Section 1: 10-Q (10-Q)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For quarterly period ended June 30, 2019

☐ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _______________ to ________________

Commission file number 0-14237

First United Corporation
(Exact name of registrant as specified in its charter)

Maryland	52-1380770
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)
19 South Second Street, Oakland, Maryland	21550-0009
(Address of principal executive offices)	(Zip Code)

(800) 470-4356
(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbols	Name of each exchange on which registered
Common Stock	FUNC	Nasdaq Stock Market

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 ☑ 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 (§232.405 of this chapter) during the preceding 12 months (or for 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 non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐
Non-accelerated filer ☐
Emerging growth company ☐
Accelerated filer ☑
Smaller reporting 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 standard 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 ☑

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 7,105,775 shares of common stock, par value $.01 per share, as of July 31, 2019.

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FIRST UNITED CORPORATION

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

FIRST UNITED CORPORATION
Consolidated Statement of Financial Condition
(In thousands, except per share data)

	June 30, 2019 (Unaudited)	December 31, 2018
Assets		
Cash and due from banks	$ 38,584	$ 22,187
Interest bearing deposits in banks	405	1,354
Cash and cash equivalents	38,989	23,541
Investment securities – available for sale (at fair value)	135,809	137,641
Investment securities – held to maturity (fair value $102,503 at June 30, 2019 and $93,760 at December 31, 2018)	97,499	94,010
Restricted investment in bank stock, at cost	4,415	5,394
Loans	1,003,616	1,007,714
Allowance for loan losses	(11,976)	(11,047)
Net loans	991,640	996,667
Premises and equipment, net	38,138	37,855
Goodwill and other intangible assets, net	11,004	11,004
Bank owned life insurance	43,908	43,317
Deferred tax assets	6,208	7,844
Other real estate owned	5,531	6,598
Operating lease right-of-use asset	2,594	—
Accrued interest receivable and other assets	29,894	20,645
Total Assets	$ 1,405,629	$ 1,384,516
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$ 281,307	$ 262,250
Interest bearing deposits	841,774	805,277
Total deposits	1,123,081	1,067,527
Short-term borrowings	31,155	77,707
Long-term borrowings	100,929	100,929
Operating lease liability	3,177	—
Accrued interest payable and other liabilities	20,492	20,649
Dividends payable	640	638
Total Liabilities	1,279,474	1,267,450
Shareholders' Equity:		
Common Stock – par value $.01 per share; Authorized 25,000 shares; issued and outstanding 7,106 shares at June 30, 2019 and 7,087 at December 31, 2018	71	71
Surplus	32,133	31,921
Retained earnings	113,951	109,477
Accumulated other comprehensive loss	(20,000)	(24,403)
Total Shareholders' Equity	126,155	117,066
Total Liabilities and Shareholders' Equity	$ 1,405,629	$ 1,384,516

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION
Consolidated Statement of Operations
(In thousands, except per share data)

	Six Months Ended June 30, 2019	2018
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 24,686	$ 21,408
Interest on investment securities		
Taxable	2,917	2,921
Exempt from federal income tax	522	473
Total investment income	3,439	3,394
Other	358	284
Total interest income	28,483	25,086
Interest expense		
Interest on deposits	3,736	1,784
Interest on short-term borrowings	131	124
Interest on long-term borrowings	1,743	1,728
Total interest expense	5,610	3,636
Net interest income	22,873	21,450
Provision for loan losses	682	716
Net interest income after provision for loan losses	22,191	20,734
Other operating income		
Net gains	44	181
Service charges on deposit accounts	1,074	1,120
Other service charges	433	440
Trust department	3,547	3,305
Debit card income	1,276	1,201
Bank owned life insurance	591	584
Brokerage commissions	441	551
Other	254	210
Total other income	7,616	7,411
Total other operating income	7,660	7,592
Other operating expenses		
Salaries and employee benefits	12,364	12,038
FDIC premiums	294	303
Equipment	1,819	1,436
Occupancy	1,418	1,252
Data processing	1,995	1,843
Professional services	522	643
Contract labor	331	337
Line rentals	415	430
Other real estate owned	929	493
Other	2,344	2,541
Total other operating expenses	22,431	21,316
Income before income tax expense	7,420	7,010
Provision for income tax expense	1,667	1,488
Net Income	$ 5,753	$ 5,522
Basic and diluted net income per common share	$ 0.81	$ 0.78
Weighted average number of basic and diluted shares outstanding	7,094	7,072
Dividends declared per common share	$ 0.18	$ 0.18

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION
Consolidated Statement of Operations
(In thousands, except per share data)

	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018
	(Unaudited)	
Interest income		
Interest and fees on loans	$ 12,496	$ 10,927
Interest on investment securities		
Taxable	1,450	1,474
Exempt from federal income tax	242	235
Total investment income	1,692	1,709
Other	223	88
Total interest income	14,411	12,724
Interest expense		
Interest on deposits	1,965	928
Interest on short-term borrowings	28	94
Interest on long-term borrowings	891	834
Total interest expense	2,884	1,856
Net interest income	11,527	10,868
Provision for loan losses	333	269
Net interest income after provision for loan losses	11,194	10,599
Other operating income		
Net gains	30	147
Service charges on deposit accounts	555	557
Other service charges	225	211
Trust department	1,832	1,641
Debit card income	676	648
Bank owned life insurance	288	285
Brokerage commissions	203	306
Other	130	87
Total other income	3,909	3,735
Total other operating income	3,939	3,882
Other operating expenses		
Salaries and employee benefits	6,146	6,119
FDIC premiums	183	170
Equipment	936	753
Occupancy	706	614
Data processing	1,054	911
Professional services	318	307
Contract labor	175	161
Line rentals	198	219
Other real estate owned	786	108
Other	1,239	1,263
Total other operating expenses	11,741	10,625
Income before income tax expense	3,392	3,856
Provision for income tax expense	790	840
Net Income	$ 2,602	$ 3,016
Basic and diluted net income per common share	$ 0.37	$ 0.43
Weighted average number of basic and diluted shares outstanding	7,100	7,077
Dividends declared per common share	$ 0.09	$ 0.09

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION
Consolidated Statement of Comprehensive Income
(In thousands)

Comprehensive Income (in thousands)	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
	(Unaudited)	
Net Income	$ 5,753	$ 5,522
Other comprehensive income, net of tax and reclassification adjustments:		
Net unrealized (losses)/gains on investments with OTTI	(274)	1,590
Net unrealized gains/(losses) on all other AFS securities	2,482	(1,308)
Net unrealized gains on HTM securities	118	83
Net unrealized (losses)/gains on cash flow hedges	(801)	551
Net unrealized gains/(losses) on pension	2,836	(794)
Net unrealized gains on SERP	42	58
Other comprehensive income, net of tax	4,403	180
Comprehensive income	$ 10,156	$ 5,702

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION
Consolidated Statement of Comprehensive Income
(In thousands)

Comprehensive Income (in thousands)	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018
	(Unaudited)	
Net Income	$ 2,602	$ 3,016
Other comprehensive income, net of tax and reclassification adjustments:		
Net unrealized (losses)/gains on investments with OTTI	(194)	945
Net unrealized gains/(losses) on all other AFS securities	1,577	(230)
Net unrealized gains on HTM securities	63	38
Net unrealized (losses)/gains on cash flow hedges	(486)	108
Net unrealized gains/(losses) on pension	707	(1,530)
Net unrealized gains on SERP	21	29
Other comprehensive income/(loss), net of tax	1,688	(640)
Comprehensive income	$ 4,290	$ 2,376

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION
Consolidated Statement of Changes in Shareholders' Equity
(In thousands, except per share data)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at January 1, 2019	$ 71	$ 31,921	$ 109,477	$ (24,403)	$ 117,066
Net income			3,151		3,151
Other comprehensive income				2,715	2,715
Stock based compensation		67			67
Common stock issued		39			39
Common stock dividend declared - $.09 per share			(639)		(639)
Balance at March 31, 2019	$ 71	$ 32,027	$ 111,989	$ (21,688)	$ 122,399
Net income			2,602		2,602
Other comprehensive income				1,688	1,688
Stock based compensation		67			67
Common stock issued		39			39
Common stock dividend declared - $.09 per share			(640)		(640)
Balance at June 30, 2019	$ 71	$ 32,133	$ 113,951	$ (20,000)	$ 126,155

FIRST UNITED CORPORATION
Consolidated Statement of Changes in Shareholders' Equity
(In thousands, except per share data)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at January 1, 2018	$ 71	$ 31,553	$ 101,359	$ (24,593)	$ 108,390
Net income			2,506		2,506
Other comprehensive income				820	820
Stock based compensation		53			53
Common stock dividend declared - $.09 per share			(635)		(635)
Balance at March 31, 2018	$ 71	$ 31,606	$ 103,230	$ (23,773)	$ 111,134
Net income			3,016		3,016
Other comprehensive loss				(640)	(640)
Stock based compensation		63			63
Common stock issued		40			40
Common stock dividend declared - $.09 per share			(639)		(639)
Balance at June 30, 2018	$ 71	$ 31,709	$ 105,607	$ (24,413)	$ 112,974

See accompanying notes to the consolidated financial statements

FIRST UNITED CORPORATION
Consolidated Statement of Cash Flows
(In thousands)

	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
	(Unaudited)	
Operating activities		
Net income	$ 5,753	$ 5,522
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	682	716
Depreciation	1,529	1,117
Stock compensation	134	116
Gains on sales of other real estate owned	(11)	(183)
Write-downs of other real estate owned	828	478
Originations of loans held for sale	(6,122)	(7,166)
Proceeds from sale of loans held for sale	5,861	6,820
Gains from sale of loans held for sale	(45)	(55)
Losses on disposal of fixed assets	1	—
Net (accretion)/amortization of investment securities discounts and premiums- AFS	(2)	27
Net amortization of investment securities discounts and premiums- HTM	20	40
Gains on sales/calls of investment securities – available-for-sale	—	(126)
Earnings on bank owned life insurance	(591)	(584)
Amortization of deferred loan fees	(336)	(358)
Amortization of operating lease right-of-use asset	136	—
Increase in accrued interest receivable and other assets	(5,138)	(1,673)
Increase in deferred tax benefit	(2)	(744)
Decrease in operating lease liability	(140)	—
(Decrease)/increase in accrued interest payable and other liabilities	(666)	2,203
Net cash provided by operating activities	1,891	6,150
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	4,228	6,058
Proceeds from maturities/calls of investment securities held-to-maturity	3,323	3,297
Proceeds from sales of investment securities available-for-sale	5,378	—
Purchases of investment securities available-for-sale	(4,744)	(1,405)
Purchases of investment securities held-to-maturity	(6,832)	—
Proceeds from sales of other real estate owned	870	1,637
Net decrease in FHLB stock	979	872
Net decrease/(increase) in loans	4,367	(23,969)
Purchases of loans	—	(25,168)
Purchases of premises and equipment	(1,813)	(5,413)
Net cash provided by/(used in) investing activities	5,756	(44,091)
Financing activities		
Net increase in deposits	55,554	1,730
Proceeds from sale of common stock	78	40
Cash dividends on common stock	(1,279)	(1,274)
Net decrease in short-term borrowings	(46,552)	(916)
Payments on long-term borrowings	—	(20,000)
Net cash provided by/(used in) financing activities	7,801	(20,420)
Increase/(decrease) in cash and cash equivalents	15,448	(58,361)
Cash and cash equivalents at beginning of the year	23,541	83,752
Cash and cash equivalents at end of period	$ 38,989	$ 25,391
Supplemental information		
Interest paid	$ 5,562	$ 3,506
Taxes paid	$ 671	$ —
Non-cash investing activities:		
Transfers from loans to other real estate owned	$ 620	$ 294
Initial recognition of operating lease right-of-use assets	$ 2,730	$ —
Initial recognition of operating lease liabilities	$ 3,317	$ —

See accompanying notes to the consolidated financial statements

Note 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements of First United Corporation and its consolidated subsidiaries, including First United Bank & Trust (the "Bank"), have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information, as required by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 270, *Interim Reporting*, and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all the information and footnotes required for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring items, have been included. Operating results for the six and three-month periods ended June 30, 2019 are not necessarily indicative of the results that may be expected for the full year or for any future interim period. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2018. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2019 presentation. Such reclassifications had no impact on net income or equity.

As used in these notes, the term "the Corporation" refers to First United Corporation and, unless the context clearly requires otherwise, its consolidated subsidiaries.

The Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of June 30, 2019 for items that should potentially be recognized or disclosed in these financial statements.

Note 2 – Earnings Per Common Share

Basic earnings per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is derived by dividing net income available to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. No common stock equivalents were outstanding at June 30, 2019.

The following tables set forth the calculation of basic and diluted earnings per common share for the six- and three-month periods ended June 30, 2019 and 2018:

	Six months ended June 30,					
	2019			2018		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$ 5,753	7,094	$ 0.81	$ 5,522	7,072	$ 0.78

	Three months ended June 30,					
	2019			2018		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$ 2,602	7,100	$ 0.37	$ 3,016	7,077	$ 0.43

Note 3 – Net Gains

The following table summarizes the gain/(loss) activity for the six- and three-month periods ended June 30, 2019 and 2018:

	Six Months Ended June 30,		Three Months Ended June 30,	
(in thousands)	2019	2018	2019	2018
Net gains/(losses):				
Available-for-sale securities:				
Realized gains	$ 73	$ 145	$ 73	$ 145
Realized losses	(73)	(19)	(67)	(10)
Gains on sale of consumer loans	45	55	25	12
Losses on disposal of fixed assets	(1)	—	(1)	—
Net gains	$ 44	$ 181	$ 30	$ 147

Note 4 – Investments

The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities.*

The amortized cost of debt securities classified as available-for-sale is adjusted for the amortization of premiums to the first call date, if applicable, or to maturity, and for the accretion of discounts to maturity, or, in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from investments. Interest and dividends are included in interest income from investments. Gains and losses on the sale of securities are recorded using the specific identification method.

The following table shows a comparison of amortized cost and fair values of investment securities at June 30, 2019 and December 31, 2018:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCL
June 30, 2019					
Available for Sale:					
U.S. government agencies	$ 30,000	$ —	$ 167	$ 29,833	$ —
Commercial mortgage-backed agencies	42,487	143	284	42,346	—
Collateralized mortgage obligations	34,010	179	62	34,127	—
Obligations of states and political subdivisions	14,379	252	—	14,631	—
Collateralized debt obligations	18,387	—	3,515	14,872	(2,341)
Total available for sale	$ 139,263	$ 574	$ 4,028	$ 135,809	$ (2,341)
Held to Maturity:					
U.S. government agencies	$ 16,090	$ 624	$ —	$ 16,714	$ —
Residential mortgage-backed agencies	47,320	237	345	47,212	—
Commercial mortgage-backed agencies	15,672	429	—	16,101	—
Collateralized mortgage obligations	3,577	5	—	3,582	—
Obligations of states and political subdivisions	14,840	4,054	—	18,894	—
Total held to maturity	$ 97,499	$ 5,349	$ 345	$ 102,503	$ —
December 31, 2018					
Available for Sale:					
U.S. government agencies	$ 30,000	$ —	$ 974	$ 29,026	$ —
Commercial mortgage-backed agencies	39,013	—	1,261	37,752	—
Collateralized mortgage obligations	36,669	—	965	35,704	—
Obligations of states and political subdivisions	20,083	132	333	19,882	—
Collateralized debt obligations	18,358	—	3,081	15,277	(1,966)
Total available for sale	$ 144,123	$ 132	$ 6,614	$ 137,641	$ (1,966)
Held to Maturity:					
U.S. government agencies	$ 16,017	$ 120	$ —	$ 16,137	$ —
Residential mortgage-backed agencies	46,491	6	1,287	45,210	—
Commercial mortgage-backed agencies	15,821	75	68	15,828	—
Collateralized mortgage obligations	3,761	—	156	3,605	—
Obligations of states and political subdivisions	11,920	1,156	96	12,980	—
Total held to maturity	$ 94,010	$ 1,357	$ 1,607	$ 93,760	$ —

Proceeds from sales/calls of available for sale securities and the realized gains and losses are as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
(in thousands)	2019	2018	2019	2018
Proceeds	$ 5,668	$ 500	$ 5,408	$ 265
Realized gains	73	145	73	145
Realized losses	73	19	67	10

The following table shows the Corporation's investment securities with gross unrealized losses and fair values at June 30, 2019 and December 31, 2018, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 months			12 months or more		
(in thousands)	Fair Value	Unrealized Losses	Number of Investments	Fair Value	Unrealized Losses	Number of Investments
June 30, 2019						
Available for Sale:						
U.S. government agencies	$ —	$ —	—	$ 29,833	$ 167	5
Commercial mortgage-backed agencies	—	—	—	18,918	284	5
Collateralized mortgage obligations	—	—	—	8,250	62	2
Collateralized debt obligations	5,848	612	4	9,024	2,903	5
Total available for sale	$ 5,848	$ 612	4	$ 66,025	$ 3,416	17
Held to Maturity:						
Residential mortgage-backed agencies	$ 5,287	$ 16	2	$ 19,088	$ 329	20
Total held to maturity	$ 5,287	$ 16	2	$ 19,088	$ 329	20
December 31, 2018						
Available for Sale:						
U.S. government agencies	$ —	$ —	—	$ 29,026	$ 974	5
Commercial mortgage-backed agencies	—	—	—	37,752	1,261	8
Collateralized mortgage obligations	232	1	1	35,472	964	8
Obligations of states and political subdivisions	3,310	48	5	11,068	285	8
Collateralized debt obligations	5,987	438	4	9,290	2,643	5
Total available for sale	$ 9,529	$ 487	10	$ 122,608	$ 6,127	34
Held to Maturity:						
Residential mortgage-backed agencies	$ 3,605	$ 51	2	$ 41,448	$ 1,236	29
Commercial mortgage-backed agencies	—	—	—	7,656	68	1
Collateralized mortgage obligations	—	—	—	3,605	156	1
Obligations of states and political subdivisions	—	—	—	2,199	96	1
Total held to maturity	$ 3,605	$ 51	2	$ 54,908	$ 1,556	32

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320 (ASC Section 320-10-35), management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first component is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other than temporary impairment ("OTTI") losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). Further discussion about the evaluation of securities for impairment can be found in Item 2 of Part I of this report under the heading "*Investment Securities*".

