SHORE BANCSHARES INC
Form 10-Q
August 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2016

OR

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

For the transition period from ________ to ________

Commission file number 0-22345

SHORE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Maryland	52-1974638

(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
28969 Information Lane, Easton, Maryland	21601
(Address of Principal Executive Offices)	(Zip Code)

(410) 763-7800

Registrant’s Telephone Number, Including Area Code

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 12,662,746 shares of common stock outstanding as of July 31, 2016.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

SHORE BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Cash and due from banks	$ 15,753	$ 15,080
Interest-bearing deposits with other banks	45,455	54,223
Federal funds sold	9	4,508
Cash and cash equivalents	61,217	73,811
Investment securities:		
Available for sale, at fair value	195,681	212,165
Held to maturity, at amortized cost – fair value of $4,121 (2016) and $4,243 (2015)	**3,995**	4,191
Loans	821,079	795,114
Less: allowance for credit losses	(8,358)	(8,316)
Loans, net	812,721	786,798
Premises and equipment, net	16,708	16,864
Goodwill	11,931	11,931
Other intangible assets, net	1,145	1,211
Other real estate owned, net	1,897	4,252
Other assets	20,395	23,920
TOTAL ASSETS	$ 1,125,690	$ 1,135,143
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 231,614	$ 229,686
Interest-bearing	729,480	745,778
Total deposits	961,094	975,464
Short-term borrowings	6,868	6,672
Other liabilities	5,407	6,040
TOTAL LIABILITIES	973,369	988,176
STOCKHOLDERS' EQUITY		
	127	126

Common stock, par value $.01 per share; shares authorized – 35,000,000; shares issued and outstanding – 12,654,849 (2016) and 12,631,160 (2015)		
Additional paid in capital	63,995	63,815
Retained earnings	87,071	83,097
Accumulated other comprehensive income (loss)	1,128	(71)
TOTAL STOCKHOLDERS' EQUITY	152,321	146,967
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,125,690	$ 1,135,143

See accompanying notes to Consolidated Financial Statements.

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SHORE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(Dollars in thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
INTEREST INCOME				
Interest and fees on loans	$ 9,117	$ 8,581	$ 18,078	$ 17,072
Interest and dividends on investment securities:				
Taxable	824	932	1,694	1,856
Tax-exempt	2	3	4	6
Interest on federal funds sold	2	-	5	1
Interest on deposits with other banks	58	26	130	52
Total interest income	10,003	9,542	19,911	18,987
INTEREST EXPENSE				
Interest on deposits	617	856	1,278	1,757
Interest on short-term borrowings	3	3	7	8
Total interest expense	620	859	1,285	1,765
NET INTEREST INCOME	9,383	8,683	18,626	17,222
Provision for credit losses	375	540	825	1,190
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	9,008	8,143	17,801	16,032
NONINTEREST INCOME				
Service charges on deposit accounts	870	658	1,683	1,292
Trust and investment fee income	364	450	715	919
Insurance agency commissions	1,941	1,932	4,700	4,407
Other noninterest income	866	748	1,484	1,255
Total noninterest income	4,041	3,788	8,582	7,873
NONINTEREST EXPENSE				
Salaries and wages	4,422	4,393	8,899	8,706
Employee benefits	964	924	2,078	2,080
Occupancy expense	583	611	1,196	1,237
Furniture and equipment expense	248	233	483	488
Data processing	854	868	1,663	1,651
Directors’ fees	131	116	235	239

Amortization of other intangible assets	33	33	66	66
FDIC insurance premium expense	268	306	550	690
Write-downs of other real estate owned	66	54	73	81
Legal and professional fees	609	373	994	1,299
Other noninterest expenses	1,187	1,389	2,467	2,467
Total noninterest expense	9,365	9,300	18,704	19,004
INCOME BEFORE INCOME TAXES	3,684	2,631	7,679	4,901
Income tax expense	1,412	1,004	2,947	1,865
NET INCOME	$ 2,272	$ 1,627	$ 4,732	$ 3,036
Basic net income per common share	$ 0.18	$ 0.13	$ 0.37	$ 0.24
Diluted net income per common share	0.18	0.13	0.37	0.24
Dividends paid per common share	0.03	-	0.06	-

See accompanying notes to Consolidated Financial Statements.

