FNCB Bancorp, Inc.
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from to

Commission File No. 000-53869

FNCB BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	**23-2900790**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
102 E. Drinker St., Dunmore, PA	**18512**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code **(570) 346-7667**

FIRST NATIONAL COMMUNITY BANCORP, INC.

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter 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 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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Common Stock, $1.25 par value	**16,616,200 shares**
(Title of Class)	(Outstanding at November 4, 2016)

Contents

Part I - Financial Information

Item 1 - Financial Statements

FNCB BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(unaudited)

(in thousands, except share data)	**September 30, 2016**	**December 31, 2015**
Assets		
Cash and cash equivalents:		
Cash and due from banks	$24,558	$19,544
Interest-bearing deposits in other banks	32,778	1,539
Total cash and cash equivalents	57,336	21,083
Securities available for sale, at fair value	263,475	253,773
Stock in Federal Home Loan Bank of Pittsburgh, at cost	2,741	6,344
Loans held for sale	185	683
Loans, net of allowance for loan and lease losses of $8,490 and $8,790	721,172	724,926
Bank premises and equipment, net	10,615	11,193
Accrued interest receivable	2,736	2,475
Intangible assets	14	137
Bank-owned life insurance	29,807	29,381
Other real estate owned	2,065	3,154
Net deferred tax assets	23,024	27,807
Other assets	8,417	9,662
Total assets	$1,121,587	$1,090,618
Liabilities		
Deposits:		
Demand (non-interest-bearing)	$157,119	$154,531
Interest-bearing	773,840	667,015
Total deposits	930,959	821,546
Borrowed funds:		
Federal Home Loan Bank of Pittsburgh advances	58,837	135,802
Subordinated debentures	14,000	14,000
Junior subordinated debentures	10,310	10,310
Total borrowed funds	83,147	160,112
Accrued interest payable	294	11,165
Other liabilities	10,614	11,617
Total liabilities	1,025,014	1,004,440
Shareholders' equity		

Preferred shares ($1.25 par)		
Authorized: 20,000,000 shares at September 30, 2016 and December 31, 2015		
Issued and outstanding: 0 shares at September 30, 2016 and December 31, 2015	-	-
Common shares ($1.25 par)		
Authorized: 50,000,000 shares at September 30, 2016 and December 31, 2015		
Issued and outstanding: 16,614,856 shares at September 30, 2016 and 16,514,245 shares at December 31, 2015	20,768	20,643
Additional paid-in capital	62,381	62,059
Retained earnings	7,506	3,714
Accumulated other comprehensive income (loss)	5,918	(238)
Total shareholders' equity	96,573	86,178
Total liabilities and shareholders’ equity	$1,121,587	$1,090,618

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

FNCB BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(in thousands, except share data)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Interest income				
Interest and fees on loans	$7,156	$6,693	$21,157	$19,640
Interest and dividends on securities:				
U.S. government agencies	848	1,061	2,678	3,044
State and political subdivisions, tax-free	9	19	30	91
State and political subdivisions, taxable	675	324	1,834	447
Other securities	69	92	259	331
Total interest and dividends on securities	1,601	1,496	4,801	3,913
Interest on interest-bearing deposits in other banks	8	10	14	42
Total interest income	8,765	8,199	25,972	23,595
Interest expense				
Interest on deposits	704	677	2,009	2,003
Interest on borrowed funds:				
Interest on Federal Home Loan Bank of Pittsburgh advances	157	128	472	367
Interest on subordinated debentures	162	162	480	1,290
Interest on junior subordinated debentures	62	50	180	150
Total interest on borrowed funds	381	340	1,132	1,807
Total interest expense	1,085	1,017	3,141	3,810
Net interest income before (credit) provision for loan and lease losses	7,680	7,182	22,831	19,785
(Credit) provision for loan and lease losses	(234)	(191)	858	(340)
Net interest income after (credit) provision for loan and lease losses	7,914	7,373	21,973	20,125
Non-interest income				
Deposit service charges	739	799	2,157	2,218
Net gain on the sale of securities	-	4	960	2,302
Net gain on the sale of mortgage loans held for sale	99	13	238	69
Net gain on the sale of SBA guaranteed loans	51	-	51	-
Net gain on the sale of other real estate owned	32	129	29	145
Loan-related fees	85	94	287	290
Income from bank-owned life insurance	137	145	426	415
Legal settlements	-	-	-	184
Other	237	195	657	720
Total non-interest income	1,380	1,379	4,805	6,343
Non-interest expense				
Salaries and employee benefits	3,263	3,240	10,366	9,582

Occupancy expense	479	500	1,301	1,665
Equipment expense	429	408	1,277	1,234
Advertising expense	157	86	422	335
Data processing expense	505	471	1,522	1,420
Regulatory assessments	199	203	629	711
Bank shares tax	253	217	746	652
Expense of other real estate owned	95	91	335	338
Legal expense	79	80	285	331
Professional fees	157	193	716	780
Insurance expense	131	128	384	528
Other operating expenses	806	798	2,399	2,301
Total non-interest expense	6,553	6,415	20,382	19,877
Income before income taxes	2,741	2,337	6,396	6,591
Income tax expense (benefit)	724	-	1,611	(40)
Net income	$2,017	$2,337	$4,785	$6,631
Earnings per share				
Basic	$0.12	$0.14	$0.29	$0.40
Diluted	$0.12	$0.14	$0.29	$0.40
Cash dividends declared per common share	$0.02	$-	$0.06	$-
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic	16,593,811	16,500,945	16,554,391	16,497,373
Diluted	16,593,811	16,500,945	16,554,391	16,497,373

