

CHOICEONE FINANCIAL SERVICES INC
Form 10-Q
November 14, 2017

**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 the quarterly period ended September 30, 2017

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: **000-19202**

ChoiceOne Financial Services, Inc.
(Exact Name of Registrant as Specified in its Charter)

Michigan **38-2659066**
(State or Other Jurisdiction of (I.R.S. Employer Identification No.)
Incorporation or Organization)

109 East Division
Sparta, Michigan **49345**
(Address of Principal Executive Offices) (Zip Code)

(616) 887-7366
(Registrant's Telephone Number, including Area Code)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes No

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

As of October 31, 2017, the Registrant had outstanding 3,451,987 shares of common stock.

PART I. FINANCIAL INFORMATIONItem 1. Financial Statements.ChoiceOne Financial Services, Inc.
CONSOLIDATED BALANCE SHEETS

| (Dollars in thousands) | September 30, 2017 (Unaudited) | December 31, 2016 (Audited) |
|---|---|--------------------------------------|
| Assets | | |
| Cash and due from banks | \$ 12,725 | \$ 14,809 |
| Securities available for sale (Note 2) | 173,306 | 174,388 |
| Federal Home Loan Bank stock | 1,994 | 1,994 |
| Federal Reserve Bank stock | 1,573 | 1,573 |
| Loans held for sale | 2,378 | 1,974 |
| Loans to other financial institutions | 13,293 | — |
| Loans (Note 3) | 394,090 | 369,000 |
| Allowance for loan losses (Note 3) | (4,216) | (4,277) |
| Loans, net | 389,874 | 364,723 |
| Premises and equipment, net | 12,271 | 12,588 |
| Cash surrender value of life insurance policies | 14,415 | 14,117 |
| Goodwill | 13,728 | 13,728 |
| Other assets | 6,495 | 7,477 |
| Total assets | \$ 642,052 | \$ 607,371 |
| Liabilities | | |
| Deposits – noninterest-bearing | \$ 136,542 | \$ 127,611 |
| Deposits – interest-bearing | 389,296 | 384,775 |
| Total deposits | 525,838 | 512,386 |
| Federal funds purchased | 2,650 | — |
| Repurchase agreements | 3,794 | 7,913 |
| Advances from Federal Home Loan Bank | 30,276 | 12,301 |
| Other liabilities | 3,188 | 3,073 |
| Total liabilities | 565,746 | 535,673 |

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Shareholders' Equity

| | | |
|--|------------|------------|
| Common stock and paid in capital, no par value; shares authorized: 7,000,000; shares outstanding: 3,451,445 at September 30, 2017 and 3,277,944 at December 31, 2016 | 50,307 | 46,299 |
| Retained earnings | 25,281 | 25,997 |
| Accumulated other comprehensive income (loss), net | 718 | (598) |
| Total shareholders' equity | 76,306 | 71,698 |
| Total liabilities and shareholders' equity | \$ 642,052 | \$ 607,371 |

See accompanying notes to interim consolidated financial statements.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

| (Dollars in thousands, except per share data) | Three Months | | Nine Months | |
|---|---------------|---------------|---------------|---------------|
| | Ended | Ended | Ended | Ended |
| | September 30, | September 30, | September 30, | September 30, |
| | 2017 | 2016 | 2017 | 2016 |
| Interest income | | | | |
| Loans, including fees | \$4,592 | \$4,210 | \$13,157 | \$12,293 |
| Securities: | | | | |
| Taxable | 651 | 594 | 1,935 | 1,731 |
| Tax exempt | 355 | 358 | 1,068 | 1,088 |
| Other | 26 | 5 | 50 | 14 |
| Total interest income | 5,624 | 5,167 | 16,210 | 15,126 |
| Interest expense | | | | |
| Deposits | 320 | 190 | 860 | 599 |
| Advances from Federal Home Loan Bank | 62 | 44 | 169 | 119 |
| Other | 3 | 2 | 10 | 7 |
| Total interest expense | 385 | 236 | 1,039 | 725 |
| Net interest income | 5,239 | 4,931 | 15,171 | 14,401 |
| Provision for loan losses | 95 | — | 120 | — |
| Net interest income after provision for loan losses | 5,144 | 4,931 | 15,051 | 14,401 |
| Noninterest income | | | | |
| Customer service charges | 1,058 | 1,030 | 3,081 | 3,020 |
| Insurance and investment commissions | 260 | 290 | 760 | 740 |
| Gains on sales of loans | 355 | 508 | 920 | 1,345 |
| Gains on sales of securities | 51 | 28 | 177 | 255 |
| (Losses) gains on sales and write-downs of other assets | 17 | (3) | 21 | (26) |
| Earnings on life insurance policies | 101 | 88 | 299 | 265 |
| Other | 141 | 124 | 399 | 360 |
| Total noninterest income | 1,983 | 2,065 | 5,657 | 5,959 |
| Noninterest expense | | | | |
| Salaries and benefits | 2,619 | 2,542 | 7,725 | 7,519 |
| Occupancy and equipment | 702 | 626 | 2,099 | 1,959 |
| Data processing | 551 | 556 | 1,681 | 1,654 |
| Professional fees | 287 | 232 | 778 | 700 |
| Supplies and postage | 102 | 92 | 293 | 312 |
| Advertising and promotional | 58 | 52 | 185 | 184 |
| Intangible amortization | — | 112 | — | 336 |
| FDIC insurance | 51 | 78 | 151 | 218 |