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SHORE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(Dollars in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$ 2,272	$ 1,627	$ 4,732	$ 3,036
Other comprehensive income				
Securities available for sale:				
Unrealized holding gains (losses) on available-for-sale securities	422	(1,723)	2,011	(495)
Tax effect	(170)	695	(812)	199
Net of tax amount	252	(1,028)	1,199	(296)
Total other comprehensive income (loss)	252	(1,028)	1,199	(296)
Comprehensive income	$ 2,524	$ 599	$ 5,931	$ 2,740

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

For the Six Months Ended June 30, 2016 and 2015

(Dollars in thousands, except per share amounts)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, January 1, 2016	$ 126	$ 63,815	$ 83,097	$ (71)	$ 146,967
Net income	-	-	4,732	-	4,732
Unrealized gains on available-for-sale securities, net of taxes	-	-	-	1,199	1,199
Common shares issued for employee stock- based awards	-	3	-	-	3
Stock-based compensation	1	177	-	-	178
Cash dividends declared	-	-	(758)	-	(758)
Balances, June 30, 2016	$ 127	$ 63,995	$ 87,071	$ 1,128	$ 152,321
Balances, January 1, 2015	$ 126	$ 63,532	$ 76,495	$ 316	$ 140,469
Net income	-	-	3,036	-	3,036
Unrealized (losses) on available-for-sale securities, net of taxes	-	-	-	(296)	(296)
Stock-based compensation	-	193	-	-	193
Balances, June 30, 2015	$ 126	$ 63,725	$ 79,531	$ 20	$ 143,402

See accompanying notes to Consolidated Financial Statements.

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SHORE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in thousands)

	For the Six Months Ended June 30, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,732	$ 3,036
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	825	1,190
Depreciation and amortization	1,230	1,228
Discount accretion on debt securities	(16)	(47)
Stock-based compensation expense	178	193
Excess tax benefits from stock-based arrangements	(14)	(2)
Deferred income tax expense	2,438	1,582
Losses on disposals of premises and equipment	2	1
(Gains) Losses on sales of other real estate owned	(2)	47
Write-downs of other real estate owned	73	81
Net changes in:		
Accrued interest receivable	(123)	143
Other assets	272	(783)
Accrued interest payable	(20)	(33)
Other liabilities	(614)	(676)
Net cash provided by operating activities	8,961	5,960
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal payments of investment securities available for sale	26,092	27,663
Purchases of investment securities available for sale	(8,143)	(20,773)
Proceeds from maturities and principal payments of investment securities held to maturity	192	112
Net change in loans	(26,750)	(31,750)
Purchases of premises and equipment	(317)	(969)
Proceeds from sales of other real estate owned	2,284	1,562
Net cash used in investing activities	(6,642)	(24,155)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net changes in:		
Noninterest-bearing deposits	1,928	9,864
Interest-bearing deposits	(16,297)	(29,959)
Short-term borrowings	197	1,821
Proceeds from the issuance of common stock	3	2

Excess tax benefits from stock-based arrangements	14	-
Common stock dividends paid	(758)	-
Net cash used in financing activities	(14,913)	(18,272)
Net decrease in cash and cash equivalents	(12,594)	(36,467)
Cash and cash equivalents at beginning of period	73,811	96,223
Cash and cash equivalents at end of period	$ 61,217	$ 59,756
Supplemental cash flows information:		
Interest paid	$ 1,303	$ 1,798
Income taxes paid	$ 523	$ 279
Transfers from loans to other real estate owned	$ -	$ 497
Change in unrealized (gain)/loss on securities available for sale	$ (1,893)	$ 105

See accompanying notes to Consolidated Financial Statements.