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

FNCB BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2016**	**2015**	**2016**	**2015**
Net income	$2,017	$2,337	$4,785	$6,631
Other comprehensive (loss) income:				
Unrealized (losses) gains on securities available for sale	(1,239)	3,465	10,288	4,461
Taxes	421	(1,178)	(3,498)	(1,516)
Net of tax amount	(818)	2,287	6,790	2,945
Reclassification adjustment for gains included in net income	-	(4)	(960)	(2,302)
Taxes	-	1	326	782
Net of tax amount	-	(3)	(634)	(1,520)
Total other comprehensive (loss) income	(818)	2,284	6,156	1,425
Comprehensive income	$1,199	$4,621	$10,941	$8,056

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

FNCB BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Nine Months Ended September 30, 2016 and 2015

(unaudited)

(in thousands, except share data)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated (Deficit) / Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, December 31, 2014	16,484,419	$ 20,605	$ 61,781	$ (32,126)	$ 1,138	$ 51,398
Net income for the period	-	-	-	6,631	-	6,631
Common shares issued under long-term incentive compensation plan	16,526	21	(21)	-	-	-
Restricted stock awards	-	-	179	-	-	179
Other comprehensive income, net of tax of $734	-	-	-	-	1,425	1,425
Balances, September 30, 2015	16,500,945	$ 20,626	$ 61,939	$ (25,495)	$ 2,563	$ 59,633
Balances, December 31, 2015	16,514,245	$ 20,643	$ 62,059	$ 3,714	$ (238)	$ 86,178
Net income for the period	-	-	-	4,785	-	4,785
Cash dividends declared, $0.06 per share	-	-	-	(993)	-	(993)
Common shares issued under long-term incentive compensation plan	52,848	66	(66)	-	-	-
Restricted stock awards	-	-	195	-	-	195
Common shares issued through dividend reinvestment / optional cash purchase plan	47,763	59	193	-	-	252
Other comprehensive income, net of tax of $3,172	-	-	-	-	6,156	6,156
Balances, September 30, 2016	16,614,856	$ 20,768	$ 62,381	$ 7,506	$ 5,918	$ 96,573

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

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FNCB BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine Months Ended September 30,	
(in thousands)	**2016**	**2015**
Operating activities:		
Net income	$4,785	$6,631
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Investment securities amortization, net	880	1,173
Equity in trust	(5)	(5)
Depreciation and amortization	1,973	1,168
Stock-based compensation expense	195	179
Provision (credit) for loan and lease losses	858	(340)
Valuation adjustment for off-balance sheet commitments	(64)	(27)
Gain on the sale of available-for-sale securities	(960)	(2,302)
Gain on the sale of loans held for sale	(238)	(69)
Gain on the sale of SBA guaranteed loans	(51)	-
Gain on the sale of other real estate owned	(29)	(145)
Valuation adjustment of other real estate owned	170	208
Income from bank-owned life insurance	(426)	(415)
Proceeds from the sale of loans held for sale	5,592	1,982
Funds used to originate loans held for sale	(4,856)	(1,352)
Deferred income tax expense	1,611	-
Increase in interest receivable	(261)	(543)
Decrease in prepaid expenses and other assets	62	829
(Decrease) increase in interest payable	(10,871)	925
Decrease in accrued expenses and other liabilities	(944)	(2,221)
Total adjustments	(7,364)	(955)
Net cash (used in) provided by operating activities	(2,579)	5,676
Cash flows from investing activities:		
Maturities, calls and principal payments of available-for-sale securities	4,972	7,326
Proceeds from the sale of securities available for sale	32,588	78,765
Purchases of securities available for sale	(37,854)	(113,042)
Redemption (purchase) of the stock of the Federal Home Loan Bank of Pittsburgh	3,603	(1,495)
Redemption of the stock of the Federal Reserve Bank	1,351	-
Net increase in loans to customers	(377)	(58,975)
Proceeds from the sale of SBA guaranteed loans	1,315	-
Proceeds from the sale of other real estate owned	1,903	697
Purchases of bank premises and equipment	(376)	(1,175)
Net cash provided by (used in) investing activities	7,125	(87,899)

Cash flows from financing activities:		
Net increase in deposits	109,413	56,706
Net (repayment of) proceeds from Federal Home Loan Bank of Pittsburgh advances - overnight	(60,500)	19,500
Proceeds from Federal Home Loan Bank of Pittsburgh advances - term	37,753	142,947
Repayment of Federal Home Loan Bank of Pittsburgh advances - term	(54,218)	(130,583)
Principal reduction on subordinated debentures	-	(11,000)
Proceeds from issuance of common shares	252	-
Cash dividends paid	(993)	-
Net cash provided by financing activities	31,707	77,570
Net increase (decrease) in cash and cash equivalents	36,253	(4,653)
Cash and cash equivalents at beginning of period	21,083	35,667
Cash and cash equivalents at end of period	$57,336	$31,014
Supplemental cash flow information		
Cash paid during the period for:		
Interest	$14,012	$2,885
Income taxes	-	22
Other transactions:		
Loans transferred to OREO and repossessed assets	1,210	149
Principal balance of loans transferred to held for sale	-	4,592
Change in deferred gain on sale of other real estate owned	5	(26)

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

FNCB BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Basis of Presentation

On October 4, 2016, First National Community Bancorp, Inc., the parent company of FNCB Bank, filed an amendment to its articles of incorporation to change the its name, effective October 17, 2016, to “FNCB Bancorp, Inc.” The Board of Directors has also amended its bylaws, effective October 17, 2016, to reflect the new name.

