

MIDDLEFIELD BANC CORP
Form 10-K
March 11, 2014

United States SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of
1934 for the fiscal year ended: December 31, 2013**

Commission File Number: 000-32561

Middlefield Banc Corp.

(Exact name of registrant as specified in its charter)

Ohio	34-1585111
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

15985 East High Street, Middlefield, Ohio 44062-0035
(440) 632-1666
**(Address, including zip code, and telephone number,
including area code, of registrant's principal executive offices)**

Securities registered pursuant to section 12(b) of the Act : none

Securities registered pursuant to section 12(g) of the Act : common stock, without par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by sections 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 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 such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

The aggregate market value on June 30, 2013 of common stock held by non-affiliates of the registrant was approximately \$53.1 million. As of March 11, 2014, there were 2,032,974 shares of common stock issued and outstanding.

Documents Incorporated by Reference Portions of the registrant's definitive proxy statements for the 2014 Annual Meeting of Shareholders are incorporated by reference in Part III of this report. Portions of the Annual Report to Shareholders for the year ended December 31, 2013 are incorporated by reference into Part I and Part II of this report.

MIDDLEFIELD BANC CORP.

YEAR ENDED DECEMBER 31, 2013

INDEX TO FORM 10-K

	Page
Part I	
Item 1. Business	3
Item 1A. Risk Factors	21
Item 1B. Unresolved Staff Comments	27
Item 2. Properties	27
Item 3. Legal Proceedings	28
Item 4. Mine Safety Disclosures	28
Part II	
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	28
Item 6. Selected Financial Data	29
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	29
Item 8. Financial Statements and Supplementary Data	29
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	29
Item 9A. Controls and Procedures	29
Item 9B. Other Information	30
Part III	
Item 10. Directors, Executive Officers of the Registrant, and Corporate Governance	30
Item 11. Executive Compensation	30
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	30
Item 13. Certain Relationships, Related Transactions, and Director Independence	30
Item 14. Principal Accountant Fees and Services	30
Part IV	
Item 15. Exhibits and Financial Statement Schedules	30
SIGNATURES	

Item 1 — Business

Middlefield Banc Corp Incorporated in 1988 under the Ohio General Corporation Law, Middlefield Banc Corp. (“Company”) is a bank holding company registered under the Bank Holding Company Act of 1956. The Company’s subsidiaries are:

The Middlefield Banking Company (“MBC”), an Ohio-chartered commercial bank that began operations in 1901. 1. MBC engages in a general commercial banking business in northeastern Ohio. The principal executive office is located at 15985 East High Street, Middlefield, Ohio 44062-0035, and its telephone number is (440) 632-1666.

EMORECO Inc., an Ohio asset resolution corporation headquartered in Middlefield, Ohio. EMORECO engages in 2. the resolution and disposition of troubled assets in central Ohio. The principal executive office is located at 15985 East High Street, Middlefield, Ohio 44062-0035, and its telephone number is (440) 632-1666.

The Middlefield Banking Company MBC was chartered under Ohio law in 1901. The Company became the holding company for MBC in 1988. MBC offers its customers a broad range of banking services, including checking, savings, and negotiable order of withdrawal (“NOW”) accounts, money market accounts, time certificates of deposit, commercial loans, real estate loans, and various types of consumer loans, safe deposit facilities, and travelers’ checks. MBC offers online banking and bill payment services to individuals and online cash management services to business customers through its website at www.middlefieldbank.com.

Engaged in a general commercial banking business in northeastern and central Ohio, MBC offers commercial banking services principally to small and medium-sized businesses, professionals, small business owners, and retail customers. MBC has developed and continues to monitor and update a marketing program to attract and retain consumer accounts, and to offer banking services and facilities compatible with the needs of its customers.

MBC’s loan products include operational and working capital loans, loans to finance capital purchases, term business loans, residential construction loans, selected guaranteed or subsidized loan programs for small businesses, professional loans, residential mortgage and commercial mortgage loans, and consumer installment loans to purchase automobiles, boats, and for home improvement and other personal expenditures. Although the bank makes agricultural loans, it currently has no significant agricultural loans.

Emerald Bank The Company acquired Emerald Bank (“EB”) on April 19, 2007 for a combination of cash and stock. Until it merged into MBC on January 20, 2014, EB operated as a separate commercial bank subsidiary of the Company, offering essentially the same range of products and services in central Ohio as MBC does in northeastern Ohio.