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Shore Bancshares, Inc.

Notes to Consolidated Financial Statements

For the Three and Six Months Ended June 30, 2016 and 2015

(Unaudited)

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Shore Bancshares, Inc. and its subsidiaries with all significant intercompany transactions eliminated. The consolidated financial statements conform to accounting principles generally accepted in the United States of America (“GAAP”) and to prevailing practices within the banking industry. The accompanying interim financial statements are unaudited; however, in the opinion of management all adjustments necessary to present fairly the consolidated financial position at June 30, 2016, the consolidated results of operations and comprehensive income for the three and six months ended June 30, 2016 and 2015, and changes in stockholders’ equity and cash flows for the six months ended June 30, 2016 and 2015, have been included. All such adjustments are of a normal recurring nature. The amounts as of December 31, 2015 were derived from the 2015 audited financial statements. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for any other interim period or for the full year. This Quarterly Report on Form 10-Q should be read in conjunction with the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2015. For purposes of comparability, certain reclassifications have been made to amounts previously reported to conform with the current period presentation.

When used in these notes, the term “the Company” refers to Shore Bancshares, Inc. and, unless the context requires otherwise, its consolidated subsidiaries.

Effective July 1, 2016, the Company’s two bank subsidiaries, The Talbot Bank of Easton Maryland and CNB were consolidated into one bank known as Shore United Bank. In these notes to the consolidated financial statements and the management discussion and analysis section, the term “the Bank” refers to Shore United Bank, unless the context requires stipulating results of the individual banks before the consolidation occurred.

Recent Accounting Standards

ASU 2014-09, *"Revenue from Contracts with Customers (Topic 606)"* amendment requires entities to recognize revenue to depict the transfer of promised goods or services to customers in amounts that reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for periods beginning after January 1, 2017. ASU 2015-14, "*Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date*" – ASU 2015-14 amendments defer the effective date of Update 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations" – ASU 2016-08 amendments are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" – ASU 2016-10 amendments clarify that contractual provisions that, explicitly or implicitly, require an entity to transfer control of additional goods or services to a customer should be distinguished from contractual provisions that, explicitly or implicitly, define the attributes of a single promised license. Attributes of a promised license define the scope of a customer's right to use or right to access an entity's intellectual property and, therefore, do not define whether the entity satisfies its performance obligation at a point in time or over time and do not create an obligation for the entity to transfer any additional rights to use or access its intellectual property. The Company is evaluating the impact that ASU 2014-09 and all amendments thereof will have on our consolidated financial statements.

ASU 2014-12, *"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 the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, *Compensation - Stock Compensation*, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. However, compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. The amendments in this ASU are effective for interim or annual reporting periods beginning after December 15, 2015; early adoption is permitted. Entities may apply the amendments in this ASU either: (1) prospectively to all awards granted or modified after the effective date; or (2) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. As of June 30, 2016, the Company has share-based payment awards that included performance targets that could be achieved after the requisite service period. The adoption of ASU No. 2014-12 did not have a material impact on the Company's Consolidated Financial Statements.

ASU No. 2015-05, *"Customer's Accounting for Fees Paid in a Cloud Computing Arrangement."* This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for a customer's accounting for service contracts. ASU No. 2015-05 is effective for interim and annual reporting periods beginning after December 15, 2015. The adoption of ASU No. 2015-05 did not have a material impact on the Company's Consolidated Financial Statements.

