CITIZENS FINANCIAL SERVICES INC
Form 10-Q
May 10, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10 Q

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

For the quarterly period ended March 31, 2017
Or

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

For the transition period from_____________________ to ___________________

Commission file number 0 13222

CITIZENS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23 2265045
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

15 South Main Street
Mansfield, Pennsylvania 16933
(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code: (570) 662 2121

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No_____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes __X__ No_____

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

Large accelerated filer ____ Accelerated filer _X__

Non-accelerated filer ____ Smaller reporting company ____
(Do not check if a smaller reporting company) Emerging growth company ____

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

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

The number of outstanding shares of the Registrant's Common Stock, as of May 2, 2017, was 3,320,366.

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

(in thousands except share data)	March 31 2017	December 31 2016
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$13,587	$16,854
Interest-bearing	1,210	900
Total cash and cash equivalents	14,797	17,754
Interest bearing time deposits with other banks	6,708	6,955
Available-for-sale securities	281,773	314,017
Loans held for sale	1,581	1,827
Loans (net of allowance for loan losses: 2017, $9,405 and 2016, $8,886)	835,902	790,725
Premises and equipment	16,949	17,030
Accrued interest receivable	3,618	4,089
Goodwill	21,089	21,089
Bank owned life insurance	26,389	26,223
Other intangibles	2,012	2,096
Receivable for settlement of security sales	1,297	7,759
Other assets	12,409	13,454
TOTAL ASSETS	$1,224,524	$1,223,018
LIABILITIES:		
Deposits:		
Noninterest-bearing	$157,426	$147,425
Interest-bearing	880,183	858,078
Total deposits	1,037,609	1,005,503
Borrowed funds	46,836	79,662
Accrued interest payable	612	720
Other liabilities	14,511	13,865
TOTAL LIABILITIES	1,099,568	1,099,750
STOCKHOLDERS' EQUITY:		
Preferred Stock $1.00 par value; authorized 3,000,000 shares March 31, 2017 and December 31, 2016; none issued in 2017 or 2016	-	-
Common stock $1.00 par value; authorized 15,000,000 shares; issued 3,704,375 at March 31, 2017 and December 31, 2016	3,704	3,704
Additional paid-in capital	42,256	42,250
Retained earnings	93,172	91,278
Accumulated other comprehensive loss	(1,421)	(1,392)
Treasury stock, at cost: 388,190 shares at March 31, 2017 and 384,671 shares at December 31, 2016	(12,755)	(12,572)

TOTAL STOCKHOLDERS' EQUITY	124,956	123,268
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,224,524	$1,223,018

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

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

	Three Months Ended March 31,	
(in thousands, except share and per share data)	2017	2016
INTEREST INCOME:		
Interest and fees on loans	$9,717	$8,596
Interest-bearing deposits with banks	35	71
Investment securities:		
Taxable	804	944
Nontaxable	668	771
Dividends	76	80
TOTAL INTEREST INCOME	11,300	10,462
INTEREST EXPENSE:		
Deposits	1,045	1,074
Borrowed funds	258	183
TOTAL INTEREST EXPENSE	1,303	1,257
NET INTEREST INCOME	9,997	9,205
Provision for loan losses	615	135
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,382	9,070
NON-INTEREST INCOME:		
Service charges	1,058	1,102
Trust	221	196
Brokerage and insurance	191	209
Gains on loans sold	101	46
Investment securities gains, net	172	27
Earnings on bank owned life insurance	166	170
Other	126	166
TOTAL NON-INTEREST INCOME	2,035	1,916
NON-INTEREST EXPENSES:		
Salaries and employee benefits	4,319	3,882
Occupancy	527	445
Furniture and equipment	139	157
Professional fees	310	287
FDIC insurance	105	157
Pennsylvania shares tax	281	150
Amortization of intangibles	76	82
ORE expenses	90	92
Other	1,344	1,660
TOTAL NON-INTEREST EXPENSES	7,191	6,912
Income before provision for income taxes	4,226	4,074
Provision for income taxes	923	791
NET INCOME	$3,303	$3,283
PER COMMON SHARE DATA:		
Net Income - Basic	$1.00	$0.98
Net Income - Diluted	$1.00	$0.98
Cash Dividends Paid	$0.425	$0.411

Number of shares used in computation - basic	3,313,616	3,356,573
Number of shares used in computation - diluted	3,313,636	3,356,573