EMORECO Organized in 2009 as an Ohio corporation under the name EMORECO, Inc. and wholly owned by the Company, the purpose of the asset resolution subsidiary is to maintain, manage, and ultimately dispose of nonperforming loans and other real estate owned (“OREO”) acquired by subsidiary banks as the result of borrower default on real-estate-secured loans. At December 31, 2013, EMORECO’s assets consist of two nonperforming loans and five OREO properties. According to Federal law governing bank holding companies the real estate must be disposed of within two years after the properties were originally acquired by EB, which occurred in May and June of 2008, although limited extensions may be granted by the Federal Reserve Bank. Federal law governing bank holding companies also provides that a holding company subsidiary has limited real estate investment powers. EMORECO may only manage and maintain property and may not improve or develop property without advance approval of the Federal Reserve Bank.

Market Area MBC’s market area in northeastern Ohio consists principally of Geauga, Portage, Trumbull, and Ashtabula Counties. Benefitting from the area’s proximity to Cleveland and Warren, population and income levels have maintained steady growth over the years. Formerly banking offices of Emerald Bank, until Emerald Bank merged into MBC on January 20, 2014, MBC’s two central Ohio branches are located in Dublin and Westerville in Franklin County, north of Columbus.

Competition The banking industry has been changing for many reasons, including continued consolidation within the banking industry, legislative and regulatory changes, and advances in technology. To deliver banking products and services more effectively and efficiently, banking institutions are opening in-store branches, installing more automated teller machines (ATMs) and investing in technology to permit telephone, personal computer, and internet banking. While all banks are experiencing the effects of the changing competitive and technological environment, the manner in which banks choose to compete is increasing the gap between large national and super-regional banks, on one hand, and community banks on the other. Large institutions are committed to becoming national or regional “brand names,” providing a broad selection of products at low cost and with advanced technology, while community banks provide most of the same products but with a commitment to personal service and with local ties to the customers and communities they serve. The Company seeks to take competitive advantage of its local orientation and community banking profile. It competes for loans principally through responsiveness to customers and its ability to communicate effectively with them and understand and address their needs. The Company competes for deposits principally by offering customers personal attention, a variety of banking services, attractive rates, and strategically located banking facilities. The Company seeks to provide high quality banking service to professionals and small and mid-sized businesses, as well as individuals, emphasizing quick and flexible responses to customer demands.

Forward-looking Statements This document contains forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995) about the Company and subsidiaries. Information incorporated in this document by reference, future filings by the Company on Form 10-Q and Form 8-K, and future oral and written statements by the Company and its management may also contain forward-looking statements. Forward-looking statements include statements about anticipated operating and financial performance, such as loan originations, operating efficiencies, loan sales, charge-offs and loan loss provisions, growth opportunities, interest rates, and deposit growth. Words such as “may,” “could,” “should,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “project,” “similar expressions are intended to identify these forward-looking statements.

Forward-looking statements are necessarily subject to many risks and uncertainties. A number of things could cause actual results to differ materially from those indicated by the forward-looking statements. These include the factors we discuss immediately below, those addressed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” other factors discussed elsewhere in this document or identified in our filings with the Securities and Exchange Commission, and those presented elsewhere by our management from time to time. Many of the risks and uncertainties are beyond our control. The following factors could cause our operating and financial performance to differ materially from the plans, objectives, assumptions, expectations, estimates, and intentions expressed in forward-looking statements:

- the strength of the United States economy in general and the strength of the local economies in which we conduct our operations; general economic conditions, either nationally or regionally, may be less favorable than we expect, resulting in a deterioration in the credit quality of our loan assets, among other things
- the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest-rate policies of the Federal Reserve Board
- inflation, interest rate, market, and monetary fluctuations
- the development and acceptance of new products and services of the Company and subsidiaries and the perceived overall value of these products and services by users, including the features, pricing, and quality compared to competitors’ products and services
- the willingness of users to substitute our products and services for those of competitors

- the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities, and insurance)

- changes in consumer spending and saving habits

Forward-looking statements are based on our beliefs, plans, objectives, goals, assumptions, expectations, estimates, and intentions as of the date the statements are made. Investors should exercise caution because the Company cannot give any assurance that its beliefs, plans, objectives, goals, assumptions, expectations, estimates, and intentions will be realized. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise.