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of the Corporation's consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for the Corporation's collateralized debt obligation ("CDO") portfolio consisting of pooled trust preferred securities. See Note 7 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during the first six months of 2019.

The Corporation does not believe that the investment securities that were in an unrealized loss position at June 30, 2019 represent an other-than-temporary impairment. The Corporation does not intend to sell nor is it anticipated that it would be required to sell any of its impaired investment securities at a loss.

The following tables present a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the six- and three-month periods ended June 30, 2019 and 2018:

	Six Months Ended June 30,	
(in thousands)	**2019**	**2018**
Balance of credit-related OTTI at January 1	$ 2,646	$ 2,958
Reduction for increases in cash flows expected to be collected	(99)	(207)
Balance of credit-related OTTI at June 30	$ 2,547	$ 2,751

	Three Months Ended June 30,	
(in thousands)	**2019**	**2018**
Balance of credit-related OTTI at April 1	$ 2,597	$ 2,903
Reduction for increases in cash flows expected to be collected	(50)	(152)
Balance of credit-related OTTI at June 30	$ 2,547	$ 2,751

The amortized cost and estimated fair value of securities by contractual maturity at June 30, 2019 are shown in the following table. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2019	
(in thousands)	**Amortized Cost**	**Fair Value**
Contractual Maturity		
Available for Sale:		
Due in one year or less	$ 225	$ 225
Due after one year through five years	16,763	16,718
Due after five years through ten years	17,968	17,876
Due after ten years	27,810	24,517
	62,766	59,336
Commercial mortgage-backed agencies	42,487	42,346
Collateralized mortgage obligations	34,010	34,127
Total available for sale	$ 139,263	$ 135,809
Held to Maturity:		
Due after one year through five years	$ 16,090	$ 16,714
Due after ten years	14,840	18,894
	30,930	35,608
Residential mortgage-backed agencies	47,320	47,212
Commercial mortgage-backed agencies	15,672	16,101
Collateralized mortgage obligations	3,577	3,582
Total held to maturity	$ 97,499	$ 102,503

Note 5 – Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio at June 30, 2019 and December 31, 2018:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
June 30, 2019						
Individually evaluated for impairment	$ 5,778	$ 8,144	$ 27	$ 3,787	$ 7	$ 17,743
Collectively evaluated for impairment	$ 294,054	$ 110,582	$ 108,244	$ 438,482	$ 34,511	$ 985,873
Total loans	$ 299,832	$ 118,726	$ 108,271	$ 442,269	$ 34,518	$ 1,003,616
December 31, 2018						
Individually evaluated for impairment	$ 5,239	$ 693	$ 17	$ 4,616	$ 10	$ 10,575
Collectively evaluated for impairment	$ 301,682	$ 117,667	$ 111,449	$ 432,291	$ 34,050	$ 997,139
Total loans	$ 306,921	$ 118,360	$ 111,466	$ 436,907	$ 34,060	$ 1,007,714

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate ("CRE") loan segment is then segregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied, non-farm, and nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The acquisition and development ("A&D") loan segment is segregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. A&D loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan is made. The commercial and industrial ("C&I") loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is segregated into two classes: amortizing term loans, which are primarily first lien loans and home equity lines of credit, which are generally second liens. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

Management uses a 10-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized; and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a substandard classification. Loans in the substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of a specific allocation of the allowance for loan losses that management believes is associated with a pending event that could trigger loss in the short-term will be classified in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in the commercial segments at origination and on an ongoing basis. The Bank's experienced Credit Quality and Portfolio Risk departments perform an annual review of all commercial relationships of $500,000 or greater. Confirmation of the appropriate risk grade is included as part of the review process on an ongoing basis. The Credit Quality and Portfolio Risk Management departments continually review and assess loans within the portfolio. In addition, the Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than $1,000,000 and/or criticized non-consumer loans greater than $500,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard within the internal risk rating system at June 30, 2019 and December 31, 2018:

(in thousands)	Pass	Special Mention	Substandard	Total
June 30, 2019				
Commercial real estate				
Non owner-occupied	$ 137,348	$ 7,457	$ 2,012	$ 146,817
All other CRE	145,127	1,721	6,167	153,015
Acquisition and development				
1-4 family residential construction	10,301	—	—	10,301
All other A&D	100,490	—	7,935	108,425
Commercial and industrial	104,496	—	3,775	108,271
Residential mortgage				
Residential mortgage - term	367,344	—	4,250	371,594
Residential mortgage - home equity	69,142	141	1,392	70,675
Consumer	34,413	4	101	34,518
Total	$ 968,661	$ 9,323	$ 25,632	$ 1,003,616
December 31, 2018				
Commercial real estate				
Non owner-occupied	$ 145,260	$ 2,904	$ 2,348	$ 150,512
All other CRE	149,076	1,752	5,581	156,409
Acquisition and development				
1-4 family residential construction	16,003	—	—	16,003
All other A&D	94,428	7,378	551	102,357
Commercial and industrial	107,174	3,703	589	111,466
Residential mortgage				
Residential mortgage - term	359,305	—	4,703	364,008
Residential mortgage - home equity	71,666	143	1,090	72,899
Consumer	33,952	4	104	34,060
Total	$ 976,864	$ 15,884	$ 14,966	$ 1,007,714

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment remains unpaid 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation’s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-accrual loans at June 30, 2019 and December 31, 2018:

(in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and Accruing	Non-Accrual	Total Loans
June 30, 2019							
Commercial real estate							
Non owner-occupied	$ 146,684	$ —	$ —	$ —	$ —	$ 133	$ 146,817
All other CRE	147,818	2,116	—	—	2,116	3,081	153,015
Acquisition and development							
1-4 family residential construction	10,301	—	—	—	—	—	10,301
All other A&D	100,702	—	74	34	108	7,615	108,425
Commercial and industrial	108,158	—	86	—	86	27	108,271
Residential mortgage							
Residential mortgage - term	368,467	138	1,464	197	1,799	1,328	371,594
Residential mortgage - home equity	69,403	241	25	79	345	927	70,675
Consumer	34,375	94	35	7	136	7	34,518
Total	$ 985,908	$ 2,589	$ 1,684	$ 317	$ 4,590	$ 13,118	$ 1,003,616
December 31, 2018							
Commercial real estate							
Non owner-occupied	$ 150,339	$ —	$ —	$ —	$ —	$ 173	$ 150,512
All other CRE	153,977	464	—	—	464	1,968	156,409
Acquisition and development							
1-4 family residential construction	16,003	—	—	—	—	—	16,003
All other A&D	94,540	197	7,411	62	7,670	147	102,357
Commercial and industrial	111,436	29	1	—	30	—	111,466
Residential mortgage							
Residential mortgage - term	360,073	302	1,359	363	2,024	1,911	364,008
Residential mortgage - home equity	71,611	461	114	—	575	713	72,899
Consumer	33,832	140	73	5	218	10	34,060
Total	$ 991,811	$ 1,593	$ 8,958	$ 430	$ 10,981	$ 4,922	$ 1,007,714

Non-accrual loans totaled $13.1 million at June 30, 2019, compared to $4.9 million at December 31, 2018. The increase in non-accrual balances at June 30, 2019 was primarily due to entering a forbearance agreement with one large A&D loan totaling $7.0 million during the first quarter 2019. At December 31, 2018, it was expected that this loan would be paid off by a prospective buyer. In the first quarter of 2019, the buyer declined to pursue the transaction and, subsequently, the Corporation entered into a forbearance agreement and placed the loan on non-accrual. During the second quarter of 2019, two additional CRE credits were added to non-accrual. Non-accrual loans that have been subject to partial charge-offs totaled $.2 million at June 30, 2019, compared to $.3 million at December 31, 2018. For the six months ended June 30, 2019, $1.7 million in specific allocations have been made related to the A&D portfolio. Loans secured by 1-4 family residential real estate properties in the process of foreclosure were $.2 million at June 30, 2019 and $.3 million at December 31, 2018.

Accruing loans past due 30 days or more decreased to .46% of the loan portfolio at June 30, 2019, compared to 1.09% at December 31, 2018. The decrease for the first six months of 2019 was primarily related to one large relationship in the commercial A&D portfolio that moved to non-accrual status in the first quarter of 2019.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL 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 non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the allocated portion of the Bank's ALL. In the second quarter of 2015, management determined that it would be prudent to establish an unallocated portion of the ALL to protect the Bank from other risks associated with the loan portfolio that may not be specifically identifiable.

The following table summarizes the primary segments of the ALL at June 30, 2019 and December 31, 2018, segregated by the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
June 30, 2019							
Individually evaluated for impairment	$ 11	$ 1,728	$ —	$ 65	$ —	$ —	$ 1,804
Collectively evaluated for impairment	$ 2,724	$ 1,566	$ 1,147	$ 3,916	$ 319	$ 500	$ 10,172
Total ALL	$ 2,735	$ 3,294	$ 1,147	$ 3,981	$ 319	$ 500	$ 11,976
December 31, 2018							
Individually evaluated for impairment	$ 13	$ 25	$ —	$ 106	$ —	$ —	$ 144
Collectively evaluated for impairment	$ 2,767	$ 1,696	$ 1,187	$ 4,438	$ 315	$ 500	$ 10,903
Total ALL	$ 2,780	$ 1,721	$ 1,187	$ 4,544	$ 315	$ 500	$ 11,047

The evaluation of the need and amount of a specific allocation of the ALL and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not required at June 30, 2019 and December 31, 2018:

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
(in thousands)	Recorded Investment	Related Allowances	Recorded Investment	Recorded Investment	Unpaid Principal Balance
June 30, 2019					
Commercial real estate					
Non owner-occupied	$ 119	$ 11	$ 133	$ 252	$ 8,445
All other CRE	—	—	5,526	5,526	5,526
Acquisition and development					
1-4 family residential construction	—	—	304	304	304
All other A&D	7,805	1,728	35	7,840	7,907
Commercial and industrial	—	—	27	27	2,241
Residential mortgage					
Residential mortgage – term	1,205	56	1,655	2,860	3,063
Residential mortgage – home equity	171	9	756	927	941
Consumer	—	—	7	7	7
Total impaired loans	$ 9,300	$ 1,804	$ 8,443	$ 17,743	$ 28,434
December 31, 2018					
Commercial real estate					
Non owner-occupied	$ 121	$ 13	$ 173	$ 294	$ 8,488
All other CRE	—	—	4,945	4,945	4,945
Acquisition and development					
1-4 family residential construction	—	—	316	316	316
All other A&D	230	25	147	377	525
Commercial and industrial	—	—	17	17	2,231
Residential mortgage					
Residential mortgage – term	993	106	2,910	3,903	4,130
Residential mortgage – home equity	—	—	713	713	726
Consumer	—	—	10	10	10
Total impaired loans	$ 1,344	$ 144	$ 9,231	$ 10,575	$ 21,371

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity (full and partial charge-offs, net of full and partial recoveries) at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. Consumer pools currently utilize a rolling 12 quarters, while Commercial pools currently utilize a rolling eight quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. Most “Pass” pools for commercial and residential real estate are further segmented based upon the geographic location of the underlying collateral. There are seven geographic regions utilized – six that represent the Bank’s lending footprint and a seventh for all out-of-market credits. Different economic environments and resultant credit risks exist in each region that are acknowledged in the assignment of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Management supplements the historical charge-off factor with a number of additional qualitative factors that are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors, which are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources, are: (a) national and local economic trends and conditions; (b) levels of and trends in delinquency rates and non-accrual loans; (c) trends in volumes and terms of loans; (d) effects of changes in lending policies; (e) experience, ability, and depth of lending staff; (f) value of underlying collateral; and (g) concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Residential mortgage and consumer loans are charged off after they are 120 days contractually past due. All other loans are charged off based on an evaluation of the facts and circumstances of each individual loan. When the Bank believes that its ability to collect is solely dependent on the liquidation of the collateral, a full or partial charge-off is recorded promptly to bring the recorded investment to an amount that the Bank believes is supported by an ability to collect on the collateral. The circumstances that may impact the Bank's decision to charge-off all or a portion of a loan include default or non-payment by the borrower, scheduled foreclosure actions, and/or prioritization of the Bank's claim in bankruptcy. There may be circumstances where, due to pending events, the Bank will place a specific allocation of the ALL on a loan for which a partial charge-off has been previously recognized. This specific allocation may be either charged off or removed depending upon the outcome of the pending event. Full or partial charge-offs are not recovered until full principal and interest on the loan have been collected, even if a subsequent appraisal supports a higher value. Loans with partial charge-offs generally remain in non-accrual status. Both full and partial charge-offs reduce the recorded investment of the loan and the ALL and are considered to be charge-offs for purposes of all credit loss metrics and trends, including the historical rolling charge-off rates used in the determination of the ALL.

The following tables present the activity in the ALL for the six- and three-month periods ended June 30, 2019 and 2018:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at January 1, 2019	$ 2,780	$ 1,721	$ 1,187	$ 4,544	$ 315	$ 500	$ 11,047
Charge-offs	—	(29)	(5)	(86)	(136)	—	(256)
Recoveries	30	111	76	195	91	—	503
Provision	(75)	1,491	(111)	(672)	49	—	682
ALL balance at June 30, 2019	$ 2,735	$ 3,294	$ 1,147	$ 3,981	$ 319	$ 500	$ 11,976
ALL balance at January 1, 2018	$ 3,699	$ 1,257	$ 869	$ 3,444	$ 203	$ 500	$ 9,972
Charge-offs	(889)	(98)	(10)	(240)	(175)	—	(1,412)
Recoveries	60	258	31	65	79	—	493
Provision	433	(245)	(104)	475	157	—	716
ALL balance at June 30, 2018	$ 3,303	$ 1,172	$ 786	$ 3,744	$ 264	$ 500	$ 9,769

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at April 1, 2019	$ 2,775	$ 2,338	$ 1,125	$ 4,497	$ 313	$ 500	$ 11,548
Charge-offs	—	—	(5)	(74)	(68)	—	(147)
Recoveries	1	99	25	87	30	—	242
Provision	(41)	857	2	(529)	44	—	333
ALL balance at June 30, 2019	$ 2,735	$ 3,294	$ 1,147	$ 3,981	$ 319	$ 500	$ 11,976
ALL balance at April 1, 2018	$ 3,976	$ 1,160	$ 860	$ 3,678	$ 296	$ 500	10,470
Charge-offs	(889)	(7)	(10)	(86)	(107)	—	(1,099)
Recoveries	1	44	13	27	44	—	129
Provision	215	(25)	(77)	125	31	—	269
ALL balance at June 30, 2018	$ 3,303	$ 1,172	$ 786	$ 3,744	$ 264	$ 500	$ 9,769

The ALL is based on estimates, and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following table presents the average recorded investment in impaired loans by class and related interest income recognized for the periods indicated:

(in thousands)	Six months ended June 30, 2019 Average investment	Six months ended June 30, 2019 Interest income recognized on an accrual basis	Six months ended June 30, 2019 Interest income recognized on a cash basis	Six months ended June 30, 2018 Average investment	Six months ended June 30, 2018 Interest income recognized on an accrual basis	Six months ended June 30, 2018 Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$ 270	$ 6	$ —	$ 813	$ 7	$ 66
All other CRE	4,853	76	—	6,625	99	56
Acquisition and development						
1-4 family residential construction	310	9	—	457	12	—
All other A&D	5,306	6	—	276	6	—
Commercial and industrial	24	—	—	305	10	—
Residential mortgage						
Residential mortgage – term	3,261	53	10	3,487	62	—
Residential mortgage – home equity	854	—	2	553	—	7
Consumer	14	—	—	23	—	—
Total	$ 14,892	$ 150	$ 12	$ 12,539	$ 196	$ 129

(in thousands)	Three months ended June 30, 2019 Average investment	Three months ended June 30, 2019 Interest income recognized on an accrual basis	Three months ended June 30, 2019 Interest income recognized on a cash basis	Three months ended June 30, 2018 Average investment	Three months ended June 30, 2018 Interest income recognized on an accrual basis	Three months ended June 30, 2018 Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$ 258	$ 3	$ —	$ 1,258	$ 3	$ —
All other CRE	4,807	38	—	5,726	50	—
Acquisition and development						
1-4 family residential construction	307	4	—	492	6	—
All other A&D	7,772	3	—	340	3	—
Commercial and industrial	27	—	—	311	5	—
Residential mortgage						
Residential mortgage – term	2,941	25	2	3,529	30	—
Residential mortgage – home equity	925	—	2	614	—	—
Consumer	16	—	—	24	—	—
Total	$ 17,053	$ 73	$ 4	$ 12,294	$ 97	$ —

The Bank modifies loan terms in the normal course of business. Among other reasons, modifications might be made in an effort to retain the loan relationship, to remain competitive in the current interest rate environment and/or to re-amortize or extend the loan's term to better match the loan's payment stream with the borrower's cash flow. A modified loan is considered to be a troubled debt restructuring ("TDR") when the Bank has determined that the borrower is troubled (i.e., experiencing financial difficulties). The Bank evaluates the probability that the borrower will be in payment default on any of its debt obligations in the foreseeable future without modification. To make this determination, the Bank performs a global financial review of the borrower and loan guarantors to assess their current ability to meet their financial obligations.

When the Bank restructures a loan to a troubled borrower, the loan terms (i.e., interest rate, payment amount, amortization period, and/or maturity date) are modified in such a way as to enable the borrower to cover the modified debt service payments based on current financials and cash flow adequacy. If a borrower's hardship is thought to be temporary, then modified terms are offered only for that time period. Where possible, the Bank obtains additional collateral and/or secondary payment sources at the time the loan is restructured in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. To date, the Bank has not forgiven any principal as a restructuring concession. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default.

All loans designated as TDRs are considered impaired loans and may be in either accruing or non-accruing status. The Bank's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition. Accordingly, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. If the loan was accruing at the time of the modification, then it continues to be in accruing status subsequent to the modification. Non-accrual TDRs may return to accruing status when there has been sufficient payment performance for a period of at least six months. TDRs are considered to be in payment default if, subsequent to modification, the loans are transferred to non-accrual status or to foreclosure. Loans may be removed from being reported as a TDR in the calendar year following the modification if the interest rate at the time of modification was consistent with the interest rate for a loan with comparable credit risk and the loan has performed according to its modified terms for at least six months.