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

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended March 31,	
(in thousands)	2017	2016
Net income	$3,303	$3,283
Other comprehensive income (loss):		
Change in unrealized gains on available for sale securities	70	1,694
Income tax effect	(24)	(577)
Change in unrecognized pension cost	60	61
Income tax effect	(21)	(21)
Less: Reclassification adjustment for investment security gains included in net income	(172)	(27)
Income tax effect	58	9
Other comprehensive income (loss), net of tax	(29)	1,139
Comprehensive income	$3,274	$4,422

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

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)	Three Months Ended March 31,	
(in thousands)	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$3,303	$3,283
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	615	135
Depreciation and amortization	108	76
Amortization and accretion of investment securities	382	567
Deferred income taxes	(174)	(115)
Investment securities gains, net	(172)	(27)
Earnings on bank owned life insurance	(166)	(170)
Originations of loans held for sale	(4,727)	(3,913)
Proceeds from sales of loans held for sale	5,075	3,005
Realized gains on loans sold	(101)	(46)
Decrease in accrued interest receivable	471	115
Decrease in accrued interest payable	(108)	(74)
Other, net	1,801	(467)
Net cash provided by operating activities	6,307	2,369
CASH FLOWS FROM INVESTING ACTIVITIES:		
Available-for-sale securities:		
Proceeds from sales	18,766	5,020
Proceeds from maturity and principal repayments	29,858	9,757
Purchase of securities	(11,039)	(25,840)
Purchase of interest bearing time deposits with other banks	(746)	-
Proceeds from redemption of regulatory stock	2,617	112
Purchase of regulatory stock	(1,288)	-
Net increase in loans	(45,880)	(4,454)
Purchase of premises and equipment	(113)	(166)
Proceeds from sale of interest bearing time deposits with other banks	750	-
Proceeds from sale of foreclosed assets held for sale	125	289
Net cash used in investing activities	(6,950)	(15,282)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	32,106	29,780
Proceeds from long-term borrowings	2	2
Net increase in short-term borrowed funds	(32,828)	(1,637)
Purchase of treasury and restricted stock	(396)	(860)
Dividends paid	(1,198)	(1,377)
Net cash (used) provided by financing activities	(2,314)	25,908
Net (decrease) increase in cash and cash equivalents	(2,957)	12,995
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	17,754	24,384
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$14,797	$37,379
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$1,411	$1,331
Income taxes paid	$-	$450
Loans transferred to foreclosed property	$307	$64

Investments and time deposits sold and not settled	$1,297	$-

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

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CITIZENS FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

Citizens Financial Services, Inc. (individually and collectively with its direct and indirect subsidiaries, the "Company") is a Pennsylvania corporation and the holding company of its wholly owned subsidiary, First Citizens Community Bank (the "Bank"), and of the Bank's wholly owned subsidiary, First Citizens Insurance Agency, Inc. ("First Citizens Insurance").

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission ("SEC") and in conformity with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. Certain of the prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or stockholders' equity. All material inter company balances and transactions have been eliminated in consolidation.

In the opinion of management of the Company, the accompanying interim financial statements at March 31, 2017 and for the periods ended March 31, 2017 and 2016 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. The financial performance reported for the Company for the three month period ended March 31, 2017 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Note 2 - Earnings per Share

The following table sets forth the computation of earnings per share. Earnings per share calculations give retroactive effect to stock dividends declared by the Company.

	Three months ended March 31,	
	2017	2016
Net income applicable to common stock	$3,303,000	$3,283,000
Basic earnings per share computation		
Weighted average common shares outstanding	3,313,616	3,356,573
Earnings per share - basic	$1.00	$0.98
Diluted earnings per share computation		
Weighted average common shares outstanding for basic earnings per share	3,313,616	3,356,573
Add: Dilutive effects of restricted stock	20	-
Weighted average common shares outstanding for dilutive earnings per share	3,313,636	3,356,573
Earnings per share - diluted	$1.00	$0.98

For the three months ended March 31, 2017 and 2016, there were 2,087 and 5,325 shares, respectively, related to the restricted stock plan that were excluded from the diluted earnings per share calculations since they were anti-dilutive. These anti-dilutive shares had per share prices ranging from $49.87-$53.15 for the three month period ended March

31, 2017 and per share prices ranging from $46.69-$53.15 for the three month period ended March 31, 2016.

Note 3 - Income Tax Expense

Income tax expense is less than the amount calculated using the statutory tax rate, primarily as a result of tax-exempt income earned from state and municipal securities and loans and investments in affordable housing tax credits.