Lending — *Loan Portfolio Composition and Activity.* The Company makes residential mortgage and commercial mortgage loans, home equity loans, secured and unsecured consumer installment loans, commercial and industrial loans, and real estate construction loans for owner-occupied and rental properties. The Company's loan policy aspires to a loan composition mix consisting of approximately 40% to 50% residential real estate loans, 35% to 40% commercial loans, consumer loans of 5% to 15%, and credit card accounts of up to 5%.

Although Ohio Bank law imposes no material restrictions on the kinds of loans the Company may make, real estate-based lending has historically been the primary focus. For prudential reasons, we avoid lending on the security of real estate located outside our market area, although previously EB had extended a number of real-estate secured loans in the southwestern Ohio market. Ohio Bank law does restrict the amount of loans an Ohio-chartered bank may make, however, generally providing that loans and extensions of credit to any single borrower may not exceed 15% of capital. An additional margin of 10% of capital is allowed for loans fully secured by readily marketable collateral. This 15% legal lending limit has not been a material restriction on lending. We can accommodate loan volumes exceeding the legal lending limit by selling loan participations to other banks. As of December 31, 2013, MBC's 15%-of-capital limit on loans to a single borrower was approximately \$8.0 million.

The Company offers specialized loans for business and commercial customers, including equipment and inventory financing, real estate construction loans and Small Business Administration loans for qualified businesses. A substantial portion of the Banks' commercial loans are designated as real estate loans for regulatory reporting purposes because they are secured by mortgages on real property. Loans of that type may be made for purpose of financing commercial activities, such as accounts receivable, equipment purchases and leasing, but they are secured by real estate to provide the Bank with an extra measure of security. Although these loans might be secured in whole or in part by real estate, they are treated in the discussions to follow as commercial and industrial loans. The Company's consumer installment loans include secured and unsecured loans to individual borrowers for a variety of purposes, including personal, home improvements, revolving credit lines, autos, boats, and recreational vehicles.

Total amount due	\$54,498	\$ 25,601	\$210,310	\$ 141,171	\$ 4,145	\$435,725
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Loans due on demand and overdrafts are included in the amount due in one year or less. The Company has no loans without a stated schedule of repayment or a stated maturity.

The following table shows on a consolidated basis the dollar amount of all loans due after December 31, 2013 that have pre-determined interest rates and the dollar amount of all loans due after December 31, 2013 that have floating or adjustable rates.

	Fixed Rate	Adjustable Rate	Total
(Dollars in thousands)			
Commercial and industrial	\$24,366	\$30,132	\$54,498
Real estate construction	5,803	19,798	25,601
Mortgage:			
Residential	15,556	194,754	210,310
Commercial	8,907	132,264	141,171
Consumer installment	4,078	67	4,145
	\$58,710	\$377,015	\$435,725

Residential Mortgage Loans A significant portion of the Company's lending consists of origination of conventional loans secured by 1-4 family real estate located in Franklin, Geauga, Portage, Trumbull, and Ashtabula Counties. Residential mortgage loans approximated \$210.3 million or 48.3% of the Company's total loan portfolio at December 31, 2013.

The Company makes loans of up to 80% of the value of the real estate and improvements securing a loan (the "loan-to-value" or "LTV" ratio) on 1-4 family real estate. The Company generally does not lend in excess of 80% of the appraised value or sales price (whichever is less) of the property unless additional collateral is obtained, thereby lowering the total LTV. The Company offers residential real estate loans with terms of up to 30 years.

As a consequence of our lending strategy adopted a number of years ago, approximately 92.6% of the portfolio of conventional mortgage loans secured by 1-4 family real estate at December 31, 2013 is adjustable rate. The Company's mortgage loans are ordinarily retained in the loan portfolio. The Company's residential mortgage loans generally have not been originated with loan documentation that would permit their sale to Fannie Mae and Freddie Mac. In 2014, however, we hired a bank officer with significant experience with mortgage lending for resale into the secondary market. His responsibilities will include developing loan origination systems to enable sale of loans into the secondary mortgage market, including loans eligible for sale to Fannie Mae and Freddie Mac.

The Company's home equity loan policy generally allows for a loan of up to 85% of a property's appraised value, less the principal balance of the outstanding first mortgage loan. The Company's home equity loans generally have terms of 10 years.

At December 31, 2013, residential mortgage loans of approximately \$7.7 million were over 90 days delinquent or nonaccruing on that date, representing 3.6% of the residential mortgage loan portfolio. At December 31, 2012, residential mortgage loans of approximately \$8.5 million were over 90 days delinquent or nonaccruing on that date, representing 4.2% of the residential mortgage loan portfolio.