ASU No. 2016-01, *"Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* This ASU, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires 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 and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU No. 2016-02, *"Leases (Topic 842)."* This ASU stipulates that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements*, and, therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. When measuring assets and liabilities arising from a lease, a lessee (and a lessor) should include payments to be made in optional periods only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. Similarly, optional payments to purchase the underlying asset should be included in the measurement of lease assets and lease liabilities only if the lessee is reasonably certain to exercise that purchase option. In addition, also consistent with the previous leases guidance, a lessee (and a lessor) should exclude most variable lease payments in measuring lease assets and lease liabilities, other than those that depend on an index or a rate or are in substance fixed payments. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease

assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in this Update is permitted for all entities. The Company is evaluating the impact that ASU 2016-02 will have on our consolidated financial statements.

ASU No. 2016-09, *"Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."* This ASU, simplifies the treatment and accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company is evaluating the impact that ASU 2016-09 will have on our consolidated financial statements.

ASU No. 2016-13, *"Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments."* The amendments in this ASU, will replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit losses, which will be more decision useful to users of the financial statements. It is not expected that an entity will need to create an economic forecast over the entire contractual life of long-dated financial assets. Therefore, the amendments will allow an entity to revert to historical loss information that is reflective of the contractual term (considering the effect of prepayments) for periods that are beyond the time frame for which the entity is able to develop reasonable and supportable forecasts. The amendments retain many of the disclosure amendments in Accounting Standards Update No. 2010-20, Receivables (Topic 310): *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,* updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. Credit losses on available-for-sale debt securities should be measured in a manner similar to current GAAP. However, the amendments require that credit losses be presented as an allowance rather than a write-down. For public entities that are U.S. Securities and Exchange Commission (SEC) filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company believes this ASU will have a significant impact on our consolidated financial statements and the method in which we calculate our credit losses, primarily on loans and available-for sale securities. At this time, the Company will continue to evaluate the impact and implementation of this standard to meet the effective date for consolidated financial statements beginning in 2019.

Note 2 – Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents (stock-based awards). The following table provides information relating to the calculation of earnings per common share:

(In thousands, except per share data)	For the Three Months Ended June 30, 2016	2015	For the Six Months Ended June 30, 2016	2015
Net income	$ 2,272	$ 1,627	$ 4,732	$ 3,036
Weighted average shares outstanding - Basic	12,648	12,629	12,642	12,627
Dilutive effect of common stock equivalents	17	9	15	9
Weighted average shares outstanding - Diluted	12,665	12,638	12,657	12,636
Earnings per common share - Basic	$ 0.18	$ 0.13	$ 0.37	$ 0.24
Earnings per common share - Diluted	$ 0.18	$ 0.13	$ 0.37	$ 0.24

There were no weighted average common stock equivalents excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2016 and 2015.

Note 3 – Investment Securities

The following table provides information on the amortized cost and estimated fair values of investment securities.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
June 30, 2016				
U.S. Treasury	$ 5,011	$ 4	$ -	$ 5,015
U.S. Government agencies	40,834	151	121	40,864
Mortgage-backed	147,299	2,001	158	149,142
Equity	644	16	-	660
Total	$ 193,788	$ 2,172	$ 279	$ 195,681
December 31, 2015				
U.S. Treasury	$ 5,078	$ 1	$ -	$ 5,079
U.S. Government agencies	49,630	89	190	49,529
Mortgage-backed	156,939	639	662	156,916
Equity	637	4	-	641
Total	$ 212,284	$ 733	$ 852	$ 212,165
Held-to-maturity securities:				
June 30, 2016				
U.S. Government agencies	$ 2,380	$ 3	$ -	$ 2,383
States and political subdivisions	1,615	123	-	1,738
Total	$ 3,995	$ 126	$ -	$ 4,121
December 31, 2015				
U.S. Government agencies	$ 2,575	$ -	$ 60	$ 2,515
States and political subdivisions	1,616	112	-	1,728
Total	$ 4,191	$ 112	$ 60	$ 4,243

The following tables provide information about gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at June 30, 2016 and December 31, 2015.