The consolidated financial statements are comprised of the accounts of FNCB Bancorp, Inc., and its wholly owned subsidiary, FNCB Bank (the “Bank”), as well as the Bank’s wholly owned subsidiaries (collectively, “FNCB”). The accounting and reporting policies of FNCB conform to accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all of the information and accompanying notes required by GAAP for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included in the consolidated financial statements. All intercompany balances and transactions have been eliminated in consolidation. Prior period amounts have been reclassified when necessary to conform to the current period’s presentation. These reclassifications did not have an impact on the operating results or financial position of FNCB. The operating results and financial position of FNCB for the nine months ended September 30, 2016, may not be indicative of future results of operations and financial position.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change in the near term are the allowance for loan and lease losses (“ALLL”), investment security valuations, the evaluation of investment securities and other real estate owned (“OREO”) for impairment, and the evaluation of deferred income taxes.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in FNCB’s audited financial statements, included in the Annual Report filed on Form 10-K as of and for the year ended December 31, 2015.

Note 2. New Authoritative Accounting Guidance

Accounting Guidance to be Adopted in Future Periods

Accounting Standard Update ("ASU") 2016-15, Statement of Cash Flows (Topic 230): "Classification of Certain Cash Receipts and Cash Payments," provides guidance on eight specific cash flow issues in order to reduce current and potential future diversity in reporting. The specific cash flow items addressed include debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions, and separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. ASU 2016-15 is effective for all entities that are required to present a statement of cash flows under Topic 230, and early adoption is permitted. The adoption of this guidance on January 1, 2018 is not expected to have a material effect on the operating results or financial position of FNCB.

Refer to Note 2 to FNCB's consolidated financial statements included in the 2015 Annual Report on Form 10-K and the Quarterly Report on Form 10-Q for the periods ended March 31, 2016 and June 30, 2016 for a discussion of additional accounting guidance applicable to FNCB that will be adopted in future periods.

Note 3. Securities

The following tables present the amortized cost, gross unrealized gains and losses, and the fair value of FNCB's securities at September 30, 2016 and December 31, 2015:

	September 30, 2016			
(in thousands)	**Amortized Cost**	**Gross Unrealized Holding Gains**	**Gross Unrealized Holding Losses**	**Fair Value**
Available-for-sale:				
Obligations of U.S. government agencies	$12,156	$ 515	$ -	$12,671
Obligations of state and political subdivisions	101,738	4,005	2	105,741
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	19,133	597	1	19,729
Collateralized mortgage obligations - commercial	99,330	3,129	-	102,459
Residential mortgage-backed securities	17,469	750	-	18,219
Corporate debt securities	500	-	58	442
Negotiable certificates of deposit	3,172	83	-	3,255
Equity securities	1,010	-	51	959
Total available-for-sale securities	$254,508	$ 9,079	$ 112	$263,475

	December 31, 2015			
(in thousands)	**Amortized Cost**	**Gross Unrealized Holding Gains**	**Gross Unrealized Holding Losses**	**Fair Value**
Available-for-sale:				
Obligations of U.S. government agencies	$43,787	$ 256	$ -	$44,043
Obligations of state and political subdivisions	75,401	428	422	75,407
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	22,162	116	9	22,269
Collateralized mortgage obligations - commercial	89,900	124	601	89,423
Residential mortgage-backed securities	18,201	58	161	18,098
Corporate debt securities	500	-	77	423
Negotiable certificates of deposit	3,173	-	11	3,162
Equity securities	1,010	-	62	948
Total available-for-sale securities	$254,134	$ 982	$ 1,343	$253,773

At September 30, 2016 and December 31, 2015, securities with a carrying amount of $262.1 million and $252.4 million, respectively, were pledged as collateral to secure public deposits and for other purposes.

The following table shows the amortized cost and approximate fair value of FNCB's available-for-sale debt securities at September 30, 2016 using contractual maturities. Expected maturities will differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Because collateralized mortgage obligations and residential mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary:

(in thousands)	September 30, 2016 Amortized Cost	Fair Value
Amounts maturing in:		
One year or less	$-	$-
After one year through five years	25,810	26,626
After five years through ten years	89,306	92,998
After ten years	2,450	2,485
Collateralized mortgage obligations	118,463	122,188
Residential mortgage-backed securities	17,469	18,219
Total	$253,498	$262,516

There were no sales of available-for-sale securities for the three months ended September 30, 2016. Gross proceeds from the sale of available-for-sale securities were $32.6 million for the nine months ended September 30, 2016, with gross gains of $960 thousand realized upon the sales. There were no losses realized upon the sales for the nine months ended September 30, 2016.

Gross proceeds from the sale of available-for-sale securities were $5.3 million and $78.8 million, respectively, for the three and nine months ended September 30, 2015, with gross gains of $4 thousand and $2.3 million, respectively, realized upon the sales. There were no gross losses realized upon the sales for the three months ended September 30, 2015. FNCB realized gross losses of $4 thousand upon the sales for the nine months ended September 30, 2015.