Investments in Qualified Affordable Housing Projects

As of March 31, 2017 and December 31, 2016, the Company was invested in four partnerships that provide affordable housing. The balance of the investments, which is included within other assets in the Consolidated Balance Sheet, was $660,000 and $700,000 as of March 31, 2017 and December 31, 2016, respectively. Investments purchased prior to January 1, 2015, are accounted for utilizing the effective yield method. As of March 31, 2017, the Company had $811,000 of tax credits remaining that will be recognized over 5.75 years. Tax credits of $35,000 and $50,000 were recognized as a reduction of tax expense during the three months ended March 31, 2017 and 2016, respectively. Amortization of the investment included in other expenses on the Consolidated Statement of Income was $40,000 and $65,000 during the three months ended March 31, 2017 and 2016, respectively.

Note 4 – Investments

The amortized cost, gross unrealized gains and losses, and fair value of investment securities at March 31, 2017 and December 31, 2016 were as follows (in thousands):

March 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agency securities	$ 147,624	$ 297	$ (263)	$ 147,658
Obligations of state and political subdivisions	87,082	1,500	(339)	88,243
Corporate obligations	3,000	95	-	3,095
Mortgage-backed securities in government sponsored entities	41,292	82	(256)	41,118
Equity securities in financial institutions	899	760	-	1,659
Total available-for-sale securities	$ 279,897	$ 2,734	$ (858)	$ 281,773
December 31, 2016				
Available-for-sale securities:				
U.S. agency securities	$ 170,276	$ 407	$ (269)	$ 170,414
U.S. treasury securities	2,999	1	-	3,000
Obligations of state and political subdivisions	95,956	1,463	(493)	96,926
Corporate obligations	3,000	50	-	3,050
Mortgage-backed securities in government sponsored entities	37,987	88	(347)	37,728
Equity securities in financial institutions	1,821	1,078	-	2,899
Total available-for-sale securities	$ 312,039	$ 3,087	$ (1,109)	$ 314,017

The following table shows the Company's gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time, which individual securities have been in a continuous unrealized loss position, at March 31, 2017 and December 31, 2016 (in thousands). As of March 31, 2017, the Company owned 80 securities whose fair value was less than their cost basis.

	Less than Twelve Months		Twelve Months or Greater		Total	
March 31, 2017	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	$61,938	$ (263)	$-	$ -	$61,938	$ (263)
Obligations of state and political subdivisions	18,733	(279)	2,117	(60)	20,850	(339)
Mortgage-backed securities in government sponsored entities	23,028	(221)	3,159	(35)	26,187	(256)
Total securities	$103,699	$ (763)	$5,276	$ (95)	$108,975	$ (858)
December 31, 2016						
U.S. agency securities	$50,947	$ (269)	$-	$ -	$50,947	$ (269)
Obligations of states and political subdivisions	28,398	(472)	767	(21)	29,165	(493)
Mortgage-backed securities in government sponsored entities	26,717	(330)	753	(17)	27,470	(347)
Total securities	$106,062	$ (1,071)	$1,520	$ (38)	$107,582	$ (1,109)

As of March 31, 2017 and December 31, 2016, the Company's investment securities portfolio contained unrealized losses on agency securities issued or backed by the full faith and credit of the United States government or are generally viewed as having the implied guarantee of the U.S. government, obligations of states and political subdivisions and mortgage backed securities issued by government sponsored entities. For fixed maturity investments management considers whether the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the Company does not intend to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings. For equity securities where the fair value has been significantly below cost for one year, the Company's policy is to recognize an impairment loss unless sufficient evidence is available that the decline is not other than temporary and a recovery period can be predicted. The Company has concluded that any impairment of its investment securities portfolio outlined in the above table is not other than temporary and is the result of interest rate changes, sector credit rating changes, or issuer-specific rating changes that are not expected to result in the non-collection of principal and interest during the period.

Proceeds from sales of securities available-for-sale for the three months ended March 31, 2017 and 2016 were $18,766,000 and $5,020,000, respectively. The gross gains and losses were as follows (in thousands):

	Three Months Ended March 31,	
	2017	2016
Gross gains	$172	$ 27

Gross losses	-	-
Net gains	$ 172	$ 27

Investment securities with an approximate carrying value of $206.5 million and $206.3 million at March 31, 2017 and December 31, 2016, respectively, were pledged to secure public funds and certain other deposits.