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| | | | | |
|---------------------------------------|---------|---------|---------|---------|
| Other | 421 | 379 | 1,327 | 1,485 |
| Total noninterest expense | 4,791 | 4,669 | 14,239 | 14,367 |
| Income before income tax | 2,336 | 2,327 | 6,470 | 5,993 |
| Income tax expense | 616 | 644 | 1,668 | 1,591 |
| Net income | \$1,720 | \$1,683 | \$4,801 | \$4,402 |
| Basic earnings per share (Note 4) * | \$0.50 | \$0.50 | \$1.39 | \$1.28 |
| Diluted earnings per share (Note 4) * | \$0.50 | \$0.50 | \$1.39 | \$1.28 |
| Dividends declared per share * | \$0.17 | \$0.16 | \$0.50 | \$0.49 |

See accompanying notes to interim consolidated financial statements.

*Note that 2016 per-share amounts have been adjusted for the 5% stock dividend paid on May 31, 2017.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

| (Dollars in thousands) | Three Months Ended September 30, 2017 | | 2016 | | Nine Months Ended September 30, 2017 | | 2016 | |
|---|--|---------|---------|---------|---|--|------|--|
| Net income | \$1,720 | \$1,683 | \$4,801 | \$4,402 | | | | |
| Other comprehensive income: | | | | | | | | |
| Changes in net unrealized gains (loss) on investment securities available for sale, net of tax expense of \$(171) and \$35 for the three months ended September 30, 2017 and September 30, 2016 respectively. Changes in net unrealized gains on investment securities available for sale, net of tax expense of \$738 and \$747 for the nine months ended September 30, 2017 and September 30, 2016 respectively. | (333) | 68 | 1,433 | 1,450 | | | | |
| Less: Reclassification adjustment for realized gain on sale of investment securities available for sale included in net income, net of tax benefit of \$17 and \$9 for the three months ended September 30, 2017 and September 30, 2016 respectively. Reclassification adjustment for realized gain on sale of investment securities available for sale included in net income, net of tax benefit of \$60 and \$87 for the nine months ended September 30, 2017 and September 30, 2016 respectively. | (34) | (19) | (117) | (168) | | | | |
| Other comprehensive income, net of tax | (367) | 49 | 1,316 | 1,282 | | | | |
| Comprehensive income | \$1,353 | \$1,732 | \$6,117 | \$5,684 | | | | |

See accompanying notes to interim consolidated financial statements.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

| (Dollars in thousands) | Number of Shares | Common Stock and Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss), Net | Total |
|--|---------------------|--|----------------------|--|-----------|
| Balance, January 1, 2016 | 3,295,228 | \$ 46,501 | \$ 22,138 | \$ 1,203 | \$ 69,842 |
| Net income | | | 4,402 | | 4,402 |
| Other comprehensive income | | | | 1,282 | 1,282 |
| Shares issued | 11,559 | 137 | | | 137 |
| Shares repurchased | (35,000) | (794) | | | (794) |
| Change in ESOP repurchase obligation | | 127 | | | 127 |
| Effect of employee stock purchases | | 9 | | | 9 |
| Stock-based compensation | 3,414 | 248 | | | 248 |
| Cash dividends declared (\$0.49 per share) * | | | (1,674) | | (1,674) |
| Balance, September 30, 2016 | 3,275,201 | \$ 46,228 | \$ 24,866 | \$ 2,485 | \$ 73,579 |
| Balance, January 1, 2017 | 3,277,944 | \$ 46,299 | \$ 25,997 | \$ (598) | \$ 71,698 |
| Net income | | | 4,801 | | 4,801 |
| Other comprehensive income | | | | 1,316 | 1,316 |
| Shares issued | 7,115 | 115 | | | 115 |
| Shares repurchased | (3,800) | (88) | | | (88) |
| Effect of employee stock purchases | | 9 | | | 9 |
| Stock options exercised | 1,000 | 13 | | | 13 |
| Stock-based compensation expense | | 180 | | | 180 |
| Restricted stock units issued | 5,197 | — | | | — |
| Stock dividend declared (5%) | 163,989 | 3,779 | (3,779) | | — |
| Cash dividends declared (\$0.50 per share) | | | (1,738) | | (1,738) |
| Balance, September 30, 2017 | 3,451,445 | \$ 50,307 | \$ 25,281 | \$ 718 | \$ 76,306 |

See accompanying notes to interim consolidated financial statements.

*Note that 2016 per-share amounts have been adjusted for the 5% stock dividend paid on May 31, 2017.