The volume and type of TDR activity is considered in the assessment of the local economic trends' qualitative factor used in the determination of the ALL for loans that are evaluated collectively for impairment.

There were 13 loans totaling $4.0 million and 16 loans totaling $4.9 million that were classified as TDRs at June 30, 2019 and December 31, 2018, respectively. The following tables present the volume and recorded investment at that time of modification of TDRs by class and type of modification that occurred during the periods indicated:

	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
(in thousands)	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Six months ended June 30, 2019						
Commercial real estate						
Non owner-occupied	—	$ —	—	$ —	—	$ —
All other CRE	—	—	—	—	—	—
Acquisition and development						
1-4 family residential construction	—	—	—	—	—	—
All other A&D	—	—	—	—	1	227
Commercial and industrial	—	—	—	—	—	—
Residential mortgage						
Residential mortgage – term	—	—	—	—	1	243
Residential mortgage – home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	—	$ —	—	$ —	2	$ 470

	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
(in thousands)	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Six months ended June 30, 2018						
Commercial real estate						
Non owner-occupied	—	$ —	—	$ —	1	$ 126
All other CRE	—	—	1	179	—	—
Acquisition and development						
1-4 family residential construction	—	—	—	—	—	—
All other A&D	—	—	—	—	—	—
Commercial and industrial	—	—	—	—	—	—
Residential mortgage						
Residential mortgage – term	—	—	—	—	—	—
Residential mortgage – home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	—	$ —	1	$ 179	1	$ 126

During the six months ended June 30, 2019, there were no new TDRs but two existing TDRs that had reached their modification maturity dates were re-modified. These re-modifications did not impact the ALL. During the six months ended June 30, 2019, there were no payment defaults.

During the six months ended June 30, 2018, there were no new TDRs but two existing TDRs that had reached their modification maturity dates were re-modified. These re-modifications did not impact the ALL. During the six months ended June 30, 2018, there were no payment defaults.

(in thousands)	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Three months ended June 30, 2018						
Commercial real estate						
Non owner-occupied	—	$ —	—	$ —	1	$ 126
All other CRE	—	—	1	179	—	—
Acquisition and development						
1-4 family residential construction	—	—	—	—	—	—
All other A&D	—	—	—	—	—	—
Commercial and industrial	—	—	—	—	—	—
Residential mortgage						
Residential mortgage – term	—	—	—	—	—	—
Residential mortgage – home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	—	$ —	1	$ 179	1	$ 126

During the three months ended June 30, 2019, there were no new TDRs, no modifications on existing TDRs and no payment defaults.

During the three months ended June 30, 2018, there were no new TDRs but two existing TDRs that had reached their modification maturity dates were re-modified. These re-modifications did not impact the ALL. During the second quarter of 2018, there were no payment defaults.

Note 6 - Other Real Estate Owned

The following table presents the components of other real estate owned ("OREO") at June 30, 2019 and December 31, 2018:

(in thousands)	June 30, 2019	December 31, 2018
Commercial real estate	$ 1,902	$ 2,599
Acquisition and development	2,598	3,218
Commercial and industrial	—	24
Residential mortgage	1,031	757
Total OREO	$ 5,531	$ 6,598

The following table presents the activity in the OREO valuation allowance for the six- and three-month periods ended June 30, 2019 and 2018:

(in thousands)	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018
Balance beginning of period	$ 1,988	$ 2,740	$ 1,366	$ 2,911
Fair value write-down	828	478	711	183
Sales of OREO	(803)	(271)	(64)	(147)
Balance at end of period	$ 2,013	$ 2,947	$ 2,013	$ 2,947

The following table presents the components of OREO expenses, net, for the six- and three-month periods ended June 30, 2019 and 2018:

(in thousands)	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018	Three Months Ended June 30, 2019	Three Months Ended June 30, 2018
(Gains)/losses on real estate, net	$ (11)	$ (183)	$ 19	$ (163)
Fair value write-down, net	828	478	711	183
Expenses, net	166	272	91	124
Rental and other income	(54)	(74)	(35)	(36)
Total OREO expense, net	$ 929	$ 493	$ 786	$ 108

Note 7 – Fair Value of Financial Instruments

The Corporation complies with the guidance of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. The Corporation also follows the guidance on matters relating to all financial instruments found in ASC Subtopic 825-10, *Financial Instruments – Overall*.

Fair value is defined as the price to sell an asset or to transfer a liability in an orderly transaction between willing market participants as of the measurement date. Fair value is best determined by values quoted through active trading markets. Active trading markets are characterized by numerous transactions of similar financial instruments between willing buyers and willing sellers. Because no active trading market exists for various types of financial instruments, many of the fair values disclosed were derived using present value discounted cash flows or other valuation techniques described below. As a result, the Corporation's ability to actually realize these derived values cannot be assumed.

The Corporation measures fair values based on the fair value hierarchy established in ASC Paragraph 820-10-35-37. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of inputs that may be used to measure fair value under the hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities. This level is the most reliable source of valuation.

Level 2: Quoted prices that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability. Level 2 inputs include inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates). It also includes inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs). Several sources are utilized for valuing these assets, including a contracted valuation service, Standard & Poor's ("S&P") evaluations and pricing services, and other valuation matrices.

Level 3: Prices or valuation techniques that require inputs that are both significant to the valuation assumptions and not readily observable in the market (i.e. supported with little or no market activity). Level 3 instruments are valued based on the best available data, some of which is internally developed, and consider risk premiums that a market participant would require.

The level established within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Transfers in and out of Level 1, 2 or 3 are recorded at fair value at the beginning of the reporting period.

Management believes that the Corporation's valuation techniques are appropriate and consistent with the techniques used by other market participants. However, the use of different methodologies and assumptions could result in a different estimate of fair values at the reporting date. The valuation techniques used by the Corporation to measure, on a recurring and non-recurring basis, the fair value of assets as of June 30, 2019 are discussed in the paragraphs that follow.

Investments – The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*.

The fair value of investments is determined using a market approach. As of June 30, 2019, the U.S. Government agencies, residential and commercial mortgage-backed securities, collateralized mortgage obligations, and state and political subdivisions bonds, excluding the TIF bonds, segments are classified as Level 2 within the valuation hierarchy. Their fair values were determined based upon market-corroborated inputs and valuation matrices, which were obtained through third party data service providers or securities brokers through which the Corporation has historically transacted both purchases and sales of investment securities. The TIF bonds are classified as Level 3 within the valuation hierarchy as they are not openly traded.

The CDO segment, which consists of pooled trust preferred securities issued by banks, thrifts and insurance companies, is classified as Level 3 within the valuation hierarchy. At June 30, 2019, the Corporation owned nine pooled trust preferred securities with an amortized cost of $18.4 million and a fair value of $14.9 million. As of June 30, 2019, the market for these securities is not active and the markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as few CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities or any securities other than those issued or guaranteed by the U.S. Department of the Treasury (the "Treasury") are depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (a) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at June 30, 2019, (b) an income valuation approach technique (i.e. present value) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than a market approach, and (c) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management relies on an independent third party to prepare both the evaluations of OTTI as well as the fair value determinations for its CDO portfolio. Management believes that the valuations are adequately reflected at June 30, 2019.

The approach used by the third party to determine fair value involved several steps, which included detailed credit and structural evaluation of each piece of collateral in each bond, projection of default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities, with a limited market for highly-rated CDO securities that are more senior in the capital structure than the securities in the CDO portfolio. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

Derivative financial instruments (Cash flow hedge) – The Corporation's open derivative positions are interest rate swap agreements. Those classified as Level 2 open derivative positions are valued using externally developed pricing models based on observable market inputs provided by a third party and validated by management. The Corporation has considered counterparty credit risk in the valuation of its interest rate swap assets.

Impaired loans – Loans included in the table below are those that are considered impaired with a specific allocation or with a partial charge-off, based upon the guidance of the loan impairment subsection of the *Receivables* Topic, ASC Section 310-10-35, under which the Corporation has measured impairment generally based on the fair value of the loan's collateral. Fair value consists of the loan balance less its valuation allowance and is generally determined based on independent third-party appraisals of the collateral or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values based upon the lowest level of input that is significant to the fair value measurements.

Other real estate owned – OREO included in the table below are considered impaired with specific write-downs. Fair value of other real estate owned is based on independent third-party appraisals of the properties. These values were determined based on the sales prices of similar properties in the approximate geographic area. These assets are included as Level 3 fair values based upon the lowest level of input that is significant to the fair value measurements.

For Level 3 assets and liabilities measured at fair value on a recurring and non-recurring basis as of June 30, 2019 and December 31, 2018, the significant unobservable inputs used in the fair value measurements were as follows:

(in thousands)		Fair Value at June 30, 2019	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Recurring:					
Investment Securities – available for sale	$	14,872	Discounted Cash Flow	Discount Rate	Range of LIBOR+ 4.50%
Non-recurring:					
Impaired Loans	$	7,234	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 12.8%)
Other Real Estate Owned	$	2,949	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 12.4%)

(in thousands)		Fair Value at December 31, 2018	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Recurring:					
Investment Securities – available for sale	$	15,277	Discounted Cash Flow	Discount Rate	Range of LIBOR+ 4.50%
Non-recurring:					
Impaired Loans	$	1,316	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 12.8%)
Other Real Estate Owned	$	2,707	Market Comparable Properties	Marketability Discount	10.0% - 15.0% (1) (weighted avg 13.5%)

NOTE:

(1) Range would include discounts taken since appraisal and estimated values

For assets measured at fair value on a recurring and non-recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2019 and December 31, 2018 are as follows:

		Fair Value Measurements at June 30, 2019 Using		
(in thousands)	**Assets Measured at Fair Value 06/30/2019**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Recurring:				
Investment securities available-for-sale:				
U.S. government agencies	$ 29,833		$ 29,833	
Commercial mortgage-backed agencies	$ 42,346		$ 42,346	
Collateralized mortgage obligations	$ 34,127		$ 34,127	
Obligations of states and political subdivisions	$ 14,631		$ 14,631	
Collateralized debt obligations	$ 14,872			$ 14,872
Financial Derivatives	$ (55)		$ (55)	
Non-recurring:				
Impaired loans	$ 7,234			$ 7,234
Other real estate owned	$ 2,949			$ 2,949

		Fair Value Measurements at December 31, 2018 Using		
(in thousands)	**Assets Measured at Fair Value 12/31/2018**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Recurring:				
Investment securities available-for-sale:				
U.S. government agencies	$ 29,026		$ 29,026	
Commercial mortgage-backed agencies	$ 37,752		$ 37,752	
Collateralized mortgage obligations	$ 35,704		$ 35,704	
Obligations of states and political subdivisions	$ 19,882		$ 19,882	
Collateralized debt obligations	$ 15,277			$ 15,277
Financial Derivative	$ 1,043		$ 1,043	
Non-recurring:				
Impaired loans	$ 1,316			$ 1,316
Other real estate owned	$ 2,707			$ 2,707

There were no transfers of assets between any of the fair value hierarchy for the six-month periods ended June 30, 2019 or 2018.

The following tables show a reconciliation of the beginning and ending balances for fair valued assets measured on a recurring basis using Level 3 significant unobservable inputs for the six and three-month periods ended June 30, 2019 and 2018:

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
(in thousands)		**Investment Securities Available for Sale**
Beginning balance January 1, 2019	$	15,277
Total losses realized/unrealized:		
Included in other comprehensive income		(405)
Ending balance June 30, 2019	$	14,872

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
(in thousands)		**Investment Securities Available for Sale**
Beginning balance January 1, 2018	$	14,920
Total gains realized/unrealized:		
Included in other comprehensive income		1,227
Ending balance June 30, 2018	$	16,147

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
(in thousands)		**Investment Securities Available for Sale**
Beginning balance April 1, 2019	$	15,152
Total losses realized/unrealized:		
Included in other comprehensive income		(280)
Ending balance June 30, 2019	$	14,872

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
(in thousands)		**Investment Securities Available for Sale**
Beginning balance April 1, 2018	$	15,977
Total gains realized/unrealized:		
Included in other comprehensive income		170
Ending balance June 30, 2018	$	16,147

Gains/losses (realized and unrealized) included in earnings for the periods identified above are reported in the Consolidated Statement of Operations in Other Operating Income. There were no gains or losses included in earnings attributable to the change in realized/unrealized gains or losses related to the assets for the six- and three-month periods ended June 30, 2019 and 2018.

The disclosed fair values may vary significantly between institutions based on the estimates and assumptions used in the various valuation methodologies. The derived fair values are subjective in nature and involve uncertainties and significant judgment. Therefore, they cannot be determined with precision. Changes in the assumptions could significantly impact the derived estimates of fair value. Disclosure of non-financial assets such as buildings as well as certain financial instruments such as leases is not required. Accordingly, the aggregate fair values presented do not represent the underlying value of the Corporation.

The following tables present fair value information about financial instruments, whether or not recognized in the Consolidated Statement of Financial Condition, for which it is practicable to estimate that value. The actual carrying amounts and estimated fair values of the Corporation's financial instruments that are included in the Consolidated Statement of Financial Condition are as follows:

	June 30, 2019		Fair Value Measurements		
(in thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Cash and due from banks	$ 38,584	$ 38,584	$ 38,584		
Interest bearing deposits in banks	405	405	405		
Investment securities - AFS	135,809	135,809		$ 120,937	$ 14,872
Investment securities - HTM	97,499	102,503		83,609	18,894
Restricted bank stock	4,415	4,415		4,415	
Loans, net	991,640	976,051			976,051
Accrued interest receivable	4,083	4,083		4,083	
Financial Liabilities:					
Deposits - non-maturity	861,832	861,832		861,832	
Deposits - time deposits	261,249	262,533		262,533	
Financial derivatives	55	55		55	
Short-term borrowed funds	31,155	31,155		31,155	
Long-term borrowed funds	100,929	103,214		103,214	
Accrued interest payable	503	503		503	

	December 31, 2018		Fair Value Measurements		
(in thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Cash and due from banks	$ 22,187	$ 22,187	$ 22,187		
Interest bearing deposits in banks	1,354	1,354	1,354		
Investment securities - AFS	137,641	137,641		$ 122,364	$ 15,277
Investment securities - HTM	94,010	93,760		80,780	12,980
Restricted bank stock	5,394	5,394		5,394	
Loans, net	996,667	967,198			967,198
Financial derivative	1,043	1,043		1,043	
Accrued interest receivable	4,175	4,175		4,175	
Financial Liabilities:					
Deposits - non-maturity	815,858	815,858		815,858	
Deposits - time deposits	251,669	252,146		252,146	
Short-term borrowed funds	77,707	77,707		77,707	
Long-term borrowed funds	100,929	102,590		102,590	
Accrued interest payable	455	455		455	

Note 8 – Accumulated Other Comprehensive Loss

The following table presents the changes in each component of accumulated other comprehensive loss for the 12 months ended December 31, 2018 and the three-month periods ended March 31, 2019 and June 30, 2019:

(in thousands)	Investment securities-with OTTI AFS	Investment securities-all other AFS	Investment securities-HTM	Cash Flow Hedge	Pension Plan	SERP	Total
Accumulated OCL, net:							
Balance – January 1, 2018	$ (2,939)	$ (2,979)	$ (1,347)	$ 582	$ (17,066)	$ (844)	$ (24,593)
Other comprehensive income/(loss) before reclassifications	1,194	(540)	—	191	(1,833)	202	(786)
Amounts reclassified from accumulated other comprehensive loss	(154)	(82)	216	—	882	114	976
Balance – December 31, 2018	$ (1,899)	$ (3,601)	$ (1,131)	$ 773	$ (18,017)	$ (528)	$ (24,403)
Other comprehensive income/(loss) before reclassifications	(44)	901	—	(315)	1,933	—	2,475
Amounts reclassified from accumulated other comprehensive loss	(36)	4	55	—	196	21	240
Balance - March 31, 2019	$ (1,979)	$ (2,696)	$ (1,076)	$ 458	$ (15,888)	$ (507)	$ (21,688)
Other comprehensive income/(loss) before reclassifications	(157)	1,581	—	(486)	511	—	1,449
Amounts reclassified from accumulated other comprehensive loss	(37)	(4)	63	—	196	21	239
Balance - June 30, 2019	$ (2,173)	$ (1,119)	$ (1,013)	$ (28)	$ (15,181)	$ (486)	$ (20,000)

The following tables present the components of other comprehensive income/(loss) for the six- and three-month periods ended June 30, 2019 and 2018:

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the Six months ended June 30, 2019			
Available for sale (AFS) securities with OTTI:			
Unrealized holding losses	$ (276)	$ 75	$ (201)
Less: accretable yield recognized in income	99	(26)	73
Net unrealized losses on investments with OTTI	(375)	101	(274)
Available for sale securities – all other:			
Unrealized holding gains	3,405	(923)	2,482
Net unrealized gains on all other AFS securities	3,405	(923)	2,482
Held to maturity securities:			
Unrealized holding gains	—	—	—
Less: amortization recognized in income	(161)	43	(118)
Net unrealized gains on HTM securities	161	(43)	118
Cash flow hedges:			
Unrealized holding losses	(1,098)	297	(801)
Pension Plan:			
Unrealized net actuarial gain	3,353	(909)	2,444
Less: amortization of unrecognized loss	(538)	146	(392)
Net pension plan liability adjustment	3,891	(1,055)	2,836
SERP:			
Unrealized net actuarial loss	—	—	—
Less: amortization of unrecognized loss	(58)	15	(43)
Less: amortization of prior service costs	1	—	1
Net SERP liability adjustment	57	(15)	42
Other comprehensive income	$ 6,041	$ (1,638)	$ 4,403