Commercial and Industrial Loans and Commercial Real Estate Loans

The Company's commercial loan services include:

- accounts receivable, inventory and working capital loans
- renewable operating lines of credit
- loans to finance capital equipment
- term business loans
- short-term notes
- selected guaranteed or subsidized loan programs for small businesses
- loans to professionals
- commercial real estate loans

Commercial real estate loans include commercial properties occupied by the proprietor of the business conducted on the premises, and income-producing or farm properties. Although the Company makes agricultural loans, it currently does not have a significant amount of agricultural loans. The primary risk of commercial real estate loans is loss of income of the owner or occupier of the property and the inability of the market to sustain rent levels. Although commercial and commercial real estate loans generally bear more risk than single-family residential mortgage loans, commercial and commercial real estate loans tend to be higher yielding, tend to have shorter terms and commonly provide for interest-rate adjustments as prevailing rates change. Accordingly, commercial and commercial real estate loans enhance a lender's interest rate risk management and, in management's opinion, promote more rapid asset and income growth than a loan portfolio comprised strictly of residential real estate mortgage loans.

Although a risk of nonpayment exists for all loans, certain specific types of risks are associated with various kinds of loans. One of the primary risks associated with commercial loans is the possibility that the commercial borrower will not generate income sufficient to repay the loan. The Company's loan policy provides that commercial loan applications must be supported by documentation indicating that there will be cash flow sufficient for the borrower to service the proposed loan. Financial statements or tax returns for at least three years must be submitted, and annual reviews are undertaken for loans of \$200,000 or more. The fair market value of collateral for collateralized commercial loans must exceed the Company's loan exposure. For this purpose fair market value is determined by independent appraisal or by the loan officer's estimate employing guidelines established by the loan policy. Term loans not secured by real estate generally have terms of five years or less, unless guaranteed by the U.S. Small Business Administration or other governmental agency, and terms loans secured by collateral having a useful life exceeding five years may have longer terms. The Company's loan policy allows for terms of up to 15 years for loans secured by commercial real estate, and one year for business lines of credit. The maximum loan-to-value ratio for commercial real estate loans is 75% of the appraised value or cost, whichever is less.

Real estate is commonly a material component of collateral for the Company's loans, including commercial loans. Although the expected source of repayment of these loans is generally the operations of the borrower's business or personal income, real estate collateral provides an additional measure of security. Risks associated with loans secured by real estate include fluctuating land values, changing local economic conditions, changes in tax policies, and a concentration of loans within a limited geographic area.

At December 31, 2013, commercial and commercial real estate loans totaled \$195.7 million, or 44.9% of the Company's total loan portfolio. At December 31, 2013, commercial and commercial real estate loans of approximately \$1.0 million were over 90 days delinquent or nonaccruing on that date, and represented 0.5% of the commercial and commercial real estate loan portfolios. At December 31, 2012, commercial and commercial real estate loans totaled \$177.9 million, or 43.6% of the Company's total loan portfolio. At December 31, 2012, commercial and commercial real estate loans of approximately \$3.4 million were over 90 days delinquent or nonaccruing on that date, and represented 1.9% of the commercial and commercial real estate loan portfolios.

Real Estate Construction

The Company originates several different types of loans that it categorizes as construction loans, including:

- residential construction loans to borrowers who will occupy the premises upon completion of construction,
- residential construction loans to builders,
- commercial construction loans, and
- real estate acquisition and development loans.

Because of the complex nature of construction lending, these loans are generally recognized as having a higher degree of risk than other forms of real estate lending. The Company's fixed-rate and adjustable-rate construction loans do not provide for the same interest rate terms on the construction loan and on the permanent mortgage loan that follows completion of the construction phase of the loan. It is the norm for the Company to make residential construction loans without an existing written commitment for permanent financing. The Company's loan policy provides that the Company may make construction loans with terms of up to one year, with a maximum loan-to-value ratio for residential construction of 80%. The Company also offers construction-to-permanent loans that have a twelve-month construction period followed by 30 years of permanent financing.

At December 31, 2013, real estate construction loans totaled \$25.6 million, or 5.9% of the Company's total loan portfolio. No real estate construction loans were over 90 days delinquent or nonaccruing on that date. At December 31, 2012, real estate construction loans totaled \$22.5 million, or 5.5% of the Company's total loan portfolio. Real estate construction loans of approximately \$0.4 million were over 90 days delinquent or nonaccruing on that date, representing 1.6% of the real estate construction loan portfolio.