ChoiceOne Financial Services, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

| (Dollars in thousands) | Nine Months Ended | |
|--|-----------------------|-----------|
| | September 30, 2017 | 2016 |
| Cash flows from operating activities: | | |
| Net income | \$4,801 | \$4,402 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Provision for loan losses | 120 | — |
| Depreciation | 944 | 757 |
| Amortization | 814 | 1,199 |
| Compensation expense on stock purchases and restricted stock units | 241 | 257 |
| Gains on sales of securities | (177) | (255) |
| Gains on sales of loans | (920) | (1,345) |
| Loans originated for sale | (28,356) | (39,173) |
| Proceeds from loan sales | 27,922 | 42,313 |
| Earnings on bank-owned life insurance | (299) | (265) |
| Gains on sales of other real estate owned | (10) | 3 |
| Proceeds from sales of other real estate owned | 579 | 28 |
| Deferred federal income tax benefit | (29) | (86) |
| Net changes in other assets | 572 | (135) |
| Net changes in other liabilities | (532) | 481 |
| Net cash from operating activities | 5,670 | 8,181 |
| Cash flows from investing activities: | | |
| Securities available for sale: | | |
| Sales | 22,521 | 14,538 |
| Maturities, prepayments and calls | 14,163 | 33,412 |
| Purchases | (33,998) | (63,780) |
| Loan originations and payments, net | (38,235) | (13,700) |
| Additions to premises and equipment | (413) | (1,112) |
| Net cash from investing activities | (35,962) | (30,642) |
| Cash flows from financing activities: | | |
| Net change in deposits | 13,452 | 2,691 |
| Net change in repurchase agreements | (4,119) | (3,043) |
| Net change in federal funds purchased | 2,650 | 624 |
| Proceeds from Federal Home Loan Bank advances | 166,500 | 271,000 |
| Payments on Federal Home Loan Bank advances | (148,525) | (245,023) |
| Issuance of common stock | 76 | 137 |
| Repurchase of common stock | (88) | (794) |
| Cash dividends | (1,738) | (1,674) |
| Net cash from financing activities | 28,208 | 23,918 |
| Net change in cash and cash equivalents | (2,084) | 1,457 |
| Beginning cash and cash equivalents | 14,809 | 11,187 |
| Ending cash and cash equivalents | \$12,725 | \$12,644 |

Supplemental disclosures of cash flow information:

| | | |
|--|---------|-------|
| Cash paid for interest | \$1,029 | \$726 |
| Cash paid for taxes | \$1,150 | \$925 |
| Loans transferred to other real estate owned | \$314 | \$483 |

See accompanying notes to interim consolidated financial statements.

ChoiceOne Financial Services, Inc.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include ChoiceOne Financial Services, Inc. (“ChoiceOne”) and its wholly-owned subsidiary, ChoiceOne Bank (the “Bank”), and the Bank’s wholly-owned subsidiary, ChoiceOne Insurance Agencies, Inc. Intercompany transactions and balances have been eliminated in consolidation.

The unaudited condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the company believes that the disclosures made are adequate to make the information not misleading.

The accompanying consolidated financial statements reflect all adjustments ordinary in nature which are, in the opinion of management, necessary for a fair presentation of the Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016, the Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2017 and September 30, 2016, the Consolidated Statements of Comprehensive Income for the three- and nine-month periods ended September 30, 2017 and September 30, 2016, the Consolidated Statements of Changes in Shareholders’ Equity for the nine-month periods ended September 30, 2017 and September 30, 2016, and the Consolidated Statements of Cash Flows for the nine-month periods ended September 30, 2017 and September 30, 2016. Operating results for the nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in ChoiceOne’s Annual Report on Form 10-K for the year ended December 31, 2016.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses inherent in the consolidated loan portfolio. Management’s evaluation of the adequacy of the allowance is an

estimate based on reviews of individual loans, assessments of the impact of current economic conditions on the portfolio and historical loss experience of seasoned loan portfolios. See Note 3 to the interim consolidated financial statements for additional information.

Management believes the accounting estimate related to the allowance for loan losses is a “critical accounting estimate” because (1) the estimate is highly susceptible to change from period to period because of assumptions concerning the changes in the types and volumes of the portfolios and economic conditions and (2) the impact of recognizing an impairment or loan loss could have a material effect on ChoiceOne’s reported assets and net income.

Stock Transactions

A total of 3,881 shares of common stock were issued to ChoiceOne’s Board of Directors for a cash price of \$89,000 under the terms of the Directors’ Stock Purchase Plan in the first nine months of 2017. A total of 1,000 shares of common stock were issued upon the exercise of stock options in the first three quarters of 2017. A total of 3,234 shares of common stock were issued to employees for a cash price of \$62,000 under the Employee Stock Purchase Plan in the first nine months of 2017. A total of 5,197 shares of common stock were issued to employees for Restricted Stock Units that vested during the first nine months of 2017.