(Dollars in thousands)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	More than 12 Months Fair Value	More than 12 Months Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2016						
Available-for-sale securities:						
U.S. Government agencies	$2,997	$ 3	$-	$ 118	$2,997	$ 121
Mortgage-backed	10,347	30	11,311	128	21,658	158
Total	$13,344	$ 33	$11,311	$ 246	$24,655	$ 279

(Dollars in thousands)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	More than 12 Months Fair Value	More than 12 Months Unrealized Losses	Total Fair Value	Total Unrealized Losses
December 31, 2015						
Available-for-sale securities:						
U.S. Government agencies	$18,981	$ 57	$-	$ 133	$18,981	$ 190
Mortgage-backed	43,881	328	21,263	334	65,144	662
Total	$62,862	$ 385	$21,263	$ 467	$84,125	$ 852
Held-to-maturity securities:						
U.S. Government agencies	$-	$ -	$2,515	$ 60	$2,515	$ 60

All of the securities with unrealized losses in the portfolio have modest duration risk, low credit risk, and minimal losses when compared to total amortized cost. The unrealized losses on debt securities that exist are the result of market changes in interest rates since original purchase. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost bases, which may be at maturity for debt securities, the Company considers the unrealized losses to be temporary.

The following table provides information on the amortized cost and estimated fair values of investment securities by maturity date at June 30, 2016.

(Dollars in thousands)	Available for sale Amortized Cost	Available for sale Estimated Fair Value	Held to maturity Amortized Cost	Held to maturity Estimated Fair Value

Due in one year or less	$20,031	$20,060	$210	$ 210
Due after one year through five years	23,065	23,151	501	544
Due after five years through ten years	10,075	10,173	402	449
Due after ten years	139,973	141,637	2,882	2,918
	193,144	195,021	3,995	4,121
Equity securities	644	660	-	-
Total	$193,788	$195,681	$3,995	$ 4,121

The maturity dates for debt securities are determined using contractual maturity dates.

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Note 4 – Loans and Allowance for Credit Losses

The Company makes residential mortgage, commercial and consumer loans to customers primarily in Talbot County, Queen Anne's County, Kent County, Caroline County and Dorchester County in Maryland and in Kent County, Delaware.

The following table provides information about the principal classes of the loan portfolio at June 30, 2016 and December 31, 2015.

(Dollars in thousands)	June 30, 2016	December 31, 2015
Construction	$81,148	$ 85,632
Residential real estate	320,041	307,063
Commercial real estate	345,713	330,253
Commercial	66,959	64,911
Consumer	7,218	7,255
Total loans	821,079	795,114
Allowance for credit losses	(8,358)	(8,316)
Total loans, net	$812,721	$ 786,798

Loans are stated at their principal amount outstanding net of any purchase premiums, deferred fees and costs. Interest income on loans is accrued at the contractual rate based on the principal amount outstanding. Fees charged and costs capitalized for originating loans are being amortized substantially on the interest method over the term of the loan. A loan is placed on nonaccrual (i.e., interest income is no longer accrued) when it is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more, unless the loan is well secured and in the process of collection. Any unpaid interest previously accrued on those loans is reversed from income.

Interest payments received on nonaccrual loans are applied as a reduction of the loan principal balance unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired if it is probable that the Company will not collect all principal and interest payments according to the loan's contractual terms. An impaired loan may show deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral. The impairment of a loan is measured at the present value of expected future cash flows using the loan's effective interest rate, or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Generally, the Company measures impairment on such loans by reference to the fair value of the collateral. Once the amount of impairment has been determined, the uncollectible portion is charged off. Income on impaired loans is recognized on a cash basis, and payments are first applied against the principal balance outstanding (i.e., placing impaired loans on nonaccrual status). Generally, interest income is not recognized on impaired loans unless the likelihood of further loss is remote. The allowance for credit losses may include specific reserves related to impaired loans. Specific reserves remain until charge offs are made. Impaired loans do not include groups of smaller balance homogenous loans such as residential mortgage and consumer installment loans that are evaluated collectively for impairment. Reserves for probable credit losses related to these loans are based on historical loss ratios and are included in the formula portion of the allowance for credit losses. See additional discussion under the caption "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