Consumer Installment Loans The Company's consumer installment loans include secured and unsecured loans to individual borrowers for a variety of purposes, including personal, home improvement, revolving credit lines, autos, boats, and recreational vehicles. The Company does not currently do any indirect lending. Unsecured consumer loans carry significantly higher interest rates than secured loans. The Company maintains a higher loan loss allowance for consumer loans, while maintaining strict credit guidelines when considering consumer loan applications.

According to the Company's loan policy, consumer loans secured by collateral other than real estate generally may have terms of up to five years, and unsecured consumer loans may have terms up to three years. Real estate security generally is required for consumer loans having terms exceeding five years.

At December 31, 2013, the Company had approximately \$4.1 million in its consumer installment loan portfolio, representing 1.0% of total loans. At December 31, 2013, consumer installment loans of approximately \$8,000 were over 90 days delinquent or nonaccruing on that date, representing 0.2% of the consumer installment loan portfolio. At December 31, 2012, the Company had approximately \$4.1 million in its consumer installment loan portfolio, representing 1.0% of total loans. At December 31, 2012, consumer installment loans of approximately \$18,000 were over 90 days delinquent or nonaccruing on that date, representing 0.4% of the consumer installment loan portfolio.

Loan Solicitation and Processing Loan originations are developed from a number of sources, including continuing business with depositors, other borrowers and real estate builders, solicitations by Company personnel and walk-in customers.

When a loan request is made, the Company reviews the application, credit bureau reports, property appraisals or evaluations, financial information, verifications of income, and other documentation concerning the creditworthiness of the borrower, as applicable to each loan type. The Company's underwriting guidelines are set by senior management and approved by the Board of Directors. The loan policy specifies each individual officer's loan approval authority. Loans exceeding an individual officer's approval authority are submitted to a committee consisting of loan officers, which has authority to approve loans up to \$1,000,000. The full Board of Directors acts as a loan committee for loans exceeding that amount.

Income from Lending Activities The Company earns interest and fee income from its lending activities. Net of origination costs, loan origination fees are amortized over the life of a loan. The Company also receives loan fees related to existing loans, including late charges. Income from loan origination and commitment fees and discounts varies with the volume and type of loans and commitments made and with competitive and economic conditions. Note 1 to the Consolidated Financial Statements included herein contains a discussion of the manner in which loan fees and income are recognized for financial reporting purposes.

Nonperforming Loans Late charges on residential mortgages and consumer loans are assessed if a payment is not received by the due date plus a grace period. When an advanced stage of delinquency appears on a single-family loan and if repayment cannot be expected within a reasonable time or a repayment agreement is not entered into, a required notice of foreclosure or repossession proceedings may be prepared by the Company's attorney and delivered to the borrower so that foreclosure proceedings may be initiated promptly, if necessary. The Company also collects late charges on commercial loans.

When the Company acquires real estate through foreclosure, voluntary deed, or similar means, it is classified as OREO until it is sold. When property is acquired in this manner, it is recorded at the lower of cost (the unpaid principal balance at the date of acquisition) or fair value, less anticipated cost to sell. Any subsequent write-down is charged to expense. All costs incurred from the date of acquisition to maintain the property are expensed. OREO is appraised during the foreclosure process, before acquisition when possible. Losses are recognized for the amount by which the book value of the related mortgage loan exceeds the estimated net realizable value of the property.

The Company undertakes regular review of the loan portfolio to assess its risks, particularly the risks associated with the commercial loan portfolio. This includes annual review of every commercial loan representing credit exposure of \$150,000 or more. An independent firm performs semi-annual loan reviews for the Company.

Classified Assets FDIC regulations governing classification of assets require nonmember commercial banks — including the Company — to classify their own assets and to establish appropriate general and specific allowances for losses, subject to FDIC review. The regulations are designed to encourage management to evaluate assets on a case-by-case basis, discouraging automatic classifications. Under this classification system, problem assets of insured institutions are classified as “substandard,” “doubtful,” or “loss.” An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Assets classified as “doubtful” have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses make collection of principal in full — on the basis of currently existing facts, conditions, and values — highly questionable and improbable. Assets classified as “loss” are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not expose the Company to risk sufficient to warrant classification in one of the above categories, but that possess some weakness, are required to be designated “special mention” by management.