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the Six months ended June 30, 2018			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 2,432	$ (658)	$ 1,774
Less: gains recognized in income	145	(39)	106
Less: accretable yield recognized in income	107	(29)	78
Net unrealized gains on investments with OTTI	2,180	(590)	1,590
Available for sale securities – all other:			
Unrealized holding losses	(1,812)	490	(1,322)
Less: losses recognized in income	(19)	5	(14)
Net unrealized losses on all other AFS securities	(1,793)	485	(1,308)
Held to maturity securities:			
Unrealized holding gains	—	—	—
Less: amortization recognized in income	(114)	31	(83)
Net unrealized gains on HTM securities	114	(31)	83
Cash flow hedges:			
Unrealized holding gains	755	(204)	551
Pension Plan:			
Unrealized net actuarial loss	(1,692)	457	(1,235)
Less: amortization of unrecognized loss	(600)	162	(438)
Less: amortization of prior service costs	(4)	1	(3)
Net pension plan liability adjustment	(1,088)	294	(794)
SERP:			
Less: amortization of unrecognized loss	(81)	22	(59)
Less: amortization of prior service costs	1	—	1
Net SERP liability adjustment	80	(22)	58
Other comprehensive income	$ 248	$ (68)	$ 180

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the Three months ended June 30, 2019			
Available for sale (AFS) securities with OTTI:			
Unrealized holding losses	$ (216)	$ 59	$ (157)
Less: accretable yield recognized in income	50	(13)	37
Net unrealized losses on investments with OTTI	(266)	72	(194)
Available for sale securities – all other:			
Unrealized holding gains	2,169	(588)	1,581
Less: gains recognized in income	6	(2)	4
Net unrealized gains on all other AFS securities	2,163	(586)	1,577
Held to maturity securities:			
Unrealized holding gains	—	—	—
Less: amortization recognized in income	(86)	23	(63)
Net unrealized gains on HTM securities	86	(23)	63
Cash flow hedges:			
Unrealized holding losses	(666)	180	(486)
Pension Plan:			
Unrealized net actuarial gain	701	(190)	511
Less: amortization of unrecognized loss	(269)	73	(196)
Net pension plan liability adjustment	970	(263)	707
SERP:			
Unrealized net actuarial loss	—	—	—
Less: amortization of unrecognized loss	(29)	8	(21)
Net SERP liability adjustment	29	(8)	21
Other comprehensive income	$ 2,316	$ (628)	$ 1,688

Components of Other Comprehensive Loss (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the Three months ended June 30, 2018			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 1,493	$ (404)	$ 1,089
Less: gains recognized in income	145	(39)	106
Less: accretable yield recognized in income	52	(14)	38
Net unrealized gains on investments with OTTI	1,296	(351)	945
Available for sale securities – all other:			
Unrealized holding losses	(325)	88	(237)
Less: losses recognized in income	(10)	3	(7)
Net unrealized losses on all other AFS securities	(315)	85	(230)
Held to maturity securities:			
Unrealized holding gains	—	—	—
Less: amortization recognized in income	(52)	14	(38)
Net unrealized gains on HTM securities	52	(14)	38
Cash flow hedges:			
Unrealized holding gains	148	(40)	108
Pension Plan:			
Unrealized net actuarial loss	(2,399)	648	(1,751)
Less: amortization of unrecognized loss	(300)	81	(219)
Less: amortization of prior service costs	(2)	—	(2)
Net pension plan liability adjustment	(2,097)	567	(1,530)
SERP:			
Unrealized net actuarial loss	—	—	—
Less: amortization of unrecognized loss	(40)	11	(29)
Net SERP liability adjustment	40	(11)	29
Other comprehensive loss	$ (876)	$ 236	$ (640)

The following table presents the details of amount reclassified from accumulated other comprehensive loss for the six- and three-month periods ended June 30, 2019 and 2018:

Amounts Reclassified from Accumulated Other Comprehensive Loss (in thousands)	Six Months Ended June 30, 2019	2018	Affected Line Item in the Statement Where Net Income is Presented
Net unrealized gains on available for sale investment securities with OTTI:			
Gains on calls	$ —	$ 145	Net gains
Accretable yield	99	107	Interest income on taxable investment securities
Taxes	(26)	(68)	Provision for income tax expense
	$ 73	$ 184	Net of tax
Net unrealized losses on available for sale investment securities - all others:			
Losses on sales	$ —	$ (19)	Net gains
Taxes	—	5	Provision for income tax expense
	$ —	$ (14)	Net of tax
Net unrealized losses on held to maturity securities:			
Amortization	$ (161)	$ (114)	Interest income on taxable investment securities
Taxes	43	31	Provision for income tax expense
	$ (118)	$ (83)	Net of tax
Net pension plan liability adjustment:			
Amortization of unrecognized loss	$ (538)	$ (600)	Other Expense
Amortization of prior service costs	—	(4)	Salaries and employee benefits
Taxes	146	163	Provision for income tax expense
	$ (392)	$ (441)	Net of tax
Net SERP liability adjustment:			
Amortization of unrecognized loss	$ (58)	$ (81)	Other Expense
Amortization of prior service costs	1	1	Salaries and employee benefits
Taxes	15	22	Provision for income tax expense
	$ (42)	$ (58)	Net of tax
Total reclassifications for the period	$ (479)	$ (412)	Net of tax

Amounts Reclassified from Accumulated Other Comprehensive Loss (in thousands)	Three Months Ended June 30, 2019	2018	Affected Line Item in the Statement Where Net Income is Presented
Net unrealized gains on available for sale investment securities with OTTI:			
Gains on calls	$ —	$ 145	Net gains
Accretable Yield	$ 50	$ 52	Interest income on taxable investment securities
Taxes	(13)	(53)	Provision for Income Tax Expense
	$ 37	$ 144	Net of tax
Net unrealized gains/(losses) on available for sale investment securities - all others:			
Gains/(losses) on sales	$ 6	$ (10)	Net gains
Taxes	(2)	3	Provision for Income Tax Expense
	$ 4	$ (7)	Net of tax
Net unrealized losses on held to maturity securities:			
Amortization	$ (86)	$ (52)	Interest income on taxable investment securities
Taxes	23	14	Provision for Income Tax Expense
	$ (63)	$ (38)	Net of tax
Net pension plan liability adjustment:			
Amortization of unrecognized loss	$ (269)	$ (300)	Salaries and employee benefits
Amortization of prior service costs	—	(2)	Salaries and employee benefits
Taxes	73	81	Provision for Income Tax Expense
	$ (196)	$ (221)	Net of tax
Net SERP liability adjustment:			
Amortization of unrecognized loss	$ (29)	$ (41)	Salaries and employee benefits
Taxes	8	11	Provision for Income Tax Expense
	$ (21)	$ (30)	Net of tax
Total reclassifications for the period	$ (239)	$ (152)	Net of tax

Note 9 – Leases

On January 1, 2019, the Corporation adopted Accounting Standards Update (“ASU”) 2016-02, “Leases” (Topic 842) and all subsequent ASUs that modified Topic 842. The adoption of Topic 842 affected the accounting treatment for operating lease agreements in which the Corporation is the lessee.

Lessee Accounting

Substantially all of the leases in which the Corporation is the lessee are comprised of real estate property for branches, ATM locations, and office equipment with terms extending through 2030. All of the Corporation’s leases are now classified as operating leases and, therefore, were previously not recognized on the Corporation’s Consolidated Statement of Financial Condition. With the adoption of Topic 842, operating lease agreements are required to be recognized on the Consolidated Statement of Financial Condition as a right-of-use (“ROU”) asset and a corresponding lease liability.

The following table represents the Consolidated Statement of Financial Condition classification of the Corporation’s ROU assets and lease liabilities. The Corporation elected not to include short-term leases (i.e., leases with remaining terms of 12 months or less), or equipment leases that were deemed immaterial on the Consolidated Statement of Financial Condition.

(in thousands)	June 30, 2019
Lease Right-of Use Assets	
Operating lease right-of-use assets	$ 2,594
Lease Liabilities	
Operating lease liabilities	$ 3,177

In calculating the present value of the lease payments, the Corporation has utilized its incremental borrowing rate based on electing the original lease term to account for each lease component.

The following table presents the weighted-average lease term and discount rate for operating leases at June 30, 2019:

	June 30, 2019
Weighted-average remaining lease term	
Operating leases	8.81 years
Weighted-average discount rate	
Operating leases	5.09%

The Corporation elected, for all classes of underlying assets, to separate lease and non-lease components. Total operating lease expense for the six months ended June 30, 2019 was $.2 million. Short-term lease expense was $37 thousand for the six months ended June 30, 2019. Total operating lease expense for the second quarter of 2019 was $.1 million. Short-term lease expense was $13 thousand for the second quarter of 2019.

Future minimum payments for operating leases with initial or remaining terms of one year or more at June 30, 2019 were as follows:

(in thousands)	Operating Leases
2019 (remainder of year)	$ 229
2020	467
2021	466
2022	459
2023	393
Thereafter	1,983
Total future minimum lease payments	3,997
Amounts representing interest	(820)
Present value of net future minimum lease payments	$ 3,177

Note 10 –Borrowed Funds

The following is a summary of short-term borrowings with original maturities of less than one year:

(Dollars in thousands)	Six Months Ended June 30, 2019	Year Ended December 31, 2018
Short-term Correspondent Bank Advance:		
Overnight borrowings, weighted average interest rate of 2.70% at December 31, 2018	$ —	$ 40,000
Securities sold under agreements to repurchase:		
Outstanding at end of period	$ 31,155	$ 37,707
Weighted average interest rate at end of period	0.35%	0.24%
Maximum amount outstanding as of any month end	$ 40,579	$ 55,648
Average amount outstanding	$ 37,218	$ 44,045
Approximate weighted average rate during the period	0.29%	0.20%

At June 30, 2019, the repurchase agreements were secured by $45.0 million in investment securities issued by government related agencies. A minimum of 102% of fair value is pledged against account balances.

At June 30, 2019, the long-term FHLB advances were secured by $214.0 million in loans.

Note 11 – Employee Benefit Plans

The following tables present the components of the net periodic pension plan cost for First United Corporation's noncontributory Defined Benefit Pension Plan (the "Pension Plan") and the Bank's Defined Benefit Supplemental Executive Retirement Plan ("Defined Benefit SERP") for the periods indicated:

Pension	**Six Months Ended June 30,**		**Three Months Ended June 30,**	
(in thousands)	**2019**	**2018**	**2019**	**2018**
Service cost	$ 133	$ 162	$ 66	$ 81
Interest cost	874	793	437	396
Expected return on assets	(1,528)	(1,620)	(764)	(810)
Amortization of net actuarial loss	538	600	269	300
Amortization of prior service cost	—	4	—	2
Net pension expense/(credit) included in employee benefits and other expense	$ 17	$ (61)	$ 8	$ (31)

Defined Benefit SERP	**Six Months Ended June 30,**		**Three Months Ended June 30,**	
(in thousands)	**2019**	**2018**	**2019**	**2018**
Service cost	$ 47	$ 56	$ 23	$ 28
Interest cost	165	150	83	75
Amortization of recognized loss	58	81	29	41
Amortization of prior service cost	(1)	(1)	—	—
Net Defined Benefit SERP expense included in employee benefits and other expense	$ 269	$ 286	$ 135	$ 144

The service cost component of net periodic benefit cost is included in salaries and benefits and all other components of net periodic benefit cost are included in other noninterest expense in the Consolidated Statement of Operations for the Corporation's Pension and Defined Benefit SERP plans.

The Pension Plan is a noncontributory defined benefit pension plan that covers our employees who were hired prior to the freeze and others who were grandfathered into the plan. The benefits are based on years of service and the employees' compensation during the last five years of employment.

Effective April 30, 2010, the Pension Plan was amended, resulting in a "soft freeze", the effect of which prohibits new entrants into the plan and ceases crediting of additional years of service after that date. Effective January 1, 2013, the Pension Plan was amended to unfreeze it for those employees for whom the sum of their (a) ages, at their closest birthday plus (b) years of service for vesting purposes equals 80 or greater. The "soft freeze" continues to apply to all other plan participants. Pension benefits for these participants are managed through discretionary contributions to the First United Corporation 401(k) Profit Sharing Plan (the "401(k) Plan").

The Bank established the Defined Benefit SERP in 2001 as an unfunded supplemental executive retirement plan. The Defined Benefit SERP is available only to a select group of management or highly compensated employees to provide supplemental retirement benefits in excess of limits imposed on qualified plans by federal tax law. Concurrent with the establishment of the Defined Benefit SERP, the Bank acquired Bank Owned Life Insurance ("BOLI") policies on the senior management personnel and officers of the Bank. The benefits resulting from the favorable tax treatment accorded the earnings on the BOLI policies are intended to provide a source of funds for the future payment of the Defined Benefit SERP benefits as well as other employee benefit costs.

The benefit obligation activity for both the Pension Plan and Defined Benefit SERP was calculated using an actuarial measurement date of January 1. Plan assets and the benefit obligations were calculated using an actuarial measurement date of December 31.

The Corporation will assess the need for future annual contributions to the pension plan based upon its funded status and an evaluation of the future benefits to be provided thereunder. A contribution of $2.0 million was made to the pension plan during the first six months of 2019. The Corporation expects to fund the annual projected benefit payments for the Defined Benefit SERP from operations.

On January 9, 2015, First United Corporation and members of management who do not participate in the Defined Benefit SERP entered into participation agreements under the Deferred Compensation Plan, each styled as a Defined Contribution SERP Agreement (the "Contribution Agreement"). Pursuant to each Contribution Agreement, First United Corporation agreed, for each Plan Year (as defined in the Deferred Compensation Plan) in which it determines that it has been Profitable (as defined in the Contribution Agreement), to make a discretionary contribution to the participant's Employer Account in an amount equal to 15% of the participant's base salary level for such Plan Year, with the first Plan Year being the year ending December 31, 2015. The Contribution Agreement provides that the participant will become 100% vested in the amount maintained in his or her Employer Account upon the earliest to occur of the following events: (a) Normal Retirement (as defined in the Contribution Agreement); (b) Separation from Service (as defined in the Contribution Agreement) following a Change of Control (as defined in the Deferred Compensation Plan) and subsequent Triggering Event (as defined in the Contribution Agreement); (c) Separation from Service due to a Disability (as defined in the Contribution Agreement); (d) with respect to a particular award of Employer Contribution Credits, the participant's completion of two consecutive Years of Service (as defined in the Contribution Agreement) immediately following the Plan Year for which such award was made; or (e) death. Notwithstanding the foregoing, however, a participant will lose entitlement to the amount maintained in his or her Employer Account in the event employment is terminated for Cause (as defined in the Contribution Agreement). In addition, the Contribution Agreement conditions entitlement to the amounts held in the Employer Account on the participant (1) refraining from engaging in Competitive Employment (as defined in the Contribution Agreement) for three years following his or her Separation from Service, (2) refraining from injurious disclosure of confidential information concerning the Corporation, and (3) remaining available, at the First United Corporation's reasonable request, to provide at least six hours of transition services per month for 12 months following his or her Separation from Service (except in the case of death or Disability), except that only item (2) will apply in the event of a Separation from Service following a Change of Control and subsequent Triggering Event.

In January 2017, the Board of Directors approved discretionary contributions to four participants totaling $112,780. The contributions had a two-year vesting period that ended on December 31, 2018. In January 2018, the Board approved discretionary contributions to four participants totaling $119,252. The contributions have a two-year vesting period. The Corporation recorded $29,812 of the related compensation for the first six months of 2019 and 2018. The Corporation recorded $14,906 of the related compensation for the second quarters of 2019 and 2018. In January 2019, the Board of Directors of First United Corporation approved discretionary contributions to four participants totaling $123,179. The contributions also have a two-year vesting period. The Corporation recorded $37,576 of related compensation expense for the first six months of 2019. The Corporation recorded $18,788 of related compensation for the second quarter of 2019.

Note 12 - Equity Compensation Plan Information

At the 2018 Annual Meeting of Shareholders, First United Corporation's shareholders approved the First United Corporation 2018 Equity Compensation Plan which authorizes the issuance of up to 325,000 shares of common stock to employees, directors and qualifying consultants pursuant to stock options, stock appreciation rights, stock awards, dividend equivalents, and other stock-based awards.

The Corporation complies with the provisions of ASC Topic 718, *Compensation-Stock Compensation*, in measuring and disclosing stock compensation cost. The measurement objective in ASC Paragraph 718-10-30-6 requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. The cost is recognized in expense over the period in which an employee is required to provide service in exchange for the award (the vesting period).

Stock-based awards were made to non-employee directors in May 2019 pursuant to First United Corporation's director compensation policy. Each director receives an annual retainer of 1,000 shares of First United Corporation common stock, plus $10,000 to be paid, at the director's election, in cash or additional shares of common stock. In 2019, a total of 14,641 fully-vested shares of common stock were issued to directors, which had a grant date fair market value of $18.30 per share. Director stock compensation expense was $133,612 for the six months ended June 30, 2019 and $115,889 for the six months ended June 30, 2018. Director stock compensation expense was $66,894 for the second quarter of 2019 and $62,331 for the same period of 2018.

Note 13 – Letters of Credit and Off Balance Sheet Liabilities

The Corporation does not issue any guarantees that would require liability recognition or disclosure other than the standby letters of credit issued by the Bank. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, the Bank's letters of credit are issued with expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral and/or personal guarantees supporting these commitments. The Bank had $8.6 million of outstanding standby letters of credit at June 30, 2019 and $3.4 million at December 31, 2018. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required by the letters of credit. Management does not believe that the amount of the liability associated with guarantees under standby letters of credit outstanding at June 30, 2019 and December 31, 2018 is material.

Note 14 – Derivative Financial Instruments

As a part of managing interest rate risk, the Bank entered into interest rate swap agreements to modify the re-pricing characteristics of certain interest-bearing liabilities. The Corporation has designated these interest rate swap agreements as cash flow hedges under the guidance of ASC Subtopic 815-30, *Derivatives and Hedging – Cash Flow Hedges*. Cash flow hedges have the effective portion of changes in the fair value of the derivative, net of taxes, recorded in net accumulated other comprehensive loss.

In March 2016, the Corporation entered into four interest rate swap contracts totaling $30.0 million notional amount, hedging future cash flows associated with floating rate trust preferred debt. These contracts include a three-year $5.0 million contract that matured on June 17, 2019, a five-year $5.0 million contract that matures on March 17, 2021, a seven-year $5.0 million contract that matures on March 17, 2023 and a 10-year $15.0 million contract that matures on March 17, 2026.