A loan is considered a troubled debt restructuring ("TDR") if a borrower is experiencing financial difficulties and a creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Loans are identified to be restructured when signs of impairment arise such as borrower interest rate reduction request, slowness to pay, or when an inability to repay becomes evident. The terms being offered are evaluated to determine if they are more liberal than those that would be indicated by policy or industry standards for similar, untroubled credits. In those situations where the terms or the interest rates are considered to be more favorable than industry standards or the current underwriting guidelines of the Company's banking subsidiary, Shore United Bank (the "Bank"), the loan is classified as a TDR. All loans designated as TDRs are considered impaired loans and may be on either accrual or nonaccrual status. In instances where the loan has been placed on nonaccrual status, six consecutive months of timely payments are required prior to returning the loan to accrual status.

All loans classified as TDRs which are restructured and accrue interest under revised terms require a full and comprehensive review of the borrower's financial condition, capacity for repayment, realistic assessment of collateral values, and the assessment of risk entered into any workout agreement. Current financial information on the borrower, guarantor, and underlying collateral is analyzed to determine if it supports the ultimate collection of principal and interest. For commercial loans, the cash flows are analyzed, both for the underlying project and globally. For consumer loans, updated salary, credit history and cash flow information is obtained. Current market conditions are also considered. Following a full analysis, the determination of the appropriate loan structure is made.

In the normal course of banking business, risks related to specific loan categories are as follows:

Construction loans – Construction loans generally finance the construction of residential real estate for builders and individuals for single family dwellings. In addition, the Bank periodically finances the construction of commercial projects. Credit risk factors include the borrower's ability to successfully complete the construction on time and within budget, changing market conditions which could affect the value and marketability of projects, changes in the borrower's ability or willingness to repay the loan and potentially rising interest rates which can impact both the borrower's ability to repay and the collateral value.

Residential real estate – Residential real estate loans are typically made to consumers and are secured by residential real estate. Credit risk arises from the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy, among other factors. Also impacting credit risk would be a shortfall in the value of the residential real estate in relation to the outstanding loan balance in the event of a default or subsequent liquidation of the real estate collateral.

Commercial real estate – Commercial real estate loans consist of both loans secured by owner occupied properties and non-owner occupied where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. These loans are subject to adverse changes in the local economy and commercial real estate markets. Credit risk associated with owner occupied properties arises from the borrower's financial stability and the ability of the borrower and the business to repay the loan. Non-owner occupied properties carry the risk of a tenant's deteriorating credit strength, lease expirations in soft markets and sustained vacancies which can adversely impact cash flow.

Commercial – Commercial loans are secured or unsecured loans for business purposes. Loans are typically secured by accounts receivable, inventory, equipment and/or other assets of the business. Credit risk arises from the successful operation of the business which may be affected by competition, rising interest rates, regulatory changes and adverse conditions in the local and regional economy.

Consumer – Consumer loans include home equity loans and lines, installment loans and personal lines of credit. Credit risk is similar to residential real estate loans above as it is subject to the borrower's continuing financial stability and the value of the collateral securing the loan.

The following tables include impairment information relating to loans and the allowance for credit losses as of June 30, 2016 and December 31, 2015.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Unallocated	Total
June 30, 2016							
Loans individually evaluated for impairment	$ 9,670	$ 9,719	$ 7,188	$ 192	$ 99	$ -	$ 26,868
Loans collectively evaluated for impairment	71,478	310,322	338,525	66,767	7,119	-	794,211
Total loans	$ 81,148	$ 320,041	$ 345,713	$ 66,959	$ 7,218	$ -	$ 821,079
Allowance for credit losses allocated to:							
Loans individually evaluated for impairment	$ 764	$ 207	$ 276	$ 45	$ -	$ -	$ 1,292
Loans collectively evaluated for impairment	980	1,828	2,595	632	206	825	7,066
Total allowance for credit losses	$ 1,744	$ 2,035	$ 2,871	$ 677	$ 206	$ 825	$ 8,358