When an insured institution classifies assets as either “substandard” or “doubtful,” it may establish allowances for loan losses in an amount deemed prudent by management. When an insured institution classifies assets as “loss,” it is required either to establish an allowance for losses equal to 100% of that portion of the assets so classified or to charge off that amount. An Ohio nonmember bank’s determination about classification of its assets and the amount of its allowances is subject to review by the FDIC, which may order the establishment of additional loss allowances. Management also employs an independent third party to semi-annually review and validate the internal loan review process and loan classifications.

The Company has experienced a decrease in substandard loans. While it appears economic conditions within our market area have stabilized, it is not certain the improvement will be sustained. While the housing market has improved, evidence of prolonged macroeconomic health could prove specious. Loans secured by residential real estate and commercial real estate account for \$11.1 million and \$6.0 million of the substandard loans, respectively. These amounts represent 88.3% of the Company’s substandard loans.

As of December 31, 2013, 2012, 2011, 2010, and 2009 consolidated classified loans were as follows:

Classified Loans at December 31,										
(Dollars in thousands)	2013		2012		2011		2010		2009	
	Amount	Percent of total loans	Amount	Percent of total loans	Amount	Percent of total loans	Amount	Percent of total loans	Amount	Percent of total loans
Classified loans:										
Special mention	\$4,685	1.08 %	\$3,364	0.82 %	\$2,653	0.66 %	\$2,868	0.77 %	\$4,322	1.22 %
Substandard	19,328	4.44 %	26,459	6.48 %	27,061	6.73 %	28,178	7.56 %	18,928	5.35 %
Doubtful	43	0.01 %	59	0.01 %	73	0.02 %	224	0.06 %	277	0.08 %
Total amount due	\$24,056	5.53 %	\$29,882	7.31 %	\$29,787	7.41 %	\$31,270	8.39 %	\$23,527	6.65 %

Other than those disclosed above, the Company does not believe there are any loans classified for regulatory purposes as loss, doubtful, substandard, special mention or otherwise, which will result in losses or have a material impact on future operations, liquidity or capital reserves. We are not aware of any other information that causes us to have serious doubts as to the ability of borrowers in general to comply with repayment terms.

Investments Investment securities provide a return on residual funds after lending activities. Investments may be in federal funds sold, corporate securities, U.S. Government and agency obligations, state and local government obligations and government-guaranteed, mortgage-backed securities. The Company generally does not invest in securities that are rated less than investment grade by a nationally recognized statistical rating organization. Ohio bank law prescribes the kinds of investments an Ohio-chartered bank may make. Permitted investments include local, state, and federal government securities, mortgage-backed securities, and securities of federal government agencies. An Ohio-chartered bank also may invest up to 10% of its assets in corporate debt and equity securities, or a higher percentage in certain circumstances. Similar to the legal lending limit on loans to any one borrower, Ohio bank law also limits to 15% of capital the amount an Ohio-chartered bank may invest in the securities of any one issuer, other than local, state, and federal government and federal government agency issuers and mortgage-backed securities issuers. These Ohio bank law provisions have not been a material constraint upon the Company's investment activities.

All securities-related activity is reported to the Company's board of directors. General changes in investment strategy are required to be reviewed and approved by the board. Senior management can purchase and sell securities in accordance with the Company's stated investment policy.

Management determines the appropriate classification of securities at the time of purchase. At this time the Company has no securities that are classified as held to maturity. Securities to be held for indefinite periods and not intended to be held to maturity or on a long-term basis are classified as available for sale. Available-for-sale securities are reflected on the balance sheet at their fair value.

The following table exhibits the consolidated amortized cost and fair value of the Company's investment portfolio:

(Dollars in thousands)	Investment Portfolio Amortized Cost and Fair Value at December 31,					
	2013		2012		2011	
	Amortized cost	Fair value	Amortized cost	Fair value	Amortized cost	Fair value
Available for Sale:						
U.S. Government agency securities	\$27,289	\$25,763	\$24,485	\$24,960	\$31,520	\$31,933
Obligations of states and political subdivisions:						
Taxable	3,787	3,795	6,888	7,626	8,207	8,973
Tax-exempt	86,524	84,819	80,391	84,970	75,807	79,427
Mortgage-backed securities in government sponsored entities	38,816	38,323	69,238	71,102	63,808	65,573
Private-label mortgage-backed securities	3,366	3,693	4,553	5,064	7,005	7,321
Equity securities in financial institutions	750	750	750			