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Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and fair value of debt securities (excludes equity securities) at March 31, 2017, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Fair Value
Available-for-sale debt securities:		
Due in one year or less	$ 36,081	$ 36,288
Due after one year through five years	141,531	142,341
Due after five years through ten years	38,172	38,283
Due after ten years	63,214	63,202
Total	$ 278,998	$ 280,114

Note 5 – Loans

The Company grants loans primarily to customers throughout north central, central and south central Pennsylvania and the southern tier of New York. Although the Company had a diversified loan portfolio at March 31, 2017 and December 31, 2016, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within these regions. The following table summarizes the primary segments of the loan portfolio and how those segments are analyzed within the allowance for loan losses as of March 31, 2017 and December 31, 2016 (in thousands):

March 31, 2017	Total Loans	Individually evaluated for impairment	Loans acquired with deteriorated credit quality	Collectively evaluated for impairment
Real estate loans:				
Residential	$ 203,817	$ 945	$ 35	$ 202,837
Commercial	267,097	6,347	1,965	258,785
Agricultural	156,299	3,476	737	152,086
Construction	26,118	-	-	26,118
Consumer	10,508	2	1	10,505
Other commercial loans	59,800	5,281	863	53,656
Other agricultural loans	24,227	1,612	-	22,615
State and political subdivision loans	97,441	-	-	97,441
Total	845,307	17,663	3,601	824,043
Allowance for loan losses	9,405	404	-	9,001
Net loans	$ 835,902	$ 17,259	$ 3,601	$ 815,042
December 31, 2016				
Real estate loans:				
Residential	$ 207,423	$ 957	$ 35	$ 206,431
Commercial	252,577	5,742	1,969	244,866
Agricultural	123,624	3,346	738	119,540
Construction	25,441	-	-	25,441
Consumer	11,005	-	4	11,001
Other commercial loans	58,639	5,994	621	52,024
Other agricultural loans	23,388	1,654	-	21,734

State and political subdivision loans	97,514	-	-	97,514
Total	799,611	17,693	3,367	778,551
Allowance for loan losses	8,886	487	-	8,399
Net loans	$790,725	$ 17,206	$ 3,367	$ 770,152

Purchased loans acquired in The First National Bank of Fredericksburg (FNB) acquisition were recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

Upon acquisition, the Company evaluated whether an acquired loan was within the scope of ASC 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality. Purchased credit-impaired ("PCI") loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Based upon management's review, there were no material increases or decreases in the expected cash flows of these loans between December 11, 2015 (the "acquisition date") and March 31, 2017. The fair value of PCI loans, on the acquisition date, was determined, primarily based on the fair value of the loans' collateral. The carrying value of PCI loans was $3,601,000 and $3,367,000 at March 31, 2017 and December 31, 2016, respectively.

The carrying value of the PCI loans was determined by projected discounted contractual cash flows.

Changes in the accretable yield for PCI loans were as follows for the three months ended March 31, 2017 and 2016, respectively (in thousands):

	March 31, 2017	March 31, 2016
Balance at beginning of period	$389	$637
Accretion	(114)	(86)
Balance at end of period	$275	$551

The following table presents additional information regarding loans acquired with specific evidence of deterioration in credit quality under ASC 310-30 (in thousands):

	March 31, 2017	December 31, 2016
Outstanding balance	$6,688	$6,487
Carrying amount	3,601	3,367

The segments of the Company's loan portfolio are disaggregated into classes to a level that allows management to monitor risk and performance. Residential real estate mortgages consist primarily of 15 to 30 year first mortgages on residential real estate, while residential real estate home equity loans are consumer purpose installment loans or lines of credit with terms of 15 years or less secured by a mortgage which is often a second lien on residential real estate. Commercial real estate loans are business purpose loans secured by a mortgage on commercial real estate. Agricultural real estate loans are loans secured by a mortgage on real estate used in agriculture production. Construction real estate loans are loans secured by residential or commercial real estate used during the construction phase of residential and commercial projects. Consumer loans are typically unsecured or primarily secured by assets other than real estate and overdraft lines of credit are typically secured by customer deposit accounts. Other commercial loans are loans for commercial purposes primarily secured by non-real estate collateral. Other agricultural loans are loans for agricultural purposes primarily secured by non-real estate collateral. State and political subdivision loans are loans to state and local municipalities for capital and operating expenses or tax free loans used to finance commercial development.

Management considers other commercial loans, other agricultural loans, state and political subdivision loans, commercial real estate loans and agricultural real estate loans which are 90 days or more past due to be impaired. Management will also consider a loan impaired based on other factors it becomes aware of, including the customer's results of operations and cash flows or if the loan is modified in a troubled debt restructuring. In addition, certain residential mortgages, home equity and consumer loans that are cross collateralized with commercial relationships that are determined to be impaired may also be classified as impaired. Impaired loans are analyzed to determine if it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allocation of the allowance for loan losses or a charge-off to the allowance for loan losses.

