represents the difference between the present value of expected future cash flows and the amortized cost basis of the security. The credit component of OTTI recognized in earnings during a period is presented in two parts based upon whether the credit impairment in the current period is the first time the security was credit impaired (initial credit impairment) or if there is additional credit impairment on a security that was credit impaired in previous periods.

	Debt Securities	Equity Securities	Total
Balance at January 1, 2014	$16,286	$4,698	$20,984
Additions:			
Initial credit impairment	—	—	—
Additional credit impairment	—	—	—
Deductions:			
Called or Sold	(4,422)	(3,114)	(7,536)
Balance at December 31, 2014	11,864	1,584	13,448
Additions:			
Initial credit impairment	—	—	—
Additional credit impairment	—	—	—
Deductions:			
Called or Sold	(160)	—	(160)
Balance at June 30, 2015	$11,704	$1,584	$13,288

The following table presents additional information about the Company’s trust preferred securities with a credit rating of below investment grade as of June 30, 2015 (dollars in thousands):

Deal Name	Type	Class	Original Cost	Amortized Cost	Fair Value	Difference (1)	Lowest Credit Rating	# of issuers currently performing	Actual deferrals/defaults (as a % of original dollar)	Expected deferrals/defaults (as a % of remaining performing collateral)	Excess Subordination as a Percentage of Current Performing Collateral (3)
	Pooled trust preferred securities:										
	Other-than-temporarily impaired										
	Available for Sale:										