The following tables present the number of, fair value and gross unrealized losses of available-for-sale securities with unrealized losses at September 30, 2016 and December 31, 2015:

	September 30, 2016								
	Less than 12 Months			12 Months or Greater			Total		
(dollars in thousands)	Number of Securities	Fair Value	Gross Unrealized Losses	Number of Securities	Fair Value	Gross Unrealized Losses	Number of Securities	Fair Value	Gross Unrealized Losses
Obligations of U.S. government agencies	-	$-	$ -	-	$-	$ -	-	$-	$ -
	1	2,013	2	-	-	-	1	2,013	2

Obligations of state and policitical subdivisions									
U.S. government/government-sponsored agencies:									
Collateralized mortgage obligations - residential	-	-	-	1	234	1	1	234	1
Collateralized mortgage obligations - commercial	-	-	-	-	-	-	-	-	-
Residential mortgage-backed securities	-	-	-	-	-	-	-	-	-
Corporate debt securities	-	-	-	1	442	58	1	442	58
Negotiable certificates of deposit	-	-	-	-	-	-	-	-	-
Equity securities	-	-	-	1	949	51	1	949	51
Total	1	$2,013	$ 2	3	$1,625	$ 110	4	$3,638	$ 112

	December 31, 2015								
	Less than 12 Months			12 Months or Greater			Total		
(dollars in thousands)	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**	**Number of Securities**	**Fair Value**	**Gross Unrealized Losses**
Obligations of U.S. government agencies	-	$-	$ -	-	$-	$ -	-	$-	$ -
Obligations of state and policitical subdivisions	31	33,022	419	1	264	3	32	33,286	422
U.S. government/government-sponsored agencies:									
Collateralized mortgage obligations - residential	4	5,738	9	-	-	-	4	5,738	9
Collateralized mortgage obligations - commercial	16	67,969	601	-	-	-	16	67,969	601
Residential mortgage-backed securities	7	16,779	161	-	-	-	7	16,779	161
Corporate debt securities	-	-	-	1	423	77	1	423	77
Negotiable certificates of deposit	12	2,913	11	-	-	-	12	2,913	11
Equity securities	-	-	-	1	938	62	1	938	62
Total	70	$126,421	$ 1,201	3	$1,625	$ 142	73	$128,046	$ 1,343

Management evaluates individual securities in an unrealized loss position quarterly for other than temporary impairment ("OTTI"). As part of its evaluation, management considers, among other things, the length of time a security's fair value is less than its amortized cost, the severity of decline, any credit deterioration of the issuer, whether or not management intends to sell the security, and whether it is more likely than not that FNCB will be required to sell the security prior to recovery of its amortized cost.

There were four securities in an unrealized loss position at September 30, 2016, including one security issued by a U.S. government-sponsored agency, one obligation of a state and political subdivision, one corporate bond, and one equity security. Three of the securities were in an unrealized loss position for greater than 12 months. Management performed a review of the fair values of all securities in an unrealized loss position as of September 30, 2016 and determined that movements in the fair values of the securities were consistent with the change in market interest rates. In addition, as part of its review, management noted that there was no material change in the credit quality of any of the issuers or other events or circumstances that may cause a significant adverse effect on the fair value of these securities. Moreover, to date, FNCB has received all scheduled principal and interest payments and expects to fully collect all future contractual principal and interest payments on all securities in an unrealized loss position at September 30, 2016. FNCB does not intend to sell the securities nor is it more likely than not that it will be required to sell the securities prior to recovery of their amortized cost. Based on the results of its review and considering the attributes of these debt and equity securities, management concluded that the individual unrealized losses were temporary and OTTI did not exist at September 30, 2016.

Investments in FHLB of Pittsburgh and Federal Reserve Bank of Philadelphia ("FRB") stock have limited marketability and are carried at cost. FNCB's investment in FHLB of Pittsburgh stock totaled $2.7 million and $6.3 million at September 30, 2016 and December 31, 2015, respectively. During the three months ended September 30, 2016, the Bank canceled its membership with the FRB, and as a result, the entire balance of FRB stock totaling $1.3 million was redeemed. FRB stock of $1.3 million is included in Other Assets in the Consolidated Statements of Financial Condition at December 31, 2015. Management noted no indicators of impairment for the FHLB of Pittsburgh stock at September 30, 2016.

Note 4. Loans

The following table summarizes loans receivable, net, by category at September 30, 2016 and December 31, 2015:

(in thousands)	**September 30, 2016**	**December 31, 2015**
Residential real estate	$ 139,963	$ 130,696
Commercial real estate	245,820	245,198
Construction, land acquisition and development	19,122	30,843

Commercial and industrial	153,799	149,826
Consumer	127,233	128,533
State and political subdivisions	41,233	46,056
Total loans, gross	727,170	731,152
Unearned income	(98)	(98)
Net deferred loan costs	2,590	2,662
Allowance for loan and lease losses	(8,490)	(8,790)
Loans, net	$ 721,172	$ 724,926

FNCB has granted loans, letters of credit and lines of credit to certain of its executive officers and directors as well as to certain related parties of executive officers and directors. For more information about related party transactions, refer to Note 6 – “Related Party Transactions” to these consolidated financial statements.

FNCB originates one- to four-family mortgage loans for sale in the secondary market. During the three months and nine months ended September 30, 2016, one-to four-family mortgages sold on the secondary market were $2.0 million and $5.3 million, respectively. FNCB retains servicing rights on these mortgages. At September 30, 2016 and December 31, 2015, there were $185 thousand and $683 thousand in one-to four-family residential mortgage loans held for sale, respectively.