The fair value of the interest rate swap contracts was $(55) thousand and $1.0 million at June 30, 2019 and December 31, 2018, respectively.

For the six months ended June 30, 2019, the Corporation recorded a decrease in the value of the derivatives of $1.1 million and the related deferred tax of $298 thousand in net accumulated other comprehensive loss to reflect the effective portion of cash flow hedges. ASC Subtopic 815-30 requires this amount to be reclassified to earnings if the hedge becomes ineffective or is terminated. There was no hedge ineffectiveness recorded for the six months ended June 30, 2019. The Corporation does not expect any losses relating to these hedges to be reclassified into earnings within the next 12 months.

Interest rate swap agreements are entered into with counterparties that meet established credit standards and the Corporation believes that the credit risk inherent in these contracts is not significant as of June 30, 2019.

The table below discloses the impact of derivative financial instruments on the Corporation's Consolidated Financial Statements for the six- and three-months ended June 30, 2019 and 2018.

Derivative in Cash Flow Hedging Relationships

(in thousands)	Amount of gain or (loss) recognized in OCI on derivative (effective portion)	Amount of gain or (loss) reclassified from accumulated OCI into income (effective portion) (a)	Amount of gain or (loss) recognized in income or derivative (ineffective portion and amount excluded from effectiveness testing) (b)
Interest rate contracts:			
Six months ended:			
June 30, 2019	$ 801	$ —	$ —
June 30, 2018	551	—	—
Three months ended:			
June 30, 2019	$ 486	$ —	$ —
June 30, 2018	108	—	—

Notes:
(a) Reported as interest expense
(b) Reported as other income

Note 15 – Assets and Liabilities Subject to Enforceable Master Netting Arrangements

Interest Rate Swap Agreements

The Corporation has entered into interest rate swap agreements to modify the re-pricing characteristics of certain interest-bearing liabilities as a part of managing interest rate risk. The swap agreements have been designated as cash flow hedges, and accordingly, the fair value of the interest rate swap contracts is reported in Other Assets or Other Liabilities on the Consolidated Statement of Financial Condition. The swap agreements were entered into with a third-party financial institution. The Corporation is party to master netting arrangements with its financial institution counterparty; however, the Corporation does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, in the form of cash and investment securities, are pledged by the Corporation as the counterparty with net liability positions in accordance with contract thresholds. See Note 14 to the Consolidated Financial Statements for more information.

Securities Sold Under Agreements to Repurchase ("Repurchase Agreements")

The Bank enters into agreements under which it sells interests in U.S. securities to certain customers subject to an obligation to repurchase, and on the part of the customers to resell, such interests. Under these arrangements, the Bank may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Bank to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Consolidated Statement of Condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. There is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Bank does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements. The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Bank be in default (i.e. fails to repurchase the U.S. securities on the maturity date of the agreement). The investment security collateral, maintained at 102% of the borrowing, is held by a third party financial institution in the counterparty's custodial account.

The following table presents the assets and liabilities subject to an enforceable master netting arrangement or repurchase agreements at June 30, 2019 and December 31, 2018.

				Gross Amounts Not Offset in the Statement of Condition		
(in thousands)	Gross Amounts of Recognized (Assets)/ Liabilities	Gross Amounts Offset in the Statement of Condition	Net Amounts of (Assets)/ Liabilities Presented in the Statement of Condition	Financial Instruments	Cash Collateral Pledged	Net Amount
June 30, 2019						
Interest Rate Swap Agreements	$ 55	$ —	$ 55	$ (55)	$ —	$ —
Repurchase Agreements	$ 31,155	$ —	$ 31,155	$ (31,155)	$ —	$ —
December 31, 2018						
Interest Rate Swap Agreements	$ (1,043)	$ —	$ (1,043)	$ 1,043	$ —	$ —
Repurchase Agreements	$ 37,707	$ —	$ 37,707	$ (37,707)	$ —	$ —

Note 16 – Adoption of New Accounting Standards and Effects of New Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 is intended to improve financial reporting about leasing transactions by requiring organizations that lease assets – referred to as "lessees" – to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. From the lessee's perspective, the new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. The guidance also eliminates the current real estate-specific provision and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs. With respect to lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense. In applying this guidance, entities will also need to determine whether an arrangement contains a lease or service agreement. Disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The amendments will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for the Corporation for annual and interim periods after December 15, 2018. The Corporation adopted ASU 2016-02 effective January 1, 2019. See Note 9 for additional details.

In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic* 842, Leases and ASU 2018-11, *Leases (Topic 842): Targeted Improvements.* ASU 2018-10 provides improvements related to ASU 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements. The amendments affect narrow aspects of the guidance issued in ASU 2016-02. ASU 2018-11 allows entities adopting ASU 2016-02 to choose an additional (and optional) transition method, under which an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. ASU 2018-11 also allows lessors to not separate non-lease components from the associated lease component if certain conditions are met.

The Corporation elected the optional transition method permitted by ASU 2018-11. Under this method, an entity shall recognize and measure leases that exist at the application date and prior comparative periods are not adjusted. In addition, the Corporation elected the package of practical expedients to leases that commenced before the effective date:

1. An entity need not reassess whether any expired or existing contracts contain leases.
2. An entity need not reassess the lease classification for any expired or existing leases.
3. An entity need not reassess initial direct costs for any existing leases.

The Corporation also elected the practical expedient, which must be applied consistently to all leases, to use hindsight in determining the lease term and in assessing impairment of our right-of-use assets. The Corporation recorded a ROU asset in the amount of approximately $2.7 million and a lease liability in the amount of approximately $3.3 million on the Consolidated Statement of Financial Condition upon adoption on January 1, 2019. The adoption did not have a material impact to the Consolidated Statements of Operations or Cash Flows.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.* ASU 2017-12 is intended to better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. ASU 2017-12 is effective for the Corporation for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Corporation adopted ASU 2017-12 effective January 1, 2019. The adoption did not have a material impact on the Corporation's Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments- Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchases financial assets with credit deterioration since their origination. The new model referred to as current expected credit losses ("CECL") model, will apply to: (a) financial assets subject to credit losses and measured at amortized cost; and (b) certain off-balance sheet credit exposures. This includes loans, held to maturity debt securities, loan commitments, financial guarantees and net investments in leases as well as reinsurance and trade receivables. The estimate of expected credit losses should consider historical information, current information, and supportable forecasts, including estimates of prepayments. ASU 2016-13 is effective for the Corporation for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Management currently intends to adopt the guidance on January 1, 2020 and is assessing the impact of this guidance on the Corporation's financial condition and results of operations. Management has formed a focus group consisting of multiple members from areas, including credit, finance, loan servicing, reporting, and information systems. The Corporation is planning to complete its data and model validation analyses during the first half of 2019, with parallel processing of our existing allowance for loan losses model with the CECL model for two to three quarters prior to implementation. Currently, the focus group has identified 11 loan segments for all data which has been populated and internally validated within the model. During 2019, the Corporation is focused on testing methodologies and refining assumptions. Concurrent with this, the Corporation is also focused on researching and resolving interpretive accounting issues in the ASU, contemplating various related accounting policies, developing processes and related controls, and considering various reporting disclosures. In December 2018, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the "FDIC") approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard. On July 17, 2019, FASB agreed to issue a proposal to delay CECL implementation deadlines for, among others, smaller reporting companies. First United Corporation currently qualifies as a small reporting company. The proposed delayed effective date is January 1, 2023 as opposed to January 1, 2020. The proposal is subject to a 30-day comment period which will begin once the proposal is officially released.

In January 2017, the FASB issued ASU 2017-04, *Intangibles- Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* ASU 2017-04 simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. Instead, if "the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit." The ASU does not change the qualitative assessment, however, it removes the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform step 2 of the goodwill impairment test. ASU 2017-04 is effective for the Corporation for annual periods beginning after December 15, 2019, and interim periods within those annual periods. The Corporation is evaluating the provisions of ASU 2017-04 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

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

INTRODUCTION

The following discussion and analysis is intended as a review of material changes in and significant factors affecting the financial condition and results of operations of First United Corporation and its consolidated subsidiaries for the periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and the notes thereto contained in Item 1 of Part I of this report, as well as the audited consolidated financial statements and related notes included in First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2018.

Unless the context clearly suggests otherwise, references in this report to "us", "we", "our", and "the Corporation" are to First United Corporation and its consolidated subsidiaries.

FORWARD-LOOKING STATEMENTS

This report may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of "forward-looking statements." Statements that are not historical in nature, including those that include the words "anticipate", "estimate", "should", "expect", "believe", "intend", and similar expressions, are based on current expectations, estimates and projections about, among other things, the industry and the markets in which we operate, and they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this report; general economic, market, or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in our competitive position or competitive actions by other companies; changes in the quality or composition of our loan and investment portfolios; our ability to manage growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond our control. Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on our business or operations. These and other risks are discussed in detail in the periodic reports that First United Corporation files with the Securities and Exchange Commission (the "SEC") (see Item 1A of Part II of this report for further information). Except as required by applicable laws, we do not intend to publish updates or revisions of any forward-looking statements we make to reflect new information, future events or otherwise.

FIRST UNITED CORPORATION

First United Corporation is a Maryland corporation chartered in 1985 and a bank holding company registered with the Board of Governors of the Federal Reserve System (the "FRB") under the Bank Holding Company Act of 1956, as amended. The Corporation's primary business is serving as the parent company of First United Bank & Trust, a Maryland trust company (the "Bank"), First United Statutory Trust I ("Trust I") and First United Statutory Trust II ("Trust II"), both Connecticut statutory business trusts. Until September 14, 2018 when it was canceled, the Corporation also served as the parent company to First United Statutory Trust III, a Delaware statutory business trust ("Trust III" and together with Trust I and Trust II, the "Trusts"). The Trusts were formed for the purpose of selling trust preferred securities that qualified as Tier 1 capital. The Bank has two consumer finance company subsidiaries - OakFirst Loan Center, Inc., a West Virginia corporation, and OakFirst Loan Center, LLC, a Maryland limited liability company-and two subsidiaries that it uses to hold real estate acquired through foreclosure or by deed in lieu of foreclosure - First OREO Trust, a Maryland statutory trust, and FUBT OREO I, LLC, a Maryland limited liability company.

At June 30, 2019, the Corporation's total assets were $1.4 billion, net loans were $991.6 million, and deposits were $1.1 billion. Shareholders' equity at June 30, 2019 was $126.2 million.

The Corporation maintains an Internet site at www.mybank.com on which it makes available, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the SEC.

ESTIMATES AND CRITICAL ACCOUNTING POLICIES

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. (See Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of Part II of First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2018). On an on-going basis, management evaluates estimates, including those related to loan losses and intangible assets, other-than-temporary impairment ("OTTI") of investment securities, income taxes, fair value of investments and pension plan assumptions. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the consolidated financial statements.

Management does not believe that any material changes in our critical accounting policies have occurred since December 31, 2018.

Allowance for Loan Losses

One of our most important accounting policies is that related to the monitoring of the loan portfolio. A variety of estimates impact the carrying value of the loan portfolio, including the calculation of the allowance for loan losses (the "ALL"), the valuation of underlying collateral, the timing of loan charge-offs and the placement of loans on non-accrual status. The ALL is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payment on loans. Estimates for loan losses are arrived at by analyzing risks associated with specific loans and the loan portfolio, current and historical trends in delinquencies and charge-offs, and changes in the size and composition of the loan portfolio. The analysis also requires consideration of the economic climate and outlook, including the economic conditions specific to Western Maryland and Northeastern West Virginia, changes in lending rates, political conditions, and legislation impacting the banking industry. Because the calculation of the ALL relies on management's estimates and judgments relating to inherently uncertain events, actual results may differ from management's estimates.

Goodwill and Other Intangible Assets

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350, *Intangibles - Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. The $11.0 million recorded as goodwill at June 30, 2019 is primarily related to the Bank's 2003 acquisition of Huntington National Bank branches and is not subject to periodic amortization.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of the Corporation's reporting units be compared to the carrying amount of its net assets, including goodwill. If the estimated current fair value of the reporting unit exceeds its carrying value, no additional testing is required and an impairment loss is not recorded. Otherwise, additional testing is performed, and to the extent such additional testing results in a conclusion that the carrying value of goodwill exceeds its implied fair value, an impairment loss is recognized.

Our goodwill relates to value inherent in the banking business, and that value is dependent upon our ability to provide quality, cost effective services in a highly competitive local market. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of our services. As such, goodwill value is ultimately supported by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill, which could adversely impact earnings in future periods. ASC Topic 350 requires an annual evaluation of goodwill for impairment. The determination of whether or not these assets are impaired involves significant judgments and estimates.

Accounting for Income Taxes

We account for income taxes in accordance with ASC Topic 740, *Income Taxes*. Under this guidance, deferred taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates that will apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Increases or decreases in the value of deferred tax assets and liabilities due to a change in tax rates are recognized as income or expense, respectively, in the period that includes the date on which the change becomes effective.

Management regularly reviews the carrying amount of the Corporation's net deferred tax assets to determine if the establishment of a valuation allowance is necessary. If management determines, based on the available evidence, that it is more likely than not that all or a portion of our net deferred tax assets will not be realized in future periods, then a deferred tax valuation allowance will be established. Consideration is given to various positive and negative factors that could affect the realization of the deferred tax assets. In evaluating this available evidence, management considers, among other things, historical performance, expectations of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with utilization of operating loss and tax credit carry forwards not expiring, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earnings trends and the timing of reversals of temporary differences. Management's evaluation is based on current tax laws as well as management's expectations of future performance.

Management expects that our adherence to the required accounting guidance may result in increased volatility in quarterly and annual effective income tax rates because of changes in judgment or measurement including changes in actual and forecasted income before taxes, tax laws and regulations, and tax planning strategies.

Other-Than-Temporary Impairment of Investment Securities

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320, *Investments – Debt and Equity Securities* (Section 320-10-35), management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating OTTI losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). This process is described more fully in the Investment Securities section of the Consolidated Balance Sheet Review.

Fair Value of Investments

We have determined the fair value of our investment securities in accordance with the requirements of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. The Corporation measures the fair market values of its investments based on the fair value hierarchy established in Topic 820. The determination of fair value of investments and other assets is discussed further in Note 7 to the consolidated financial statements presented elsewhere in this report.

Pension Plan Assumptions

Our pension plan costs are calculated using actuarial concepts, as discussed within the requirements of ASC Topic 715, *Compensation – Retirement Benefits.* Pension expense and the determination of our projected pension liability are based upon two critical assumptions: (a) the discount rate; and (b) the expected return on plan assets. We evaluate each of these critical assumptions annually. Other assumptions impact the determination of pension expense and the projected liability including the primary employee demographics, such as retirement patterns, employee turnover, mortality rates, and estimated employer compensation increases. These factors, along with the critical assumptions, are carefully reviewed by management each year in consultation with our pension plan consultants and actuaries. Further information about our pension plan assumptions, the plan's funded status, and other plan information is included in Note 11 to the consolidated financial statements presented elsewhere in this report.

SELECTED FINANCIAL DATA

The following table sets forth certain selected financial data for the six-month periods ended June 30, 2019 and 2018 and is qualified in its entirety by the detailed information and unaudited financial statements, including the notes thereto, included elsewhere in this quarterly report.

	As of or for the Six months ended June 30,	
	2019	2018
Per Share Data		
Basic and diluted net income per common share	$ 0.81	$ 0.78
Basic and diluted book value per common share	$ 17.75	$ 15.95
Significant Ratios		
Return on Average Assets (a)	0.82%	0.84%
Return on Average Equity (a)	9.39%	9.94%
Average Equity to Average Assets	8.74%	8.47%

Note: [(a)] Annualized

RESULTS OF OPERATIONS

Overview

Consolidated net income was $5.8 million for the first six months of 2019, compared to $5.5 million for the same period of 2018. Basic and diluted net income per common share for the first six months of 2019 were both $.81, compared to basic and diluted net income per common share of $.78 for the same period of 2018. The increase in earnings was primarily due to an increase in net interest income of $1.4 million and an increase of $.2 million in other operating income for the first six months of 2019 when compared to the same time period of 2018. Increases in wealth management income and debit card income were the contributing factors in the increase in other operating income. These changes were partially offset by a slight decline in service charge income, particularly non-sufficient funds (“NSF”) income and service charges on personal demand deposit accounts. Other operating expenses increased $1.1 million for the first six months of 2019 as compared to the first six months of 2018. Salaries and benefits increased $.3 million due to new hires and merit increases in 2018 and increased life and health insurance costs related to increased claims. Equipment, occupancy and data processing expenses increased $.7 million in the first six months of 2019. These increases were primarily attributable to increased depreciation expense related to the on-going branch renovation projects. The increase in data processing expenses were related to new services implemented in late 2018 and early 2019. Other real estate owned (“OREO”) expenses increased $.4 million in the first six months of 2019 due to valuation allowance write-downs on properties. These changes were offset by a $.3 million decrease in other miscellaneous expenses such as marketing, legal and professional, consulting, dues and licenses, contract labor, trust department expense and miscellaneous loan fees. The net interest margin for the first six months of 2019 and the first six months of 2018, on a fully tax equivalent (“FTE”) basis, was 3.70% and 3.71%, respectively.

The provision for loan losses was $.7 million for both the six-month period ended June 30, 2019 and the six-month period ended June 30, 2018. Specific allocations have been made for impaired loans where management has determined that the collateral supporting the loans is not adequate to cover the loan balance, and the qualitative factors affecting the ALL have been adjusted based on the current economic environment and the characteristics of the loan portfolio. During the second quarter of 2019, a specific allocation of $1.0 million was made on a non-accrual loan based on the receipt of a new appraisal on the property which was offset by the effect of a decrease in loan balances and a reduction of qualitative factors related to the mortgage pool as a result of the continued improvement in the historical loss factors.

Net interest income increased $1.4 million during the first six months of 2019 over the same period in 2018 due to a $3.4 million increase in interest income, offset by a $2.0 million increase in interest expense. The increase in interest income was due to increases of $3.3 million in interest and fees on loans and $.1 million in interest income on investments. The increase in interest and fees on loans was due primarily to an increase in the rate earned attributable to loans repricing, new loans booked at higher rates and increased balances related to the strong loan growth in 2018. The increase in investment interest income was due primarily to an increase in the rate earned related to increased rates on the Collateralized Debt Obligation (“CDO”) portfolio.