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Unallocated	Total
December 31, 2015							
Loans individually evaluated for impairment	$ 11,598	$ 7,945	$ 7,762	$ 161	$ 122	$ -	$ 27,588
Loans collectively evaluated for impairment	74,034	299,118	322,491	64,750	7,133	-	767,526
Total loans	$ 85,632	$ 307,063	$ 330,253	$ 64,911	$ 7,255	$ -	$ 795,114
Allowance for credit losses allocated to:							
Loans individually evaluated for impairment	$ 619	$ 435	$ 340	$ -	$ 7	$ -	$ 1,401
Loans collectively evaluated for impairment	1,027	1,746	2,659	558	149	776	6,915
Total allowance for credit losses	$ 1,646	$ 2,181	$ 2,999	$ 558	$ 156	$ 776	$ 8,316

The following tables provide information on impaired loans and any related allowance by loan class as of June 30, 2016 and December 31, 2015. The difference between the unpaid principal balance and the recorded investment is the amount of partial charge-offs that have been taken.

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	Quarter-to-date average recorded investment	Year-to-date average recorded investment	Interest income recognized
June 30, 2016							
Impaired nonaccrual loans:							
Construction	$ 11,000	$ 2,562	$ 2,867	$ 739	$ 5,489	$ 6,353	$ -
Residential real estate	5,886	4,046	1,579	134	3,914	3,103	-
Commercial real estate	2,832	1,777	409	121	2,058	2,308	-
Commercial	212	147	45	45	164	161	-
Consumer	99	99	-	-	106	114	-
Total	20,029	8,631	4,900	1,039	11,731	12,039	-
Impaired accruing TDRs:							
Construction	4,241	3,449	792	25	4,244	4,142	43
Residential real estate	4,095	2,719	1,376	73	4,931	5,300	102
Commercial real estate	5,001	1,589	3,412	155	5,066	5,215	85
Commercial	-	-	-	-	-	-	-
Consumer	-	-	-	-	-	-	-
Total	13,337	7,757	5,580	253	14,241	14,657	230
Total impaired loans:							
Construction	15,241	6,011	3,659	764	9,733	10,495	43
Residential real estate	9,980	6,764	2,955	207	8,845	8,403	102
Commercial real estate	7,834	3,366	3,822	276	7,124	7,523	85
Commercial	212	147	45	45	164	161	-
Consumer	99	99	-	-	106	114	-
Total	$ 33,366	$ 16,387	$ 10,481	$ 1,292	$ 25,972	$ 26,696	$ 230

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	June 30, 2015 Quarter-to-date average recorded investment	Year-to-date average recorded investment	Interest income recognized
December 31, 2015							
Impaired nonaccrual loans:							
Construction	$ 11,850	$ 4,647	$ 2,882	$ 588	$ 8,478	$ 8,169	$ -
Residential real estate	2,563	1,773	487	208	2,041	2,159	-
Commercial real estate	2,988	1,813	209	9	2,707	2,698	-
Commercial	175	161	-	-	95	72	-
Consumer	128	98	23	7	123	123	-
Total	17,704	8,492	3,601	812	13,444	13,221	-
Impaired accruing TDRs:							
Construction	4,069	3,266	803	31	4,109	4,064	40
Residential real estate	5,686	2,380	3,306	227	7,393	6,866	160
Commercial real estate	5,740	1,702	4,038	331	6,238	6,255	116
Commercial	-	-	-	-	41	43	-
Consumer	-	-	-	-	-	-	-
Total	15,495	7,348	8,147	589	17,781	17,228	316
Total impaired loans:							
Construction	15,919	7,913	3,685	619	12,587	12,233	40
Residential real estate	8,249	4,153	3,793	435	9,434		