Stock-Based Compensation

Effective July 1, 2013, ChoiceOne began granting Restricted Stock Units to a select group of employees under the Stock Incentive Plan of 2012. All of the Restricted Stock Units are initially unvested and vest in three annual installments on each of the next three anniversaries of the grant date. Certain additional vesting provisions apply. Each unit, once vested, is settled by delivery of one share of ChoiceOne common stock.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on securities available for sale and changes in the funded status of post-retirement plans, net of tax, which are also recognized as a separate component of shareholders’ equity.

Revenue Recognition

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The ASU adopts a standardized approach for revenue recognition and was a joint effort with the International Accounting Standards Board (IASB). The new revenue recognition standard is based on a core principle of recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU does not apply to financial instruments. The ASU is effective for public entities for reporting periods beginning after December 15, 2017 (therefore, for the year ending December 31, 2018 for the Corporation). Early implementation is not allowed for public companies. Management is completing an overall assessment of noninterest revenue streams and evaluating the expanded disclosure requirements.

Reclassifications

Certain amounts presented in prior periods have been reclassified to conform to the current presentation.

NOTE 2 - SECURITIES

The fair value of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

| (Dollars in thousands) | September 30, 2017 | | | |
|------------------------------------|--------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. Government and federal agency | \$51,086 | \$ 11 | \$ (444) |) \$50,653 |
| U.S. Treasury | 4,025 | — | (10) |) 4,015 |
| State and municipal | 94,360 | 1,459 | (224) |) 95,595 |
| Mortgage-backed | 9,501 | 17 | (98) |) 9,420 |
| Corporate | 5,696 | 16 | (17) |) 5,695 |
| Foreign debt | 4,512 | — | (72) |) 4,440 |
| Equity securities | 3,083 | 294 | — |) 3,377 |
| Asset-backed securities | 112 | — | (1) |) 111 |
| Total | \$172,375 | \$ 1,797 | \$ (866) |) \$173,306 |

December 31, 2016

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| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|------------------------------------|----------------|------------------------|-------------------------|-------------|
| U.S. Government and federal agency | \$59,864 | \$ 34 | \$ (846 |) \$59,052 |
| U.S. Treasury | 4,111 | — | (39 |) 4,072 |
| State and municipal | 89,169 | 748 | (944 |) 88,973 |
| Mortgage-backed | 7,925 | 19 | (155 |) 7,789 |
| Corporate | 7,069 | 12 | (40 |) 7,041 |
| Foreign debt | 4,514 | — | (114 |) 4,400 |
| Equity securities | 2,617 | 266 | — | 2,883 |
| Asset-backed securities | 182 | — | (4 |) 178 |
| Total | \$175,451 | \$ 1,079 | \$ (2,142 |) \$174,388 |

ChoiceOne reviews its securities portfolio on a quarterly basis to determine whether unrealized losses are considered to be temporary or other-than-temporary. No other-than-temporary impairment charges were recorded in the nine months ended September 30, 2017. ChoiceOne believed that unrealized losses on securities were temporary in nature and were due to changes in interest rates and reduced market liquidity and not as a result of credit quality issues.

Presented below is a schedule of maturities of securities as of September 30, 2017, the fair value of securities as of September 30, 2017 and December 31, 2016, and the weighted average yields of securities as of September 30, 2017:

| (Dollars in thousands) | Securities maturing within: | | | | Fair Value at September 30, 2017 | Fair Value at Dec. 31, 2016 |
|------------------------------------|-----------------------------|----------|-----------|--------------|---|-----------------------------------|
| | Less than | 1 Year - | 5 Years - | More than | | |
| | 1 Year | 5 Years | 10 Years | 10 Years | | |
| U.S. Government and federal agency | \$20,250 | \$28,460 | \$1,943 | \$— | \$50,653 | \$59,052 |
| U.S. Treasury notes and bonds | — | 4,015 | — | — | 4,015 | 4,072 |
| State and municipal | 8,362 | 47,395 | 36,016 | 3,822 | 95,595 | 88,973 |
| Corporate | 5,302 | 393 | — | — | 5,695 | 7,041 |
| Foreign debt securities | 1,000 | 3,440 | — | — | 4,440 | 4,400 |
| Asset-backed securities | 111 | — | — | — | 111 | 178 |
| Total debt securities | 35,025 | 83,703 | 37,959 | 3,822 | 160,509 | 163,716 |
| Mortgage-backed securities | — | 9,330 | 90 | — | 9,420 | 7,789 |
| Equity securities (1) | — | — | 1,000 | 2,377 | 3,377 | 2,883 |
| Total | \$35,025 | \$93,033 | \$39,049 | \$6,199 | \$173,306 | \$174,388 |

(1) Equity securities are preferred and common stock that may or may not have a stated maturity.