During the three months ended September 30, 2016, FNCB sold the guaranteed principal balance of three loans that were guaranteed by the Small Business Administration (“SBA”) totaling $1.3 million. A net gain of $51 thousand was realized upon the sale and included in non-interest income for the three and nine months ended September 30, 2016. FNCB retained the servicing rights on these loans. There were no sales of guaranteed loans during the three or nine months ended September 30, 2015.

FNCB does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, and bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios.

There were no material changes to the risk characteristics of FNCB's loan segments, loan classification and credit grading systems and methodology for determining the adequacy of the ALLL during the nine months ended September 30, 2016. Refer to Note 2 to FNCB's consolidated financial statements included in the 2015 Annual Report on Form 10-K for information about the risk characteristics related to FNCB's loan segments, loan classification and credit grading systems and methodology for determining the adequacy of the ALLL.

Each quarter, management evaluates the ALLL and adjusts the ALLL as appropriate through a provision or credit for loan losses. While management uses the best information available to make evaluations, future adjustments to the ALLL may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of its examination process, bank regulators periodically review the ALLL. These regulators may require FNCB to adjust the ALLL based on their analysis of information available at the time of examination.

The following table summarizes activity in the ALLL by loan category for the three and nine months ended September 30, 2016 and 2015:

(in thousands)	**Loan Category** Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition and Development	Commercial and Industrial	Consumer	State and Political Subdivisions	Unallocated	Total
Three months ended September 30, 2016: Allowance for loan losses:								
Beginning balance, July 1, 2016	$1,099	$ 3,095	$ 717	$ 1,565	$ 1,350	$ 733	$ -	$8,559
Charge-offs	(37)	-	-	(18)	(134)	-	-	(189)
Recoveries	2	1	-	184	167	-	-	354
Provisions (credits)	49	185	(50)	(232)	50	(236)	-	(234)
Ending balance, September 30, 2016	$1,113	$ 3,281	$ 667	$ 1,499	$ 1,433	$ 497	$ -	$8,490

Three months ended September 30, 2015: Allowance for loan losses:								
Beginning balance, July 1, 2015	$1,484	$ 4,041	$ 778	$ 1,878	$ 1,643	$ 504	$ -	$10,328
Charge-offs	(66)	-	(683)	(21)	(198)	-	-	(968)
Recoveries	23	278	-	140	215	-	-	656
Provisions (credits)	(132)	(84)	874	(738)	(147)	(32)	68	(191)
Ending balance, September 30, 2015	$1,309	$ 4,235	$ 969	$ 1,259	$ 1,513	$ 472	$ 68	$9,825
Nine months ended September 30, 2016: Allowance for loan losses:								
Beginning balance, January 1, 2016	$1,333	$ 3,346	$ 853	$ 1,205	$ 1,494	$ 485	$ 74	$8,790
Charge-offs	(61)	(251)	-	(1,082)	(652)	-	-	(2,046)
Recoveries	4	4	9	396	475	-	-	888
Provisions (credits)	(163)	182	(195)	980	116	12	(74)	858
Ending balance, September 30, 2016	$1,113	$ 3,281	$ 667	$ 1,499	$ 1,433	$ 497	$ -	$8,490
Nine months ended September 30, 2015: Allowance for loan losses:								
Beginning balance, January 1, 2015	$1,772	$ 4,663	$ 665	$ 2,104	$ 1,673	$ 598	$ 45	$11,520
Charge-offs	(135)	(912)	(689)	(163)	(538)	-	-	(2,437)
Recoveries	34	296	-	307	445	-	-	1,082
Provisions (credits)	(362)	188	993	(989)	(67)	(126)	23	(340)
Ending balance, September 30, 2015	$1,309	$ 4,235	$ 969	$ 1,259	$ 1,513	$ 472	$ 68	$9,825

The following table represents the allocation of the ALLL and the related loan balance, by loan category, disaggregated based on the impairment methodology at September 30, 2016 and December 31, 2015:

(in thousands)	Loan Category Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition and Development	Commercial and Industrial	Consumer	State and Political Subdivisions	Unallocated	Total
September 30, 2016								
Allowance for loan losses:								
Individually evaluated for impairment	$6	$406	$ -	$ -	$1	$ -	$ -	$413
Collectively evaluated for impairment	1,107	2,875	667	1,499	1,432	497	-	8,077
Total	$1,113	$3,281	$667	$1,499	$1,433	$497	$ -	$8,490
Loans receivable:								
Individually evaluated for impairment	$1,876	$3,128	$370	$22	$299	$ -	$ -	$5,695
Collectively evaluated for impairment	138,087	242,692	18,752	153,777	126,934	41,233	-	721,475
Total	$139,963	$245,820	$19,122	$153,799	$127,233	$41,233	$ -	$727,170
December 31, 2015								
Allowance for loan losses:								
Individually evaluated for impairment	$92	$287	$1	$ -	$1	$ -	$ -	$381
Collectively evaluated for impairment	1,241	3,059	852	1,205	1,493	485	74	8,409
Total	$1,333	$3,346	$853	$1,205	$1,494	$485	$74	$8,790
Loans receivable:								
Individually evaluated for impairment	$2,930	$3,831	$646	$203	$351	$ -	$ -	$7,961
Collectively evaluated for	127,766	241,367	30,197	149,623	128,182	46,056	-	723,191

impairment								
Total	$130,696	$245,198	$ 30,843	$ 149,826	$128,533	$ 46,056	$ -	$731,152

Credit Quality Indicators – Commercial Loans

Management continuously monitors the credit quality of FNCB's commercial loans by regularly reviewing certain credit quality indicators. Management utilizes credit risk ratings as the key credit quality indicator for evaluating the credit quality of FNCB's loan receivables.