Interest expense on our interest-bearing liabilities increased by $2.0 million during the six months ended June 30, 2019 when compared to the same period of 2018, due primarily to increased rates on our deposit products in 2018 in response to the rising rate environment.

Other operating income remained flat during the first six months of 2019 when compared to the same period of 2018. Slight increases in wealth management income and debit card income were offset by a slight decline in service charge income.

Other operating expenses increased $1.1 million for the first six months of 2019 as compared to the first six months of 2018. Salaries and benefits increased $.3 million due to new hires and merit increases in 2018 and increased life and health insurance costs related to increased claims. Equipment, occupancy and data processing expenses increased $.7 million in the first six months of 2019. These increases were primarily attributable to increased depreciation expense as we continue to invest in our branch network and new data processing services. OREO expenses increased $.4 million due to valuation allowance write-downs on properties in the first six months of 2019 as a result of new appraisals and reduced selling prices. These changes were offset slightly by a decrease in other miscellaneous expenses such as marketing, legal and professional, consulting, dues and licenses, contract labor, trust department expense and miscellaneous loan fees.

Consolidated net income was $2.6 million for the second quarter of 2019, compared to $3.0 million for the same period of 2018. Basic and diluted net income per common share for the second quarter of 2019 were both $.37, compared to basic and diluted net income per common share of $.43 for the same period of 2018. The decrease in earnings was attributable to increased other operating expenses relating to a $.4 million increase in equipment, occupancy and data processing expenses and a $.7 million increase in OREO expenses due primarily to valuation allowance write-downs on properties as a result of new appraisals and lower selling prices, offset by an increase in net interest income of $.7 million, an increase of $.1 million in wealth management income, and slight increases in service charge and debit card income. The net interest margin for the second quarter of 2019 and the second quarter of 2018, on an FTE basis, was 3.68%, and 3.73%, respectively.

The provision for loan losses was $.3 million for both the second quarter of 2019 and the second quarter of 2018. Specific allocations have been made for impaired loans where management has determined that the collateral supporting the loans is not adequate to cover the loan balance, and the qualitative factors affecting the ALL have been adjusted based on the current economic environment and the characteristics of the loan portfolio. During the second quarter of 2019, a specific allocation of $1.0 million was made on a non-accrual loan based on the receipt of a new appraisal on the property which was offset by the effect of a decrease in loan balances and a reduction of qualitative factors related to the mortgage pool as a result of the continued improvement in the historical loss factors.

Net interest income increased $.7 million during the second quarter of 2019 over the same period in 2018 due to a $1.7 million increase in interest income, offset by a $1.0 million increase in interest expense. The increase in interest income was due to increases of $1.6 million in interest and fees on loans and $.1 million in interest income on investments. The increase in interest and fees on loans was due primarily to an increase in the rate earned attributable to loans repricing, new loans booked at higher rates and increased balances related to the strong loan growth in 2018. The increase in investment interest income was due primarily to an increase in the rate earned related to increased rates on the CDO portfolio.

Interest expense on our interest-bearing liabilities increased by $1.0 million during the second quarter of 2019 when compared to the same period of 2018, due primarily to increased interest expense on deposits that resulted from strong deposit growth in the first quarter as well as the increased rates as we offered product specials and increased pricing on the full relationship customer.

Other operating income remained stable during the second quarter of 2019 when compared to the same period of 2018. Slight increases in wealth management income and debit card income were offset by a slight decline in service charge income.

Other operating expenses increased for the second quarter of 2019 when compared to the second quarter of 2018. These increases related to a $.4 million increase in equipment, occupancy and data processing expenses due to increased depreciation expense as discussed above and a $.7 million increase in OREO expenses due to valuation allowance write-downs on properties.

Net Interest Income

Net interest income is the largest source of operating revenue and is the difference between the interest earned on interest-earning assets and the interest expense incurred on interest-bearing liabilities. For analytical and discussion purposes, net interest income is adjusted to an FTE basis to facilitate performance comparisons between taxable and tax-exempt assets. FTE income is determined by increasing tax-exempt income by an amount equal to the federal income taxes that would have been paid if this income were taxable at the statutorily applicable rate.

The following table sets forth the average balances, net interest income and expense, and average yields and rates of our interest-earning assets and interest-bearing liabilities for the six- and three-month periods ended June 30, 2019 and 2018:

	Six Months Ended June 30,					
	2019			2018		
(dollars in thousands)	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
Assets						
Loans	$ 1,007,010	$ 24,712	4.95%	$ 923,726	$ 21,431	4.68%
Investment Securities:						
Taxable	206,683	2,917	2.85%	217,374	2,921	2.71%
Non taxable	26,031	935	7.24%	18,558	847	9.20%
Total	232,714	3,852	3.34%	235,932	3,768	3.22%
Federal funds sold	25,600	190	1.51%	22,581	140	1.25%
Interest-bearing deposits with other banks	1,115	9	1.69%	2,219	9	0.82%
Other interest earning assets	4,560	159	7.03%	5,108	135	5.33%
Total earning assets	1,270,999	28,922	4.59%	1,189,566	25,483	4.32%
Allowance for loan losses	(11,597)			(10,569)		
Non-earning assets	142,723			135,448		
Total Assets	**$ 1,402,125**			**$ 1,314,445**		
Liabilities and Shareholders' Equity						
Interest-bearing demand deposits	$ 161,349	$ 294	0.37%	$ 174,063	$ 71	0.08%
Interest-bearing money markets	257,517	1,085	0.85%	216,197	331	0.31%
Savings deposits	160,671	148	0.19%	162,163	90	0.11%
Time deposits:						
Less than $100k	104,193	664	1.28%	107,635	523	0.98%
$100k or more	151,990	1,545	2.05%	117,105	769	1.32%
Short-term borrowings	42,864	131	0.62%	50,169	124	0.50%
Long-term borrowings	100,929	1,743	3.48%	111,592	1,728	3.12%
Total interest-bearing liabilities	979,513	5,610	1.15%	938,924	3,636	0.78%
Non-interest-bearing deposits	266,022			245,202		
Other liabilities	34,037			19,048		
Shareholders' Equity	122,553			111,271		
Total Liabilities and Shareholders' Equity	**$ 1,402,125**			**$ 1,314,445**		
Net interest income and spread		**$ 23,312**	3.44%		**$ 21,847**	3.54%
Net interest margin			3.70%			3.71%

Note:

(1) The above table reflects the average rates earned or paid stated on an FTE basis assuming a 21% tax rate for 2019 and 2018. Non-GAAP interest income on a fully taxable equivalent was $439 and $397, respectively.
(2) Net interest margin is calculated as net interest income divided by average earning assets.
(3) The average yields on investments are based on amortized cost.

Net interest income, on an FTE basis, increased $1.5 million (6.7%) during the first six months of 2019 over the same period in 2018 due to a $3.4 million (13.5%) increase in interest income, offset by a $2.0 million (54.3%) increase in interest expense. The net interest margin was 3.70% for first six months of 2019 and 3.71% for the first six months of 2018.

Comparing the first six months of 2019 to the same period of 2018, the increase in interest income was due to increases of $3.3 million in interest and fees on loans and $.1 million in interest income on investments. The increase in interest and fees on loans was due primarily to an increase in the rate earned of 27 basis points attributable to loans repricing, new loans booked at higher rates and increased balances related to the strong loan growth in 2018. The increase in investment interest income was due primarily to an increase in the rate earned of 12 basis points related to increased rates on the CDO portfolio.

Interest expense on our interest-bearing liabilities increased by $2.0 million during the six months ended June 30, 2019 when compared to the same period of 2018, due primarily to increased rates on our deposit products in 2018 in response to the rising rate environment.

The average balance on interest-bearing deposits increased by $58.6 million when comparing the first six months of 2019 to the same period of 2018. The average rate paid on these deposits increased by 89 basis points during the same time due to the rising interest rate environment. The average rate paid on short-term borrowings increased by 12 basis points as pricing on overnight borrowings increased throughout 2018. The average balance on long-term borrowings decreased by $10.7 million as a result of the repayment of two FHLB advances totaling $5.0 million at their maturity in January 2018 and the shift of $15.0 million of an FHLB advance from long-term to short-term borrowings at its maturity in April 2018.

	Three Months Ended June 30,					
	2019			2018		
(dollars in thousands)	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
Assets						
Loans	$ 1,007,404	$ 12,509	4.98%	$ 939,303	$ 10,938	4.67%
Investment Securities:						
Taxable	209,319	1,450	2.79%	215,604	1,474	2.74%
Non taxable	24,425	435	7.14%	18,328	422	9.24%
Total	233,744	1,885	3.24%	233,932	1,896	3.25%
Federal funds sold	34,037	145	1.72%	10,906	15	0.55%
Interest-bearing deposits with other banks	754	4	2.14%	1,790	4	0.90%
Other interest earning assets	4,379	74	6.79%	5,167	69	5.35%
Total earning assets	1,280,318	14,617	4.58%	1,191,098	12,922	4.35%
Allowance for loan losses	(11,877)			(10,573)		
Non-earning assets	146,380			134,236		
Total Assets	**$ 1,414,821**			**$ 1,314,761**		
Liabilities and Shareholders' Equity						
Interest-bearing demand deposits	$ 162,527	$ 165	0.41%	$ 174,961	$ 42	0.10%
Interest-bearing money markets	261,682	580	0.89%	209,801	176	0.34%
Savings deposits	162,850	75	0.19%	164,096	46	0.11%
Time deposits:						
Less than $100k	104,668	349	1.34%	105,028	260	0.99%
$100k or more	153,688	796	2.08%	116,873	404	1.39%
Short-term borrowings	36,832	28	0.30%	52,576	94	0.72%
Long-term borrowings	100,929	891	3.55%	105,709	834	3.16%
Total interest-bearing liabilities	983,176	2,884	1.18%	929,044	1,856	0.80%
Non-interest-bearing deposits	266,521			253,713		
Other liabilities	40,177			19,280		
Shareholders' Equity	124,947			112,724		
Total Liabilities and Shareholders' Equity	**$ 1,414,821**			**$ 1,314,761**		
Net interest income and spread		**$ 11,733**	3.40%		**$ 11,066**	3.55%
Net interest margin			3.68%			3.73%

Note:

(4) The above table reflects the average rates earned or paid stated on an FTE basis assuming a 21% tax rate for 2019 and 2018. Non-GAAP interest income on a fully taxable equivalent was $206 and $198, respectively.
(5) Net interest margin is calculated as net interest income divided by average earning assets.
(6) The average yields on investments are based on amortized cost.

Net interest income, on an FTE basis, increased $.7 million (6.0%) during the second quarter of 2019 over the same period in 2018 due to a $1.7 million (13.1%) increase in interest income and a $1.0 million (55.4%) increase in interest expense. The net interest margin for the second quarter of 2019 was 3.68%, compared to 3.73% for the second quarter of 2018.

Comparing the second quarter of 2019 to the same period of 2018, the increase in interest income was primarily due to an increase of $1.6 million in interest and fees on loans. The increase in interest and fees on loans was due primarily to an increase in the rate earned of 31 basis points attributable to loans repricing at higher rates, new loans booked at higher rates and increased balances related to the strong loan growth in 2018.

Interest expense on our interest-bearing liabilities increased by $1.0 million during the second quarter of 2019 when compared to the same period of 2018, due primarily to increased interest expense on deposits that resulted from strong deposit growth in the first quarter as well as the increased rates as we offered product specials and increased pricing on the full relationship customer.

The average balance on interest-bearing deposits increased by $74.7 million when comparing the second quarter of 2019 to the same period of 2018. The average rate paid on these deposits increased by 45 basis points during the same time due to the rising interest rate environment. The average rate paid on short-term borrowings decreased by 42 basis points, as the strong deposit growth enabled us to fully repay $40.0 million of overnight borrowings early in the first quarter of 2019. The average balance on long-term borrowings decreased by $4.8 million as a result of the shift of $15.0 million of an FHLB advance from long-term to short-term borrowings at its maturity in April 2018.

The following table sets forth an analysis of volume and rate changes in interest income and interest expense for our average interest-earning assets and average interest-bearing liabilities for the six-month periods ended June 30, 2019 and 2018:

	2019 Compared to 2018		
(in thousands and tax equivalent basis)	**Volume**	**Rate**	**Net**
Interest Income:			
Loans	$ 1,949	$ 1,332	$ 3,281
Taxable Investments	(145)	141	(4)
Non-taxable Investments	344	(256)	88
Federal funds sold	19	31	50
Interest-bearing deposits	(5)	5	0
Other interest earning assets	(15)	39	24
Total interest income	2,147	1,292	3,439
Interest Expense:			
Interest-bearing demand deposits	(5)	228	223
Interest-bearing money markets	64	690	754
Savings deposits	(1)	59	58
Time deposits less than $100	(17)	158	141
Time deposits $100 or more	230	546	776
Short-term borrowings	(18)	25	7
Long-term borrowings	(166)	181	15
Total interest expense	87	1,887	1,974
Net interest income	$ 2,060	$ (595)	$ 1,465

Note:

(1) The change in interest income/expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

The following table sets forth an analysis of volume and rate changes in interest income and interest expense for our average interest-earning assets and average interest-bearing liabilities for the three-month periods ended June 30, 2019 and 2018:

	2019 Compared to 2018		
(in thousands and tax equivalent basis)	**Volume**	**Rate**	**Net**
Interest Income:			
Loans	$ 795	$ 776	$ 1,571
Taxable Investments	(43)	19	(24)
Non-taxable Investments	141	(128)	13
Federal funds sold	32	98	130
Interest-bearing deposits	(2)	2	0
Other interest earning assets	(11)	16	5
Total interest income	912	783	1,695
Interest Expense:			
Interest-bearing demand deposits	(3)	126	123
Interest-bearing money markets	44	360	404
Savings deposits	0	29	29
Time deposits less than $100	(1)	90	89
Time deposits $100 or more	128	264	392
Short-term borrowings	(28)	(38)	(66)
Long-term borrowings	(38)	95	57
Total interest expense	102	926	1,028
Net interest income	$ 810	$ (143)	$ 667

Note:

(1) The change in interest income/expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Provision for Loan Losses

The provision for loan losses was $.7 million for both the six-month period ended June 30, 2019 and the six-month period ended June 30, 2018. For the six months ended June 30, 2019, specific allocations of $1.7 million were made related to the movement of one large A&D loan totaling $7.0 million to non-accrual during the first quarter. At December 31, 2018, it was expected that this loan would be paid off by a prospective buyer. In the first quarter of 2019, the buyer declined to pursue the transaction and, subsequently, the Corporation entered into a forbearance agreement and placed the loan on non-accrual and established a $.7 million specific allocation. During the second quarter of 2019, an additional specific allocation of $1.0 million was made for this loan based on the receipt of a new appraisal on the property which was offset by the effect of a decrease in loan balances and a reduction of qualitative factors related to the mortgage pool as a result of the continued improvement in the historical loss factors.

The provision for loan losses was $.3 million for both the second quarter of 2019 and 2018. During the second quarter of 2019, a specific allocation of $1.0 million was made on a non-accrual loan based on the receipt of a new appraisal on the property which was offset by the effect of a decrease in loan balances and a reduction of qualitative factors related to the mortgage pool as a result of the continued improvement in the historical loss factors.

Other Operating Income

Other operating income, exclusive of gains, increased $.2 million during the first six months of 2019 when compared to the same period of 2018. The increase resulted from increases in wealth management income, debit card income and income related to the dissolution of an investment in a title company.

Net gains of $44 thousand were reported in other income for the first six months of 2019, compared to net gains of $181 thousand during the same period of 2018.

Other operating income, exclusive of gains, increased $.2 million during the second quarter of 2019 when compared to the same period of 2018. This increase was primarily attributable to increased wealth management and debit card income.

Net gains of $30 thousand were reported in other income for the second quarter of 2019, compared to net gains of $147 thousand during the same period of 2018.

The following table shows the major components of other operating income for the six- and three-month periods ended June 30, 2019 and 2018, exclusive of net gains:

	Income as % of Total Other Operating Income				Income as % of Total Other Operating Income			
	Six Months Ended June 30,				Three Months Ended June 30,			
	2019		2018		2019		2018	
Service charges on deposit accounts	$ 1,074	14%	$ 1,120	16%	$ 555	14%	$ 557	15%
Other service charges	433	6%	440	5%	225	6%	211	6%
Trust department	3,547	46%	3,305	45%	1,832	47%	1,641	44%
Debit card Income	1,276	17%	1,201	16%	676	17%	648	17%
Bank owned life insurance	591	8%	584	8%	288	8%	285	8%
Brokerage commissions	441	6%	551	7%	203	5%	306	8%
Other income	254	3%	210	3%	130	3%	87	2%
	$ 7,616	100%	$ 7,411	100%	$ 3,909	100%	$ 3,735	100%

Other Operating Expenses

Other operating expenses increased $1.1 million for the first six months of 2019 when compared to the first six months of 2018. Salaries and benefits increased $.3 million due to new hires and merit increases in 2018 and increased life and health insurance costs related to increased claims. Equipment, occupancy and data processing expenses increased $.7 million in the first six months of 2019. These increases were primarily attributable to increased depreciation expense as we continue to invest in our branch network and new data processing services. OREO expenses increased $.4 million due to valuation allowance write-downs on properties in the first six months of 2019 as a result of new appraisals and reduced selling prices. These changes were offset slightly by a decrease in other miscellaneous expenses such as marketing, legal and professional, consulting, dues and licenses, contract labor, trust department expense and miscellaneous loan fees.

Other operating expenses increased for the second quarter of 2019 when compared to the second quarter of 2018. These increases related to a $.4 million increase in equipment, occupancy and data processing expenses due to increased depreciation expense as discussed above and a $.7 million increase in OREO expenses due to valuation allowance write-downs on properties.