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses and balances in the loan portfolio was as follows:

| (Dollars in thousands) | Agricultural land Industrial | Commercial Consumer | Commercial Real Estate | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Unallocated | Total |
|--|------------------------------------|------------------------|------------------------------|------------------------------|--------------------------------|-------------------------------|-------------|----------|
| <u>Allowance for Loan Losses Three Months Ended September 30, 2017</u> | | | | | | | | |
| Beginning balance | \$ 395 | \$ 904 | \$ 294 | \$ 1,551 | \$ 25 | \$ 748 | \$ 181 | \$ 4,098 |
| Charge-offs | — | (12) | (52) | — | — | (9) | — | (73) |
| Recoveries | — | 4 | 16 | 65 | — | 11 | — | 96 |
| Provision | (1) | (98) | 1 | (152) | 1 | (140) | 484 | 95 |
| Ending balance | \$ 394 | \$ 798 | \$ 259 | \$ 1,464 | \$ 26 | \$ 610 | \$ 665 | \$ 4,216 |
| <u>Nine Months Ended September 30, 2017</u> | | | | | | | | |
| Beginning balance | \$ 433 | \$ 688 | \$ 305 | \$ 1,438 | \$ 62 | \$ 1,014 | \$ 337 | \$ 4,277 |
| Charge-offs | — | (374) | (189) | — | — | (44) | — | (607) |
| Recoveries | — | 4 | 107 | 226 | 40 | 49 | — | 426 |
| Provision | (39) | 480 | 36 | (200) | (76) | (409) | 328 | 120 |
| Ending balance | \$ 394 | \$ 798 | \$ 259 | \$ 1,464 | \$ 26 | \$ 610 | \$ 665 | \$ 4,216 |
| Individually evaluated for impairment | \$ — | \$ 5 | \$ 4 | \$ 54 | \$ — | \$ 228 | \$ — | \$ 291 |
| Collectively evaluated for impairment | \$ 394 | \$ 793 | \$ 255 | \$ 1,410 | \$ 26 | \$ 382 | \$ 665 | \$ 3,925 |
| <u>Three Months Ended September 30, 2016</u> | | | | | | | | |
| Beginning balance | \$ 399 | \$ 656 | \$ 279 | \$ 1,133 | \$ 44 | \$ 1,222 | \$ 563 | \$ 4,296 |
| Charge-offs | — | — | (68) | — | — | (25) | — | (93) |
| Recoveries | — | 8 | 49 | 5 | — | 11 | — | 73 |
| Provision | (11) | (55) | 30 | 340 | (3) | (205) | (96) | — |
| Ending balance | \$ 388 | \$ 609 | \$ 290 | \$ 1,478 | \$ 41 | \$ 1,003 | \$ 467 | \$ 4,276 |
| <u>Nine Months Ended September 30, 2016</u> | | | | | | | | |
| Beginning balance | \$ 420 | \$ 586 | \$ 297 | \$ 1,030 | \$ 46 | \$ 1,388 | \$ 427 | \$ 4,194 |
| Charge-offs | — | (33) | (136) | — | — | (94) | — | (263) |
| Recoveries | — | 31 | 119 | 35 | — | 160 | — | 345 |
| Provision | (32) | 26 | 10 | 412 | (5) | (451) | 40 | — |

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| | | | | | | | | |
|---------------------------------------|--------|--------|--------|----------|-------|----------|--------|---------|
| Ending balance | \$ 388 | \$ 610 | \$ 290 | \$ 1,477 | \$ 41 | \$ 1,003 | \$ 467 | \$4,276 |
| Individually evaluated for impairment | \$ 4 | \$ 8 | \$ 1 | \$ 167 | \$ — | \$ 321 | \$ — | \$501 |
| Collectively evaluated for impairment | \$ 384 | \$ 602 | \$ 289 | \$ 1,310 | \$ 41 | \$ 682 | \$ 467 | \$3,775 |

Loans

September 30, 2017

| | | | | | | | | |
|---------------------------------------|-----------|------------|-----------|------------|----------|-----------|--|-----------|
| Individually evaluated for impairment | \$ 424 | \$ 192 | \$ 34 | \$ 936 | \$ — | \$ 2,472 | | \$4,058 |
| Collectively evaluated for Impairment | 45,682 | 101,244 | 23,977 | 122,480 | 7,298 | 89,351 | | 390,032 |
| Ending balance | \$ 46,106 | \$ 101,436 | \$ 24,011 | \$ 123,416 | \$ 7,298 | \$ 91,823 | | \$394,090 |

December 31, 2016

| | | | | | | | | |
|---------------------------------------|-----------|-----------|-----------|------------|----------|-----------|--|-----------|
| Individually evaluated for impairment | \$ 526 | \$ 301 | \$ 28 | \$ 1,073 | \$ — | \$ 2,983 | | \$4,911 |
| Collectively evaluated for impairment | 44,088 | 95,787 | 21,568 | 109,689 | 6,153 | 86,804 | | 364,089 |
| Ending balance | \$ 44,614 | \$ 96,088 | \$ 21,596 | \$ 110,762 | \$ 6,153 | \$ 89,787 | | \$369,000 |

The process to monitor the credit quality of ChoiceOne's loan portfolio includes tracking (1) the risk ratings of business loans, (2) the level of classified business loans, and (3) delinquent and nonperforming consumer loans. Business loans are risk rated on a scale of 1 to 8. A description of the characteristics of the ratings follows:

Risk ratings 1 and 2: These loans are considered pass credits. They exhibit good to exceptional credit risk and demonstrate the ability to repay the loan from normal business operations.