FNCB's loan rating system assigns a degree of risk to commercial loans based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. Management analyzes these non-homogeneous loans individually by grading the loans as to credit risk and probability of collection for each type of loan. Commercial and industrial loans include commercial indirect auto loans which are not individually risk rated, and construction, land acquisition and development loans include residential construction loans which are also not individually risk rated. These loans are monitored on a pool basis due to their homogeneous nature as described in "Credit Quality Indicators – Other Loans" below. FNCB risk rates certain residential real estate loans and consumer loans that are part of a larger commercial relationship using its credit grading system as described in "Credit Quality Indicators – Commercial Loans." The grading system contains the following basic risk categories:

1. Minimal Risk
2. Above Average Credit Quality
3. Average Risk
4. Acceptable Risk
5. Pass - Watch
6. Special Mention
7. Substandard - Accruing
8. Substandard - Non-Accrual
9. Doubtful
10. Loss

This analysis is performed on a quarterly basis using the following definitions for risk ratings:

Pass - Assets rated 1 through 5 are considered pass ratings. These assets show no current or potential problems and are considered fully collectible. All such loans are considered collectively for ALLL calculation purposes. However, accruing loans modified under a troubled debt restructuring ("TDRs") that have been performing for an extended period of time, do not represent a higher risk of loss, and have been upgraded to a pass rating are evaluated individually for impairment.

Special Mention – Assets classified as special mention do not currently expose FNCB to a sufficient degree of risk to warrant an adverse classification but do possess credit deficiencies or potential weaknesses deserving close attention. Special Mention assets have a potential weakness or pose an unwarranted financial risk which, if not corrected, could weaken the asset and increase risk in the future.

Substandard - Assets classified as substandard have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that FNCB will sustain some loss if the deficiencies are not corrected.

Doubtful - Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable based on current circumstances.

Loss - Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted.

Credit Quality Indicators – Other Loans

Certain residential real estate loans, consumer loans, and commercial indirect auto loans are monitored on a pool basis due to their homogeneous nature. Loans that are delinquent 90 days or more are placed on non-accrual status unless collection of the loan is in process and reasonably assured. FNCB utilizes accruing versus non-accrual status as the credit quality indicator for these loan pools.

The following tables present the recorded investment in loans receivable by loan category and credit quality indicator at September 30, 2016 and December 31, 2015:

	Credit Quality Indicators September 30, 2016									
	Commercial Loans						**Other Loans**			
(in thousands)	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Subtotal Commercial**	**Accruing Loans**	**Non-accrual Loans**	**Subtotal Other**	**Total Loans**
Residential real estate	$24,477	$349	$366	$ -	$ -	$25,192	$114,023	$749	$114,772	$139,963
Commercial real estate	235,487	4,624	4,904	-	-	245,015	-	-	-	245,015

Construction, land acquisition and development	9,755	348	4,190	-	-	14,294	4,564	264	4,828	19,122
Commercial and industrial	146,771	925	1,626	-	-	149,321	4,431	48	4,478	153,799
Consumer	2,494	-	37	-	-	2,532	124,494	207	124,701	127,233
State and political subdivisions	37,884	2,992	357	-	-	41,233	-	-	-	41,233
Total	$456,868	$9,238	$11,481	$ -	$ -	$477,586	$247,512	$1,268	$248,779	$726,366

	Credit Quality Indicators December 31, 2015 Commercial Loans						Other Loans			
(in thousands)	Pass	Special Mention	Substandard	Doubtful	Loss	Subtotal Commercial	Accruing Loans	Non-accrual Loans	Subtotal Other	Total Loans
Residential real estate	$21,018	$449	$984	$ -	$ -	$22,451	$107,204	$1,041	$108,245	$130,696
Commercial real estate	225,850	11,356	7,992	-	-	245,198	-	-	-	245,198
Construction, land acquisition and development	23,946	358	5,137	-	-	29,441	1,402	-	1,402	30,843
Commercial and industrial	142,242	595	2,209	-	-	145,046	4,775	5	4,780	149,826
Consumer	2,747	9	39	-	-	2,795	125,392	346	125,738	128,533
State and political subdivisions	45,464	120	472	-	-	46,056	-	-	-	46,056
Total	$461,267	$12,887	$16,833	$ -	$ -	$490,987	$238,773	$1,392	$240,165	$731,152

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded investment in these non-accrual loans was $2.4 million and $3.8 million at September 30, 2016 and December 31, 2015, respectively. Generally, loans are placed on non-accrual status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accrual status. There were no loans past due 90 days or more and still accruing at September 30, 2016 and December 31, 2015.