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables by class, excluding PCI loans, with the associated allowance amount, if applicable (in thousands):

March 31, 2017	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Real estate loans:					
Mortgages	$ 949	$ 568	$ 322	$ 890	$ 28
Home Equity	55	-	55	55	10
Commercial	8,628	5,937	410	6,347	47
Agricultural	3,487	2,146	1,330	3,476	103
Construction	-	-	-	-	-
Consumer	2	-	2	2	2
Other commercial loans	5,797	4,806	475	5,281	195
Other agricultural loans	1,612	1,593	19	1,612	19
State and political subdivision loans	-	-	-	-	-
Total	$ 20,530	$ 15,050	$ 2,613	$ 17,663	$ 404
December 31, 2016					
Real estate loans:					
Mortgages	$ 953	$ 570	$ 330	$ 900	$ 22
Home Equity	57	-	57	57	10
Commercial	7,958	5,697	45	5,742	45
Agricultural	3,347	2,000	1,347	3,347	54
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
Other commercial loans	6,159	5,135	859	5,994	326
Other agricultural loans	1,653	1,629	24	1,653	30
State and political subdivision loans	-	-	-	-	-
Total	$ 20,127	$ 15,031	$ 2,662	$ 17,693	$ 487

The following tables includes the average balance of impaired financing receivables by class and the income recognized on these receivables for the three month periods ended March 31, 2017 and 2016(in thousands):

	For the Three Months Ended					
	March 31, 2017			March 31, 2016		
	Average Recorded Investmen	Interest Income Recognized	Interest Income Recognized Cash Basis	Average Recorded Investmen	Interest Income Recognized	Interest Income Recognized Cash Basis
Real estate loans:						
Mortgages	$ 894	$ 3	$ -	$ 391	$ 4	$ -
Home Equity	56	1	-	60	1	-
Commercial	5,793	24	3	6,179	26	-
Agricultural	3,382	31	-	165	2	-
Construction	-	-	-	-	-	-
Consumer	1	-	-	-	-	-
Other commercial loans	5,597	40	10	5,952	66	1
Other agricultural loans	1,627	23	-	105	1	-
State and political						

subdivision loans	-	-	-	-	-	-
Total	$17,350	$ 122	$ 13	$12,852	$ 100	$ 1

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Credit Quality Information

For commercial real estate, agricultural real estate, construction, other commercial, other agricultural and state and political subdivision loans, management uses a nine grade internal risk rating system to monitor credit quality. The first five categories are considered not criticized and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The definitions of each rating are defined below:

- Pass (Grades 1-5) – These loans are to customers with credit quality ranging from an acceptable to very high quality and are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.
- Special Mention (Grade 6) – This loan grade is in accordance with regulatory guidance and includes loans where a potential weakness or risk exists, which could cause a more serious problem if not corrected.
- Substandard (Grade 7) – This loan grade is in accordance with regulatory guidance and includes loans that have a well-defined weakness based on objective evidence and be characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful (Grade 8) – This loan grade is in accordance with regulatory guidance and includes loans that have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.
- Loss (Grade 9) – This loan grade is in accordance with regulatory guidance and includes loans that are considered uncollectible, or of such value that continuance as an asset is not warranted.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay the loan as agreed, the Company's loan rating process includes several layers of internal and external oversight. The Company's loan officers are responsible for the timely and accurate risk rating of the loans in each of their portfolios at origination and on an ongoing basis under the supervision of management. All commercial and agricultural loans are reviewed annually to ensure the appropriateness of the loan grade. In addition, the Company engages an external consultant on at least an annual basis to 1) review a minimum of 55% of the dollar volume of the commercial loan portfolio on an annual basis, 2) review new loans originated for over $1.0 million in the last year, 3) review a majority of borrowers with commitments greater than or equal to $1.0 million, 4) review selected loan relationships over $750,000 which are over 30 days past due or classified Special Mention, Substandard, Doubtful, or Loss, and 5) such other loans which management or the consultant deems appropriate.

The following tables represent credit exposures by internally assigned grades as of March 31, 2017 and December 31, 2016 (in thousands):

March 31, 2017	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	$240,229	$14,732	$ 12,136	$ -	$ -	$267,097
Agricultural	143,715	7,835	4,749	-	-	156,299
Construction	26,118	-	-	-	-	26,118
Other commercial loans	53,657	1,560	4,498	85	-	59,800
Other agricultural loans	21,218	1,300	1,709	-	-	24,227
State and political subdivision loans	83,548	13,095	798	-	-	97,441
Total	$568,485	$38,522	$ 23,890	$ 85	$ -	$630,982

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	$225,185	$14,045	$ 13,347	$ -	$ -	$252,577
Agricultural	110,785	8,231	4,608	-	-	123,624
Construction	25,441	-	-	-	-	25,441
Other commercial loans	51,396	2,049	5,105	89	-	58,639