Risk rating 3: These loans are considered pass credits. They exhibit acceptable credit risk and demonstrate the ability to repay the loan from normal business operations.

Risk rating 4: These loans are considered pass credits. However, they have potential developing weaknesses that, if not corrected, may cause deterioration in the ability of the borrower to repay the loan. While a loss is possible for a loan with this rating, it is not anticipated.

Risk rating 5: These loans are considered special mention credits. Loans in this risk rating are considered to be inadequately protected by the net worth and debt service coverage of the borrower or of any pledged collateral. These loans have well defined weaknesses that may jeopardize the borrower's ability to repay the loan. If the weaknesses are not corrected, loss of principal and interest could be probable.

Risk rating 6: These loans are considered substandard credits. These loans have well defined weaknesses, the severity of which makes collection of principal and interest in full questionable. Loans in this category may be placed on nonaccrual status.

Risk rating 7: These loans are considered doubtful credits. Some loss of principal and interest has been determined to be probable. The estimate of the amount of loss could be affected by factors such as the borrower's ability to provide additional capital or collateral. Loans in this category are on nonaccrual status.

Risk rating 8: These loans are considered loss credits. They are considered uncollectible and will be charged off against the allowance for loan losses.

Information regarding the Bank's credit exposure is as follows:

Corporate Credit Exposure - Credit Risk Profile By Creditworthiness Category

| (Dollars in thousands) | Agricultural | | Commercial and Industrial | | Commercial Real Estate | |
|------------------------|----------------------|-------------------|---------------------------|-------------------|------------------------|-------------------|
| | September 30, 2017 | December 31, 2016 | September 30, 2017 | December 31, 2016 | September 30, 2017 | December 31, 2016 |
| | Risk ratings 1 and 2 | \$12,488 | \$12,005 | \$12,691 | \$12,135 | \$8,069 |
| Risk rating 3 | 23,957 | 23,852 | 64,953 | 56,714 | 72,370 | 59,343 |
| Risk rating 4 | 8,865 | 7,505 | 23,141 | 25,895 | 39,920 | 39,641 |
| Risk rating 5 | 373 | 726 | 484 | 1,267 | 1,530 | 1,867 |
| Risk rating 6 | 423 | 526 | 167 | 77 | 1,527 | 1,898 |
| Risk rating 7 | — | — | — | — | — | — |
| | \$46,106 | \$44,614 | \$101,436 | \$96,088 | \$123,416 | \$110,762 |

Corporate Credit Exposure - Credit Risk Profile Based On Payment Activity

| (Dollars in thousands) | Consumer | | Construction Real Estate | | Residential Real Estate | |
|------------------------|--------------------|-------------------|--------------------------|-------------------|-------------------------|-------------------|
| | September 30, 2017 | December 31, 2016 | September 30, 2017 | December 31, 2016 | September 30, 2017 | December 31, 2016 |
| | Performing | \$23,995 | \$21,590 | \$7,298 | \$6,153 | \$91,252 |
| Nonperforming | — | — | — | — | 132 | 229 |
| Nonaccrual | 16 | 6 | — | — | 439 | 791 |
| | \$24,011 | \$21,596 | \$7,298 | \$6,153 | \$91,823 | \$89,787 |

There were no loans that were considered troubled debt restructurings ("TDRs") that were modified during the three- and nine-month periods ended September 30, 2017. The following schedule provides information on loans that were considered TDRs that were modified during the three- and nine-month periods ended September 30, 2016:

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2016 | |
|--|---------------------------------------|-------------------|--------------------------------------|-------------------|
| | Pre-Modification | Post-Modification | Pre-Modification | Post-Modification |
| | | | | |

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| (Dollars in thousands) | Outstanding | | Outstanding | | Outstanding | |
|-------------------------|-------------|------------|-------------|------------|-------------|------------|
| | Number | Recorded | Number | Recorded | Number | Recorded |
| | of | Investment | of | Investment | of | Investment |
| Commercial Real estate | — | \$ — | 1 | \$ 113 | — | \$ 113 |
| Residential Real Estate | — | — | 2 | 156 | — | 156 |
| Total | — | \$ — | 3 | \$ 269 | — | \$ 269 |

The pre-modification and post-modification outstanding recorded investment represents amounts as of the date of loan modification. If a difference exists between the pre-modification and post-modification outstanding recorded investment, it represents impairment recognized through the provision for loan losses computed based on a loan's post-modification present value of expected future cash flows discounted at the loan's original effective interest rate. If no difference exists, a loss is not expected to be incurred based on an assessment of the borrower's expected cash flows.