The following tables present the delinquency status of performing (accruing) and non-accrual loans at September 30, 2016 and December 31, 2015:

	September 30, 2016 Delinquency Status				
(in thousands)	**0-29 Days Past Due**	**30-59 Days Past Due**	**60-89 Days Past Due**	**>/= 90 Days Past Due**	**Total**
Performing (accruing) loans:					
Real estate:					
Residential real estate	$138,889	$118	$207	$ -	$139,214
Commercial real estate	243,392	707	573	-	244,672
Construction, land acquisition and development	18,841	17	-	-	18,858
Total real estate	401,122	842	780	-	402,744
Commercial and industrial	153,312	200	239	-	153,751
Consumer	125,990	750	286	-	127,026
State and political subdivisions	41,233	-	-	-	41,233
Total performing (accruing) loans	721,657	1,792	1,305	-	724,754
Non-accrual loans:					
Real estate:					
Residential real estate	426	11	-	312	749
Commercial real estate	124	154	764	106	1,148
Construction, land aquisition and development	264	-	-	-	264
Total real estate	814	165	764	418	2,161
Commercial and industrial	-	-	-	48	48
Consumer	69	1	1	136	207
State and political subdivisions	-	-	-	-	-
Total non-accrual loans	883	166	765	602	2,416
Total loans receivable	$722,540	$1,958	$2,070	$602	$727,170

(in thousands)	December 31, 2015 Delinquency Status 0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total
Performing (accruing) loans:					
Real estate:					
Residential real estate	$129,206	$51	$225	$ -	$129,482
Commercial real estate	243,168	53	286	-	243,507
Construction, land acquisition and development	30,475	26	-	-	30,501
Total real estate	402,849	130	511	-	403,490
Commercial and industrial	149,329	236	66	-	149,631
Consumer	126,760	994	433	-	128,187
State and political subdivisions	46,056	-	-	-	46,056
Total peforming (accruing) loans	724,994	1,360	1,010	-	727,364
Non-accrual loans:					
Real estate:					
Residential real estate	923	99	44	148	1,214
Commercial real estate	1,576	-	115	-	1,691
Construction, land acquisition and development	342	-	-	-	342
Total real estate	2,841	99	159	148	3,247
Commercial and industrial	98	-	-	97	195
Consumer	69	21	3	253	346
State and political subdivisions	-	-	-	-	-
Total non-accrual loans	3,008	120	162	498	3,788
Total loans receivable	$728,002	$1,480	$1,172	$498	$731,152

The following tables present a distribution of the recorded investment, unpaid principal balance and the related allowance for FNCB's impaired loans, which have been analyzed for impairment under Accounting Standards Codification ("ASC") 310, at September 30, 2016 and December 31, 2015. Non-accrual loans, other than TDRs, with balances less than the $100 thousand loan relationship threshold are not evaluated individually for impairment and are accordingly not included in the following tables. However, these loans are evaluated collectively for impairment as homogenous pools in the general allowance under ASC Topic 450. Total non-accrual loans, other than TDRs, with balances less than the $100 thousand loan relationship threshold that were evaluated under ASC Topic 450 amounted to $0.8 million at September 30, 2016 and December 31, 2015.

(in thousands)	September 30, 2016 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no allowance recorded:			
Real estate:			
Residential real estate	$406	$ 480	$ -
Commercial real estate	435	504	-
Construction, land acquisition and development	370	777	-
Total real estate	1,211	1,761	-
Commercial and industrial	22	54	-
Consumer	-	-	-
State and political subdivisions	-	-	-
Total impaired loans with no related allowance recorded	1,233	1,815	-
With a related allowance recorded:			
Real estate:			
Residential real estate	1,470	1,470	6
Commercial real estate	2,693	2,693	406
Construction, land acquisition and development	-	-	-
Total real estate	4,163	4,163	412
Commercial and industrial	-	-	-
Consumer	299	299	1
State and political subdivisions	-	-	-
Total impaired loans with a related allowance recorded	4,462	4,462	413
Total impaired loans:			
Real estate:			
Residential real estate	1,876	1,950	6

Commercial real estate	3,128	3,197	406
Construction, land acquisition and development	370	777	-
Total real estate	5,374	5,924	412
Commercial and industrial	22	54	-
Consumer	299	299	1
State and political subdivisions	-	-	-
Total impaired loans	$5,695	$ 6,277	$ 413

(in thousands)	December 31, 2015 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no allowance recorded:			
Real estate:			
Residential real estate	$1,042	$ 1,138	$ -
Commercial real estate	1,850	2,868	-
Construction, land acquisition and development	470	844	-
Total real estate	3,362	4,850	-
Commercial and industrial	124	156	-
Consumer	-	-	-
State and political subdivisions	-	-	-
Total impaired loans with no related allowance recorded	3,486	5,006	-
With a related allowance recorded:			
Real estate:			
Residential real estate	1,888	1,888	92
Commercial real estate	1,981	1,981	287
Construction, land acquisition and development	176	176	1
Total real estate	4,045	4,045	380
Commercial and industrial	79	79	-
Consumer	351	351	1
State and political subdivisions	-	-	-
Total impaired loans with a related allowance recorded	4,475	4,475	381
Total impaired loans:			
Real estate:			
Residential real estate	2,930	3,026	92
Commercial real estate	3,831	4,849	287
Construction, land acquisition and development	646	1,020	1
Total real estate	7,407	8,895	380
Commercial and industrial	203	235	-
Consumer	351	351	1
State and political subdivisions	-	-	-
Total impaired loans	$7,961	$ 9,481	$ 381

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The following table presents the average balance and interest income by loan category recognized on impaired loans for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
	2016		**2015**		**2016**		**2015**	
(in thousands)	**Average Balance**	**Interest Income (1)**	**Average Balance**	**Interest Income (1)**	**Average Balance**	**Interest Income (1)**	**Average Balance**	**Interest Income (1)**
Real estate:								
Residential real estate	$1,933	$ 21	$2,413	$ 28	$2,416	$ 69	$2,659	$ 92
Commercial real estate	2,835	23	7,017	24	3,476	69	6,884	82
Construction, land acquisition and development	379	1	459	5	452	5	465	14
Total real estate	5,147	45	9,889	57	6,344	143	10,008	188
Commercial and industrial	196	-	140	1	315	2	142	1
Consumer	299	1	354	3	301	7	357	9
State and political subdivisions	-	-	-	-	-	-	-	-
Total impaired loans	$5,642	$ 46	$10,383	$ 61	$6,960	$ 152	$10,507	$ 198

(1) Interest income represents income recognized on performing TDRs.