The composition of other operating expenses for the six- and three-month periods ended June 30, 2019 and 2018 is illustrated in the following table:

	Expense as % of Total Other Operating Expenses				Expense as % of Total Other Operating Expenses			
	Six Months Ended June 30,				Three Months Ended June 30,			
	2019		2018		2019		2018	
Salaries and employee benefits	$ 12,364	55%	$ 12,038	56%	$ 6,146	51%	$ 6,119	58%
FDIC premiums	294	1%	303	1%	183	2%	170	2%
Equipment	1,819	8%	1,436	7%	936	8%	753	7%
Occupancy	1,418	6%	1,252	6%	706	6%	614	6%
Data processing	1,995	9%	1,843	9%	1,054	9%	911	8%
Professional Services	522	2%	643	3%	318	3%	307	3%
Contract Labor	331	2%	337	2%	175	1%	161	1%
Line rentals	415	2%	430	2%	198	2%	219	2%
Other real estate owned	929	4%	493	2%	786	7%	108	1%
Other	2,344	11%	2,541	12%	1,239	11%	1,263	12%
	$ 22,431	100%	$ 21,316	100%	$ 11,741	100%	$ 10,625	100%

Provision for Income Taxes

In reporting interim financial information, income tax provisions should be determined under the procedures set forth in ASC Topic 740, *Income Taxes* (Section 740-270-30). This guidance provides that at the end of each interim period, an entity should make its best estimate of the effective tax rate expected to be applicable for the full fiscal year. The rate so determined should be used in providing for income taxes on a current year-to-date basis. The effective tax rate should reflect anticipated investment tax credits, capital gains rates, and other available tax planning alternatives. In arriving at this effective tax rate, however, no effect should be included for the tax related to significant, unusual or extraordinary items that will be separately reported or reported net of their related tax effect in reports for the interim period or for the fiscal year.

The effective tax rate for the first six months of 2019 was 22.5%, compared to an effective tax rate of 21.2% for the first six months of 2018. The increase in the effective tax rate was due to a reduction in tax-exempt income and the low income housing tax credits nearing their maturity.

FINANCIAL CONDITION

Balance Sheet Overview

Total assets increased by $21.1 million to $1.4 billion at June 30, 2019 when compared to assets at December 31, 2018. During the first six months of 2019, cash and interest-bearing deposits in other banks increased $15.4 million, the investment portfolio increased $1.7 million and gross loans decreased $4.1 million. The increase in cash was due to strong deposit growth in the first quarter of 2019, offset by the full repayment of $40.0 million in overnight borrowings at December 31, 2018. Premises and equipment increased slightly by $.3 million due to continued investment in our branch network, offset by normal depreciation during the first six months of 2019. OREO balances decreased $1.1 million due to $.8 million in sales of properties, $.9 million in valuation allowance write-downs as a result of new appraisals and lower selling prices, offset by additions of new properties of $.6 million. Other assets increased by $9.3 million, primarily due to the increase in the pension asset related to the $2.0 million contribution made to the plan in the first quarter of 2019 as well as an increase in the market value of the pension assets of $3.8 million and a $2.3 million timing difference due to the delayed receipt of cash from a participation loan payoff at the end of the second quarter. Total liabilities at June 30, 2019 increased $12.0 million when compared to December 31, 2018. This increase was attributable to the strong deposit growth of $55.6 million in the first six months of 2019, offset by a decline in short-term borrowings of $46.6 million. The deposit growth during the first quarter of 2019 enabled us to fully repay the $40.0 million in overnight borrowings with correspondent banks that was on our balance sheet at December 31, 2018. Our Treasury Management product decreased by $6.6 million as customers utilized cash balances during the second quarter of 2019. Total shareholders' equity increased $9.1 million due to the increase in retained earnings and the decline in accumulated other comprehensive loss.

Loan Portfolio

The following table presents the composition of our loan portfolio at the dates indicated:

(dollars in thousands)	June 30, 2019		December 31, 2018	
Commercial real estate	$ 299,832	30%	$ 306,921	31%
Acquisition and development	118,726	12%	118,360	12%
Commercial and industrial	108,271	11%	111,466	11%
Residential mortgage	442,269	44%	436,907	43%
Consumer	34,518	3%	34,060	3%
Total Loans	$ 1,003,616	100%	$ 1,007,714	100%

Comparing June 30, 2019 to December 31, 2018, outstanding loans decreased by $4.1 million. Commercial real estate ("CRE") loans decreased $7.1 million due primarily to the payoff of balances for several large credits in the first quarter of 2019. Acquisition and development ("A&D") loans increased slightly by $.4 million due to new production offset by payoffs received in the second quarter. Commercial and industrial ("C&I") loans decreased $3.2 million due to one large payoff received in the second quarter. Residential mortgages increased $5.4 million, primarily due to new loans booked in purchase money and construction loans in our in-house adjustable rate mortgage products. The consumer portfolio increased slightly by $.5 million due to increased balances in our student loan portfolio. Approximately 27% of the commercial loan portfolio was collateralized by real estate at both June 30, 2019 and December 31, 2018.

Risk Elements of Loan Portfolio

The following table presents the risk elements of our loan portfolio at the dates indicated. Management is not aware of any potential problem loans other than those listed in this table or discussed below.

(dollars in thousands)	June 30, 2019	% of Applicable Portfolio	December 31, 2018	% of Applicable Portfolio
Non-accrual loans:				
Commercial real estate	$ 3,214	1.07%	$ 2,141	0.70%
Acquisition and development	7,615	6.41%	147	0.10%
Commercial and industrial	27	0.02%	—	0.00%
Residential mortgage	2,255	0.51%	2,624	0.60%
Consumer	7	0.02%	10	0.00%
Total non-accrual loans	$ 13,118	1.31%	$ 4,922	0.49%
Accruing Loans Past Due 90 days or more:				
Acquisition and development	34		62	
Residential mortgage	276		363	
Consumer	7		5	
Total loans past due 90 days or more	$ 317		$ 430	
Total non-accrual and accruing loans past due 90 days or more	$ 13,435		$ 5,352	
Restructured Loans (TDRs):				
Performing	$ 3,823		$ 4,633	
Non-accrual (included above)	220		231	
Total TDRs	$ 4,043		$ 4,864	
Other real estate owned	$ 5,531		$ 6,598	
Impaired loans without a valuation allowance	$ 8,443		$ 9,231	
Impaired loans with a valuation allowance	9,300		1,344	
Total impaired loans	$ 17,743		$ 10,575	
Valuation allowance related to impaired loans	$ 1,804		$ 144	

Performing loans considered to be impaired (including performing troubled debt restructurings, or TDRs), as defined and identified by management, amounted to $13.1 million at June 30, 2019 and $4.9 million at December 31, 2018. Loans are identified as impaired when, based on current information and events, management determines that we will be unable to collect all amounts due according to contractual terms. These loans consist primarily of A&D loans and CRE loans. The increase in impaired loans with a valuation allowance at June 30, 2019 as compared to December 31, 2018 was due to the movement of a $7.0 million A&D loan to non-accrual status in the first quarter of 2019 and specific reserves of $1.7 million as previously discussed. The fair values are generally determined based upon independent third- party appraisals of the collateral or discounted cash flows based upon the expected proceeds. Specific allocations have been made where management believes there is insufficient collateral to repay the loan balance if liquidated and there is no secondary source of repayment available.

The following table presents the details of impaired loans that are TDRs by class at June 30, 2019 and December 31, 2018:

	June 30, 2019		December 31, 2018	
(in thousands)	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Performing				
Commercial real estate				
Non owner-occupied	2	$ 239	3	$ 356
All other CRE	1	2,324	2	2,555
Acquisition and development				
1-4 family residential construction	1	304	1	230
All other A&D	1	225	1	316
Commercial and industrial	—	—	—	—
Residential mortgage				
Residential mortgage – term	6	731	7	1,176
Residential mortgage – home equity	—	—	—	—
Consumer	—	—	—	—
Total performing	11	$ 3,823	14	$ 4,633
Non-accrual				
Commercial real estate				
Non owner-occupied	—	$ —	—	$ —
All other CRE	—	—	—	—
Acquisition and development				
1-4 family residential construction	—	—	—	—
All other A&D	—	—	—	—
Commercial and industrial	—	—	—	—
Residential mortgage				
Residential mortgage – term	2	220	2	231
Residential mortgage – home equity	—	—	—	—
Consumer	—	—	—	—
Total non-accrual	2	220	2	231
Total TDRs	13	$ 4,043	16	$ 4,864

The level of TDRs decreased $.8 million during the six months ended June 30, 2019. Three accruing loans totaling $.7 million were repaid in the first six months of 2019. Additionally, $.1 million in net principal payments were received during the same time period.

Allowance and Provision for Loan Losses

The ALL is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the 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 non-performing loans.

The ALL is also based on estimates, and actual losses will vary from current estimates. These estimates are reviewed quarterly, and as adjustments, either positive or negative, become necessary, a corresponding increase or decrease is made in the ALL. The methodology used to determine the adequacy of the ALL is consistent with prior years. An estimate for probable losses related to unfunded lending commitments, such as letters of credit and binding but unfunded loan commitments is also prepared. This estimate is computed in a manner similar to the methodology described above, adjusted for the probability of actually funding the commitment.

The following table presents a summary of the activity in the ALL for the six months ended June 30:

(dollars in thousands)	2019	2018
Balance, January 1	$ 11,047	$ 9,972
Charge-offs:		
Commercial real estate	—	(889)
Acquisition and development	(29)	(98)
Commercial and industrial	(5)	(10)
Residential mortgage	(86)	(240)
Consumer	(136)	(175)
Total charge-offs	(256)	(1,412)
Recoveries:		
Commercial real estate	30	60
Acquisition and development	111	258
Commercial and industrial	76	31
Residential mortgage	195	65
Consumer	91	79
Total recoveries	503	493
Net credit recoveries/(losses)	247	(919)
Provision for loan losses	682	716
Balance at end of period	$ 11,976	$ 9,769
Allowance for loan losses to gross loans outstanding (as %)	1.19%	1.04%
Net recoveries/charge-offs to average loans outstanding during the period, annualized (as %)	0.05%	0.20%

The ALL was $12.0 million at June 30, 2019 and $11.0 million at December 31, 2018. The provision for loan losses was $.7 million for both the first six months of 2019 and the first six months of 2018. Net recoveries of $.2 million were recorded for the six months ended June 30, 2019, compared to net charge offs of $.9 million for the six months ended June 30, 2018. The ratio of the ALL to loans outstanding was 1.19% at June 30, 2019, 1.10% at December 31, 2018 and 1.04% at June 30, 2018.

The ratio of net recoveries to average loans for the six months ended June 30, 2019 was an annualized .05%, compared to a net charge-off to average loans of .20% for the same period in 2018 and a net charge-off to average loans ratio of .11% for the year ended December 31, 2018. The CRE portfolio had an annualized net recovery rate of .02% as of June 30, 2019, compared to a net charge-off rate of .33% as of December 31, 2018. The A&D loans had an annualized net recovery rate of .14% as of June 30, 2019, compared to a net recovery rate of .15% as of December 31, 2018. The C&I loans had a net recovery rate of .13% as of June 30, 2019, compared to .06% as of December 31, 2018. The residential mortgage ratios were a net recovery rate of .05% as of June 30, 2019, compared to a net charge-off rate of .01% as of December 31, 2018, and the consumer loan ratios were net charge-off rates of .26% and .95% as of June 30, 2019 and December 31, 2018, respectively.

Management believes that the ALL at June 30, 2019 is adequate to provide for probable losses inherent in our loan portfolio. Amounts that will be recorded for the provision for loan losses in future periods will depend upon trends in the loan balances, including the composition of the loan portfolio, changes in loan quality and loss experience trends, potential recoveries on previously charged-off loans and changes in other qualitative factors. Management also applies interest rate risk, collateral value and debt service sensitivity analyses to the Commercial real estate loan portfolio and obtains new appraisals on specific loans under defined parameters to assist in the determination of the periodic provision for loan losses.

Investment Securities

At June 30, 2019, the total amortized cost basis of the available-for-sale investment portfolio was $139.3 million, compared to a fair value of $135.8 million. Unrealized gains and losses on securities available-for-sale are reflected in accumulated other comprehensive loss, a component of shareholders' equity. The amortized cost basis of the held to maturity portfolio was $97.5 million, compared to a fair value of $102.5 million.

The following table presents the composition of our securities portfolio at amortized cost and fair values at the dates indicated:

	June 30, 2019			December 31, 2018		
(dollars in thousands)	Amortized Cost	Fair Value (FV)	FV as % of Total	Amortized Cost	Fair Value (FV)	FV as % of Total
Securities Available-for-Sale:						
U.S. government agencies	$ 30,000	$ 29,833	22%	$ 30,000	$ 29,026	21%
Commercial mortgage-backed agencies	42,487	42,346	31%	39,013	37,752	27%
Collateralized mortgage obligations	34,010	34,127	25%	36,669	35,704	26%
Obligations of state and political subdivisions	14,379	14,631	11%	20,083	19,882	15%
Collateralized debt obligations	18,387	14,872	11%	18,358	15,277	11%
Total available for sale	$ 139,263	$ 135,809	100%	$ 144,123	$ 137,641	100%
Securities Held to Maturity:						
U.S. government agencies	$ 16,090	$ 16,714	16%	$ 16,017	$ 16,137	17%
Residential mortgage-backed agencies	47,320	47,212	46%	46,491	45,210	48%
Commercial mortgage-backed agencies	15,672	16,101	16%	15,821	15,828	17%
Collateralized mortgage obligations	3,577	3,582	4%	3,761	3,605	4%
Obligations of state and political subdivisions	14,840	18,894	18%	11,920	12,980	14%
Total held to maturity	$ 97,499	$ 102,503	100%	$ 94,010	$ 93,760	100%

Total investment securities available-for-sale decreased by $1.8 million since December 31, 2018. At June 30, 2019, the securities classified as available-for-sale included a net unrealized loss of $3.5 million, which represents the difference between the fair value and amortized cost of securities in the portfolio.

As discussed in Note 7 to the consolidated financial statements presented elsewhere in this report, the Corporation measures fair market values based on the fair value hierarchy established in ASC Topic 820, *Fair Value Measurements and Disclosures*. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Level 3 prices or valuation techniques require inputs that are both significant to the valuation assumptions and are not readily observable in the market (i.e. supported with little or no market activity). These Level 3 instruments are valued based on both observable and unobservable inputs derived from the best available data, some of which is internally developed, and considers risk premiums that a market participant would require.

Approximately $120.9 million of the available-for-sale portfolio was valued using Level 2 pricing and had net unrealized gains of $61 thousand at June 30, 2019. The remaining $14.9 million of the securities available-for-sale represents the entire CDO portfolio, which was valued using significant unobservable inputs (Level 3 assets). The $3.5 million in net unrealized losses associated with this portfolio relates to 9 pooled trust preferred securities that comprise the CDO portfolio. Net unrealized losses of $2.3 million represent non-credit related OTTI charges on seven of the securities, while $1.2 million of unrealized losses relates to two securities which have had no credit related OTTI.

The following table provides a summary of the trust preferred securities in the CDO portfolio and the credit status of these securities as of June 30, 2019:

Level 3 Investment Securities Available for Sale

(Dollars in thousands)

Investment Description		First United Level 3 Investments				Security Credit Status					
Deal	Class	Amortized Cost	Fair Market Value	Unrealized Gain/ (Loss)	Lower Credit Rating	Original Collateral	Deferrals/ Defaults as % of Original Collateral	Performing Collateral	Collateral Support	Collateral Support as % of Performing Collateral	Number of Performing Issuers/ Total Issuers
Preferred Term Security XVIII*	C	1,913	1,338	(575)	C	676,565	15.47%	291,560	11,635	3.99%	41 / 57
Preferred Term Security XVIII	C	2,746	2,007	(739)	C	676,565	15.47%	291,560	11,635	3.99%	41 / 57
Preferred Term Security XIX*	C	1,811	1,624	(187)	C	700,535	6.18%	490,262	27,434	5.60%	52 / 57
Preferred Term Security XIX*	C	1,079	975	(104)	C	700,535	6.18%	490,262	27,434	5.60%	52 / 57
Preferred Term Security XIX*	C	2,490	2,274	(216)	C	700,535	6.18%	490,262	27,434	5.60%	52 / 57
Preferred Term Security XIX*	C	1,080	975	(105)	C	700,535	6.18%	490,262	27,434	5.60%	52 / 57
Preferred Term Security XXII*	C-1	1,552	1,269	(283)	C	1,386,600	10.86%	679,548	60,990	8.98%	60 / 74
Preferred Term Security XXII*	C-1	3,879	3,172	(707)	C	1,386,600	10.86%	679,548	60,990	8.98%	60 / 74
Preferred Term Security XXIII	C-1	1,837	1,238	(599)	C	1,467,000	14.79%	720,108	61,624	8.56%	76 / 90
Total Level 3 Securities Available for Sale		18,387	14,872	(3,515)							

The terms of the debentures underlying trust preferred securities allow the issuer of the debentures to defer interest payments for up to 20 quarters, and, in such case, the terms of the related trust preferred securities allow their issuers to defer dividend payments for up to 20 quarters. Some of the issuers of the trust preferred securities in our investment portfolio have defaulted and/or deferred payments ranging from 6.18% to 15.47% of the total collateral balances underlying the securities. The securities were designed to include structural features that provide investors with credit enhancement or support to provide default protection by subordinated tranches. These features include over-collateralization of the notes or subordination, excess interest or spread which will redirect funds in situations where collateral is insufficient, and a specified order of principal payments. There are securities in our portfolio that are under-collateralized, which does represent additional stress on our tranche. However, in these cases, the terms of the securities require excess interest to be redirected from subordinate tranches as credit support, which provides additional support to our investment.

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of ASC Topic 320 (Section 320-10-35), management must assess whether (a) the Corporation has the intent to sell the security and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair value of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses. The other losses are recognized in other comprehensive income. In estimating OTTI charges, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the security, (4) changes in the rating of a security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Due to the duration and the significant market value decline in the pooled trust preferred securities held in our portfolio, we performed more extensive testing on these securities for purposes of evaluating whether or not an OTTI has occurred.