There were no TDRs as of September 30, 2017 where the borrower was past due with respect to principal and/or interest for 30 days or more during the three months and nine months ended September 30, 2017 that had been modified during the year prior to the default. The following schedule provides information on TDRs as of September 30, 2016 where the borrower was past due with respect to principal and/or interest for 30 days or more during the three months and nine months ended September 30, 2016 that had been modified during the year prior to the default:

| (Dollars in thousands) | Three Months | | Nine Months | |
|------------------------|-----------------------|------------|-----------------------|------------|
| | Ended | Recorded | Ended | Recorded |
| | September 30, 2016 | Investment | September 30, 2016 | Investment |
| Commercial real estate | — | \$ — | 1 | \$ 113 |

Loans are classified as performing when they are current as to principal and interest payments or are past due on payments less than 90 days. Loans are classified as nonperforming when they are past due 90 days or more as to principal and interest payments or are considered a troubled debt restructuring.

Impaired loans by loan category as of September 30, 2017 and 2016 were as follows:

| (Dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| September 30, 2017 | | | | | |
| With no related allowance recorded | | | | | |
| Agricultural | \$ 424 | \$ 455 | \$ — | \$ 288 | \$ — |
| Commercial and industrial | 58 | 69 | — | 137 | — |
| Consumer | — | — | — | — | — |
| Commercial real estate | 113 | 245 | — | 104 | — |
| Residential real estate | 136 | 147 | — | 103 | — |
| Subtotal | 731 | 916 | — | 632 | — |
| With an allowance recorded | | | | | |
| Agricultural | — | — | — | 161 | — |
| Commercial and industrial | 134 | 134 | 5 | 195 | 1 |
| Consumer | 34 | 35 | 4 | 33 | 1 |
| Commercial real estate | 823 | 904 | 54 | 884 | 26 |
| Residential real estate | 2,336 | 2,354 | 228 | 2,475 | 75 |
| Subtotal | 3,327 | 3,427 | 291 | 3,748 | 103 |
| Agricultural | 424 | 455 | — | 449 | — |
| Commercial and industrial | 192 | 203 | 5 | 332 | 1 |
| Consumer | 34 | 35 | 4 | 33 | 1 |
| Commercial real estate | 936 | 1,149 | 54 | 988 | 26 |
| Residential real estate | 2,472 | 2,501 | 228 | 2,578 | 75 |
| Total | \$ 4,058 | \$ 4,343 | \$ 291 | \$ 4,380 | \$ 103 |
| September 30, 2016 | | | | | |
| With no related allowance recorded | | | | | |
| Agricultural | \$ 489 | \$ 493 | \$ — | \$ 154 | \$ (1) |
| Commercial and industrial | 177 | 177 | — | 63 | — |
| Consumer | 5 | 5 | — | 1 | — |
| Commercial real estate | 230 | 351 | — | 1,071 | 33 |
| Residential real estate | 266 | 266 | — | 134 | 46 |
| Subtotal | 1,167 | 1,292 | — | 1,423 | 78 |
| With an allowance recorded | | | | | |
| Agricultural | 45 | 45 | 4 | 79 | 16 |
| Commercial and industrial | 273 | 247 | 8 | 242 | 4 |
| Consumer | 21 | 21 | 1 | 22 | 3 |
| Commercial real estate | 1,229 | 1,799 | 167 | 1,426 | 116 |
| Residential real estate | 2,843 | 2,859 | 321 | 2,670 | 308 |
| Subtotal | 4,411 | 4,971 | 501 | 4,439 | 447 |

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| | | | | | |
|---------------------------|----------|----------|--------|----------|--------|
| Agricultural | 534 | 538 | 4 | 233 | 15 |
| Commercial and industrial | 449 | 424 | 8 | 305 | 4 |
| Consumer | 26 | 26 | 1 | 23 | 3 |
| Commercial real estate | 1,459 | 2,150 | 167 | 2,497 | 149 |
| Residential real estate | 3,110 | 3,125 | 321 | 2,804 | 354 |
| Total | \$ 5,578 | \$ 6,263 | \$ 501 | \$ 5,862 | \$ 525 |

An aging analysis of loans by loan category follows:

| (Dollars in thousands) | 30 to 59 Days | 60 to 89 Days | Greater Than 90 Days (1) | Total | Loans Not Past Due | Total Loans | 90 Days Past Due and Accruing |
|---------------------------|---------------------|---------------------|--------------------------------------|---------|--------------------------|----------------|--|
| September 30, 2017 | | | | | | | |
| Agricultural | \$— | \$— | \$ 83 | \$ 83 | \$46,023 | \$46,106 | \$ — |
| Commercial and industrial | — | — | 58 | 58 | 101,378 | 101,436 | — |
| Consumer | 132 | 1 | 11 | 144 | 23,867 | 24,011 | — |
| Commercial real estate | — | — | 113 | 113 | 123,303 | 123,416 | — |
| Construction real estate | — | — | — | — | 7,298 | 7,298 | — |
| Residential real estate | 625 | 24 | 221 | 870 | 90,953 | 91,823 | 132 |
| | \$757 | \$25 | \$486 | \$1,268 | \$392,822 | \$394,090 | \$ 132 |
| December 31, 2016 | | | | | | | |
| Agricultural | \$— | \$— | \$— | \$— | \$44,614 | \$44,614 | \$ — |
| Commercial and industrial | — | 30 | 245 | 275 | 95,813 | 96,088 | — |
| Consumer | 99 | 2 | 6 | 107 | 21,489 | 21,596 | — |
| Commercial real estate | — | — | 260 | 260 | 110,502 | 110,762 | — |
| Construction real estate | — | — | — | — | 6,153 | 6,153 | — |
| Residential real estate | 1,027 | 109 | 646 | 1,782 | 88,005 | 89,787 | 229 |
| | \$1,126 | \$141 | \$1,157 | \$2,424 | \$366,576 | \$369,000 | \$ 229 |

(1) Includes nonaccrual loans.

Nonaccrual loans by loan category follow:

| (Dollars in thousands) | September 30, 2017 | December 31, 2016 |
|---------------------------|--------------------------|-------------------------|
| Agricultural | \$ 423 | \$ 482 |
| Commercial and industrial | 59 | 245 |
| Consumer | 17 | 6 |
| Commercial real estate | 211 | 458 |
| Construction real estate | — | — |
| Residential real estate | 439 | 792 |
| | \$ 1,149 | \$ 1,983 |

NOTE 4 - EARNINGS PER SHARE

Earnings per share are based on the weighted average number of shares outstanding during the period. A computation of basic earnings per share and diluted earnings per share follows:

| (Dollars in thousands, except per share data) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| <u>Basic Earnings Per Share</u> | | | | |
| Net income available to common shareholders | \$1,720 | \$1,683 | \$4,801 | \$4,402 |
| Weighted average common shares outstanding | 3,452,278 | 3,439,633 | 3,448,341 | 3,455,141 |
| Basic earnings per share | \$0.50 | \$0.50 | \$1.39 | \$1.28 |
| <u>Diluted Earnings Per Share</u> | | | | |
| Net income available to common shareholders | \$1,720 | \$1,683 | \$4,801 | \$4,402 |
| Weighted average common shares outstanding | 3,452,278 | 3,439,633 | 3,448,341 | 3,455,141 |
| Plus dilutive stock options and restricted stock units | 6,370 | 4,146 | 4,744 | 4,380 |
| Weighted average common shares outstanding and potentially dilutive shares | 3,458,648 | 3,443,780 | 3,453,085 | 3,459,520 |
| Diluted earnings per share | \$0.50 | \$0.50 | \$1.39 | \$1.28 |

Note that 2016 share amounts have been adjusted for the 5% stock dividend paid on May 31, 2017.

There were 31,500 stock options for the three months ended September 30, 2017 and 32,550 for the three months ended September 30, 2016 with an exercise price more than the average market price which have been excluded from the calculation of diluted earnings above.

NOTE 5 – FINANCIAL INSTRUMENTS

Financial instruments as of the dates indicated were as follows:

| (Dollars in thousands) | Carrying Amount | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|--------------------|----------------------------|---|---|--|
| <u>September 30, 2017</u> | | | | | |
| Assets: | | | | | |
| Cash and due from banks | \$12,725 | \$12,725 | \$12,725 | \$— | \$— |
| Securities available for sale | 173,306 | 173,306 | 1,877 | 157,886 | 13,543 |
| Federal Home Loan Bank and Federal Reserve Bank stock | 3,567 | 3,567 | — | 3,567 | — |
| Loans held for sale | 2,378 | 2,451 | — | 2,451 | — |
| Loans to other financial institutions | 13,293 | 13,699 | — | — | 13,699 |
| Loans, net | 389,874 | 391,408 | — | — | 391,408 |
| Liabilities: | | | | | |
| Noninterest-bearing deposits | 136,542 | 136,542 | — | 136,542 | — |
| Interest-bearing deposits | 389,296 | 388,603 | — | 388,603 | — |
| Federal funds purchased | 2,650 | 2,650 | — | 2,650 | — |
| Repurchase agreements | 3,794 | 3,794 | — | 3,794 | — |
| Federal Home Loan Bank advances | 30,276 | 30,298 | — | 30,298 | — |
| <u>December 31, 2016</u> | | | | | |
| Assets: | | | | | |
| Cash and due from banks | \$14,809 | \$14,809 | \$14,809 | \$— | \$— |
| Securities available for sale | 174,388 | 174,388 | 1,383 | 157,902 | 15,103 |
| Federal Home Loan Bank and Federal Reserve Bank stock | 3,567 | 3,567 | — | 3,567 | — |
| Loans held for sale | 1,974 | 2,044 | — | 2,044 | — |
| Loans, net | 364,723 | 365,780 | — | — | 365,780 |
| Liabilities: | | | | | |
| Noninterest-bearing deposits | 127,611 | 127,611 | — | 127,611 | — |

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