The market for these securities as of June 30, 2019 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as no new CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities, or any securities other than those issued or guaranteed by the U.S. Department of the Treasury (the "Treasury"), are very depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (a) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at June 30, 2019, (b) an income valuation approach technique (i.e. present value) that maximizes the use of relevant unobservable inputs and minimizes the use of observable inputs will be equally or more representative of fair value than a market approach, and (c) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management relies on an independent third party to prepare both the evaluations of OTTI and the fair value determinations for the CDO portfolio. Management does not believe that there were any material differences in the OTTI evaluations and pricing between December 31, 2018 and June 30, 2019.

The approach used by the third party to determine fair value involved several steps, which included detailed credit and structural evaluation of each piece of collateral in each bond, projection of default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities, with a limited market for highly-rated CDO securities that are more senior in the capital structure than the securities in the CDO portfolio. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that no securities had credit-related OTTI during the first six months of 2019.

Deposits

The following table presents the composition of our deposits at the dates indicated:

(dollars in thousands)	**June 30, 2019**		**December 31, 2018**	
Non-interest bearing demand deposits:				
Retail	$ 281,307	25%	$ 262,250	25%
Interest-bearing deposits:				
Demand	162,182	14%	163,334	15%
Money Market:				
Retail	254,949	23%	234,038	22%
Savings deposits	163,394	15%	156,236	15%
Time deposits less than $100,000:				
Retail	99,522	9%	99,088	9%
Time deposits $100,000 or more:				
Retail	136,727	12%	127,581	12%
Brokered	25,000	2%	25,000	2%
Total Deposits	$ 1,123,081	100%	$ 1,067,527	100%

Total deposits increased $55.6 million during the first six months of 2019 when compared to deposits at December 31, 2018. During the first six months of 2019, non-interest bearing deposits increased $19.1 million. This growth was driven by both our retail market and our commercial market, as we continued to grow existing relationships as well as engage new relationships. Traditional savings accounts increased $7.2 million as our Prime Saver product continues to be the savings product of choice. Total demand deposits decreased $1.2 million and total money market accounts increased $20.9 million due primarily to new balances in our Value money market account introduced in late 2018. Time deposits less than $100,000 increased $.4 million and time deposits greater than $100,000 increased $9.1 million. In the fourth quarter of 2018, two short-term brokered CDs were purchased to shift $25.0 million of overnight borrowings as a tool to lock in pricing and manage interest rate risk. These brokered CDs have maturities of less than 18 months.

Borrowed Funds

The following table presents the composition of our borrowings at the dates indicated:

(in thousands)	**June 30, 2019**	**December 31, 2018**
Fed Funds Purchased	$ —	$ 40,000
Securities sold under agreements to repurchase	31,155	37,707
Total short-term borrowings	$ 31,155	$ 77,707
FHLB advances	$ 70,000	$ 70,000
Junior subordinated debt	30,929	30,929
Total long-term borrowings	$ 100,929	$ 100,929

Total short-term borrowings decreased by $46.6 million during the first six months of 2019. This decrease was due to a decrease in overnight borrowings of $40.0 million due to the strong deposit growth to repay the borrowings. Long-term borrowings remained constant during the first six months of 2019.

Liquidity Management

Liquidity is a financial institution's capability to meet customer demands for deposit withdrawals while funding all credit-worthy loans. The factors that determine the institution's liquidity are:

- Reliability and stability of core deposits;
- Cash flow structure and pledging status of investments; and
- Potential for unexpected loan demand.

We actively manage our liquidity position through regular meetings of a sub-committee of executive management, known as the Treasury Team, which looks forward 12 months at 30-day intervals. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Monthly reviews by management and quarterly reviews by the Asset and Liability Committee under prescribed policies and procedures are designed to ensure that we will maintain adequate levels of available funds.

It is our policy to manage our affairs so that liquidity needs are fully satisfied through normal Bank operations. That is, the Bank will manage its liquidity to minimize the need to make unplanned sales of assets or to borrow funds under emergency conditions. The Bank will use funding sources where the interest cost is relatively insensitive to market changes in the short run (periods of one year or less) to satisfy operating cash needs. The remaining normal funding will come from interest-sensitive liabilities, either deposits or borrowed funds. When the marginal cost of needed wholesale funding is lower than the cost of raising this funding in the retail markets, the Corporation may supplement retail funding with external funding sources such as:

1. Unsecured Fed Funds lines of credit with upstream correspondent banks (M&T Bank, Pacific Coast Banker's Bank ("PCBB"), PNC Financial Services ("PNC"), Atlantic Community Bankers Bank, Community Bankers Bank, SunTrust and Zions National Bank).
2. Secured advances with the FHLB of Atlanta, which are collateralized by eligible one to four family residential mortgage loans, home equity lines of credit, commercial real estate loans, various securities and pledged cash.
3. Secured line of credit with the Fed Discount Window for use in borrowing funds up to 90 days, using municipal securities as collateral.
4. Brokered deposits, including CDs and money market funds, provide a method to generate deposits quickly. These deposits are strictly rate driven but often provide the most cost-effective means of funding growth.
5. One Way Buy CDARS/ICS funding – a form of brokered deposits that has become a viable supplement to brokered deposits obtained directly.

Management believes that we have adequate liquidity available to respond to current and anticipated liquidity demands and is not aware of any trends or demands, commitments, events or uncertainties that are likely to materially affect our ability to maintain liquidity at satisfactory levels.

Market Risk and Interest Sensitivity

Our primary market risk is interest rate fluctuation. Interest rate risk results primarily from the traditional banking activities that we engage in, such as gathering deposits and extending loans. Many factors, including economic and financial conditions, movements in interest rates and consumer preferences affect the difference between the interest earned on our assets and the interest paid on our liabilities. Interest rate sensitivity refers to the degree that earnings will be impacted by changes in the prevailing level of interest rates. Interest rate risk arises from mismatches in the repricing or maturity characteristics between interest-bearing assets and liabilities. Management seeks to minimize fluctuating net interest margins, and to enhance consistent growth of net interest income through periods of changing interest rates. Management uses interest sensitivity gap analysis and simulation models to measure and manage these risks. The interest rate sensitivity gap analysis assigns each interest-earning asset and interest-bearing liability to a time frame reflecting its next repricing or maturity date. The differences between total interest-sensitive assets and liabilities at each time interval represent the interest sensitivity gap for that interval. A positive gap generally indicates that rising interest rates during a given interval will increase net interest income, as more assets than liabilities will reprice. A negative gap position would benefit us during a period of declining interest rates.

At June 30, 2019, we were asset sensitive.

Our interest rate risk management goals are:

- Ensure that the Board of Directors and senior management will provide effective oversight and ensure that risks are adequately identified, measured, monitored and controlled;
- Enable dynamic measurement and management of interest rate risk;
- Select strategies that optimize our ability to meet our long-range financial goals while maintaining interest rate risk within policy limits established by the Board of Directors;
- Use both income and market value oriented techniques to select strategies that optimize the relationship between risk and return; and
- Establish interest rate risk exposure limits for fluctuation in net interest income ("NII"), net income and economic value of equity.

In order to manage interest sensitivity risk, management formulates guidelines regarding asset generation and pricing, funding sources and pricing, and off-balance sheet commitments. These guidelines are based on management's outlook regarding future interest rate movements, the state of the regional and national economy, and other financial and business risk factors. Management uses computer simulations to measure the effect on net interest income of various interest rate scenarios. Key assumptions used in the computer simulations include cash flows and maturities of interest rate sensitive assets and liabilities, changes in asset volumes and pricing, and management's capital plans. This modeling reflects interest rate changes and the related impact on net interest income over specified periods.

We evaluate the effect of a change in interest rates of +/-100 basis points to +/-400 basis points on both NII and Net Portfolio Value ("NPV") / Economic Value of Equity ("EVE"). We concentrate on NII rather than net income as long as NII remains the significant contributor to net income.

NII modeling allows management to view how changes in interest rates will affect the spread between the yield paid on assets and the cost of deposits and borrowed funds. Unlike traditional Gap modeling, NII modeling takes into account the different degree to which installments in the same repricing period will adjust to a change in interest rates. It also allows the use of different assumptions in a falling versus a rising rate environment. The period considered by the NII modeling is the next eight quarters.

NPV / EVE modeling focuses on the change in the market value of equity. NPV / EVE is defined as the market value of assets less the market value of liabilities plus/minus the market value of any off-balance sheet positions. By effectively looking at the present value of all future cash flows on or off the balance sheet, NPV / EVE modeling takes a longer-term view of interest rate risk. This complements the shorter-term view of the NII modeling.

Measures of NII at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

Based on the simulation analysis performed at June 30, 2019 and December 31, 2018, management estimated the following changes in net interest income, assuming the indicated rate changes:

(Dollars in thousands)	June 30, 2019	December 31, 2018
+400 basis points	$ 1,064	$ (1,939)
+300 basis points	$ 1,018	$ (1,284)
+200 basis points	$ 831	$ (652)
+100 basis points	$ 498	$ (163)
-100 basis points	$ (1,493)	$ (4,007)

This estimate is based on assumptions that may be affected by unforeseeable changes in the general interest rate environment and any number of unforeseeable factors. Rates on different assets and liabilities within a single maturity category adjust to changes in interest rates to varying degrees and over varying periods of time. The relationships between lending rates and rates paid on purchased funds are not constant over time. Management can respond to current or anticipated market conditions by lengthening or shortening the Bank's sensitivity through loan repricings or changing its funding mix. The rate of growth in interest-free sources of funds will influence the level of interest-sensitive funding sources. In addition, the absolute level of interest rates will affect the volume of earning assets and funding sources. As a result of these limitations, the interest-sensitive gap is only one factor to be considered in estimating the net interest margin.

Management believes that no material changes in our market risks, our procedures used to evaluate and mitigate those risks, or our actual or simulated sensitivity positions have occurred since December 31, 2018. Our NII simulation analysis as of December 31, 2018 is included in Item 7 of Part II Item 7 of Part II of our Annual Report on Form 10-K for the year ended December 31, 2018 under the heading "Market Risk and Interest Sensitivity.

Impact of Inflation – Our assets and liabilities are primarily monetary in nature, and as such, future changes in prices do not affect the obligations to pay or receive fixed and determinable amounts of money. During inflationary periods, monetary assets lose value in terms of purchasing power and monetary liabilities have corresponding purchasing power gains. The concept of purchasing power is not an adequate indicator of the impact of inflation on financial institutions because it does not incorporate changes in our earnings.

Capital Resources

We require capital to fund loans, satisfy our obligations under the Bank's letters of credit, meet the deposit withdrawal demands of the Bank's customers, and satisfy our other monetary obligations. To the extent that deposits are not adequate to fund our capital requirements, we can rely on the funding sources identified above under the heading "Liquidity Management". At June 30, 2019, the Bank had $115.0 million available through unsecured lines of credit with correspondent banks, $2.1 million available through a secured line of credit with the Fed Discount Window and approximately $144.0 million available through the FHLB. Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our ability to meet our future capital requirements.

In addition to operational requirements, the Bank and the Corporation are subject to risk-based capital regulations, which were adopted and are monitored by federal banking regulators. These regulations are used to evaluate capital adequacy and require an analysis of an institution's asset risk profile and off-balance sheet exposures, such as unused loan commitments and stand-by letters of credit.

On July 2, 2013, the FRB approved final rules that substantially amended the regulatory risk-based capital rules applicable to First United Corporation. The Federal Deposit Insurance Corporation subsequently approved the same rules which apply to the Bank. The final rules implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act and were implemented as of March 31, 2015.

The Basel III capital rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and which refine the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation under the final rules are: (a) a new common equity Tier 1 capital ratio of 4.5%; (b) a Tier 1 capital ratio of 6% (increased from 4%); (c) a total capital ratio of 8% (unchanged from current rules); and (d) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a "capital conservation buffer" above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (1) a common equity Tier 1 capital ratio of 7.0%, (2) a Tier 1 capital ratio of 8.5%, and (3) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The Basel III capital final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that no longer qualify as Tier 1 capital, some of which will be phased out over time. Under the final rules, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations like the Corporation and the Bank that are not considered "advanced approaches" banking organizations may make a one-time permanent election to continue to exclude these items. The Corporation and the Bank made this election in their first quarter 2015 regulatory filings in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Corporation's available-for-sale securities portfolio. Additionally, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 (such as the Corporation's TPS Debentures) in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The Basel III capital rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions if their capital levels begin to show signs of weakness. These revisions were effective January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions are required to meet the following capital level requirements in order to qualify as "well capitalized": (a) a new common equity Tier 1 capital ratio of 6.5%; (b) a Tier 1 capital ratio of 8% (increased from 6%); (c) a total capital ratio of 10% (unchanged from current rules); and (d) a Tier 1 leverage ratio of 5% (increased from 4%).

The Basel III capital rules set forth certain changes for the calculation of risk-weighted assets. These changes include (a) an increased number of credit risk exposure categories and risk weights; (b) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (c) revisions to recognition of credit risk mitigation; (d) rules for risk weighting of equity exposures and past due loans, and (e) revised capital treatment for derivatives and repo-style transactions.

Regulators may require higher capital ratios when warranted by the particular circumstances or risk profile of a given banking organization. In the current regulatory environment, banking organizations must stay well capitalized in order to receive favorable regulatory treatment on acquisition and other expansion activities and favorable risk-based deposit insurance assessments. Our capital policy establishes guidelines meeting these regulatory requirements and takes into consideration current or anticipated risks as well as potential future growth opportunities.

The following table presents our capital ratios as of the dates indicated:

	June 30, 2019	December 31, 2018	Required for Capital Adequacy Purposes	Required to be Well Capitalized
Total Capital (to risk-weighted assets)				
Consolidated	16.46%	15.91%	8.00%	10.00%
First United Bank & Trust	15.79%	15.43%	8.00%	10.00%
Tier 1 Capital (to risk-weighted assets)				
Consolidated	15.33%	14.87%	6.00%	8.00%
First United Bank & Trust	14.63%	14.35%	6.00%	8.00%
Common Equity Tier 1 Capital (to risk-weighted assets)				
Consolidated	12.88%	12.45%	4.50%	6.50%
First United Bank & Trust	14.63%	14.35%	4.50%	6.50%
Tier 1 Capital (to average assets)				
Consolidated	11.65%	11.47%	4.00%	5.00%
First United Bank & Trust	10.87%	10.70%	4.00%	5.00%

Contractual Obligations, Commitments and Off-Balance Sheet Arrangements

Contractual Obligations

The Corporation enters into contractual obligations in the normal course of business. Among these obligations are FHLB advances and junior subordinated debentures, operating lease agreements for banking and subsidiaries' offices and for data processing and telecommunications equipment. Comparing June 30, 2019 to December 31, 2018, short-term borrowings decreased $46.6 million, primarily due to the full repayment of overnight borrowings that were included in the December 31, 2018 balances.

Commitments

Loan commitments are made to accommodate the financial needs of our customers. Letters of credit commit us to make payments on behalf of customers when certain specified future events occur. The credit risks inherent in loan commitments and letters of credit are essentially the same as those involved in extending loans to customers, and these arrangements are subject to our normal credit policies. We are not a party to any other off-balance sheet arrangements.

Commitments to extend credit in the form of consumer, commercial and business at the dates indicated were as follows:

(in thousands)	June 30, 2019	December 31, 2018
Residential Mortgage - home equity	$ 53,239	$ 49,294
Residential Mortgage - construction	5,467	6,790
Commercial	58,885	63,668
Consumer - personal credit lines	3,976	3,847
Standby letters of credit	8,579	3,391
Total	$ 130,146	$ 126,990

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The information required by this item is included in Item 2 of Part I of this report under the caption "*Market Risk and Interest Sensitivity*" and in Item 7 of Part II of First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2018 under the heading "Market Risk and Interest Sensitivity" both of which are incorporated in this Item 3 by reference.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 with the SEC, such as this Quarterly Report, is recorded, processed, summarized and reported within the periods specified in those rules and forms, and that such information is accumulated and communicated to our management, including First United Corporation's principal executive officer ("PEO") and its principal financial officer ("PFO"), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls as of June 30, 2019 was carried out under the supervision and with the participation of management, including the PEO and the PFO. Based on that evaluation, management, including the PEO and the PFO, has concluded that our disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

During the quarter ended June 30, 2019, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

The risks and uncertainties to which our financial condition and operations are subject are discussed in detail in Item 1A of Part I of First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2018. Management does not believe that any material changes in our risk factors have occurred since they were last disclosed.

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

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits filed or furnished with this quarterly report are listed in the following Exhibit Index.

Exhibit	Description
31.1	Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith)
31.2	Certifications of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith)
32	Certification of the Principal Executive Officer and the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith)
101.INS	XBRL Instance Document (filed herewith)
101.SCH	XBRL Taxonomy Extension Schema (filed herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (filed herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (filed herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase (filed herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (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.

FIRST UNITED CORPORATION

Date: August 8, 2019	/s/ Carissa L. Rodeheaver Carissa L. Rodeheaver, CPA, CFP Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
Date: August 8, 2019	/s/ Tonya K. Sturm Tonya K. Sturm, Senior Vice President, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

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Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

Certifications of the Principal Executive Officer
Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Carissa L. Rodeheaver, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First United Corporation;

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 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 13a-15(f) and 15d-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 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 adversely 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.

Date: August 8, 2019

/s/ Carissa L. Rodeheaver
Carissa L. Rodeheaver, CPA, CFP
Chairman of the Board, President and Chief Executive Officer
(Principal Executive Officer)

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Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

Certifications of the Principal Financial Officer
Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Tonya K. Sturm, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First United Corporation;

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 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 13a-15(f) and 15d-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 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 adversely 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.

Date: August 8, 2019

/s/ Tonya K. Sturm
Tonya K. Sturm, Senior Vice President,
Chief Financial Officer
(Principal Financial Officer)

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Section 4: EX-32 (EX-32)

Exhibit 32

Certification of Periodic Report
Pursuant to 18 U.S.C. § Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, each of the undersigned hereby certifies that (i) the Quarterly Report of First United Corporation on Form 10-Q for the quarter ended June 30, 2019 filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of First United Corporation.

Date: August 8, 2019	/s/ Carissa L. Rodeheaver Carissa L. Rodeheaver, CPA, CFP Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
Date: August 8, 2019	/s/ Tonya K. Sturm Tonya K. Sturm, Senior Vice President, Chief Financial Officer (Principal Financial Officer)

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