The additional interest income that would have been earned on non-accrual and restructured loans had these loans performed in accordance with their original terms approximated $48 thousand and $175 thousand for the three and nine months ended September 30, 2016, respectively, and $112 thousand and $298 thousand for the three and nine months ended September 30, 2015.

Troubled Debt Restructured Loans

TDRs at September 30, 2016 and December 31, 2015 were $4.3 million and $5.8 million, respectively. Accruing and non-accruing TDRs were $4.1 million and $0.2 million, respectively at September 30, 2016, and $5.0 million and $0.8 million, respectively at December 31, 2015. Approximately $266 thousand and $295 thousand in specific reserves have been established for TDRs as of September 30, 2016 and December 31, 2015, respectively. FNCB was not committed to lend additional funds to any loan classified as a TDR at September 30, 2016 and December 31, 2015.

The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date, capitalization of real estate taxes, or a permanent reduction of the recorded investment in the loan.

The following tables show the pre- and post- modification recorded investment in loans modified as TDRs during the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30, 2016					Nine Months Ended September 30, 2016				
(in thousands)	**Number of Contracts**		**Pre-Modification Outstanding Recorded Investment**		**Post-Modification Outstanding Recorded Investment**	**Number of Contracts**		**Pre-Modification Outstanding Recorded Investment**		**Post-Modification Outstanding Recorded Investment**
Troubled debt restructurings:										
Residential real estate	1	$	95	$	99	1	$	95	$	99
Commercial real estate	-		-		-	-		-		-
Construction, land acquisition, and development	-		-		-	-		-		-
Commercial and industrial	-		-		-	-		-		-
Consumer	-		-		-	-		-		-
State and political subdivisions	-		-		-	-		-		-
Total new troubled debt restructurings	1	$	95	$	99	1	$	95	$	99

	Three Months Ended September 30, 2015					Nine Months Ended September 30, 2015				
(in thousands)	**Number of Contracts**		**Pre-Modification Outstanding Recorded Investment**		**Post-Modification Outstanding Recorded Investment**	**Number of Contracts**		**Pre-Modification Outstanding Recorded Investment**		**Post-Modification Outstanding Recorded Investment**
Troubled debt restructurings:										
Residential real estate	-	$	-	$	-	5	$	810	$	827
Commercial real estate	-		-		-	1		1,654		742
Construction, land acquisition, and development	-		-		-	1		96		96
Commercial and industrial	1		79		79	1		79		79
Consumer	-		-		-	-		-		-
State and political subdivisions	-		-		-	-		-		-
Total new troubled debt restructurings	1	$	79	$	79	8	$	2,639	$	1,744

The following table presents the types of modifications made during the three and nine months ended September 30, 2016 and 2015:

(in thousands)	Three months ended September 30, 2016				Nine months ended September 30, 2016			
	Extension of Term	Extension of Term and Capitalization of Taxes	Principal Forbearance	Total Modifications	Extension of Term	Extension of Term and Capitalization of Taxes	Principal Forbearance	Total Modifications
Residential real estate	$-	$ 95	$ -	$ 95	$-	$ 95	$ -	$ 95
Commercial real estate	-	-	-	-	-	-	-	-
Construction, land acquisition and development	-	-	-	-	-	-	-	-
Commercial and industrial	-	-	-	-	-	-	-	-
Consumer	-	-	-	-	-	-	-	-
State and political subdivisions	-	-	-	-	-	-	-	-
Total modifications	$-	$ 95	$ -	$ 95	$-	$ 95	$ -	$ 95

(in thousands)	Three months ended September 30, 2015				Nine months ended September 30, 2015			
	Extension of Term	Extension of Term and Capitalization of Taxes	Principal Forbearance	Total Modifications	Extension of Term	Extension of Term and Capitalization of Taxes	Principal Forbearance	Total Modifications
Residential real estate	$-	$ -	$ -	$ -	$709	$ 118	$ -	$ 810
Commercial real estate	-	-	-	-	-	-	1,654	1,654
Construction, land acquisition and development	-	-	-	-	96	-	-	96
Commercial and industrial	-	-	79	79	-	-	79	79
Consumer	-	-	-	-	-	-	-	-
State and political subdivisions	-	-	-	-	-	-	-	-
Total modifications	$-	$ -	$ 79	$ 79	$805	$ 118	$ 1,733	$ 2,639

The one loan modified as a TDR during the nine months ended September 30, 2016 resulted in a $1 thousand increase to the specific reserve in the ALLL at September 30, 2016. Although the eight loans modified as TDRs during the nine months ended September 30, 2015 did not result in an increase to the specific reserve in the ALLL at September 30, 2015, charge-offs resulting from the modified TDRs totaled $912 thousand for the nine months ended September 30, 2015.

The following table presents the number and recorded investment of TDRs which have defaulted (defined as past due 90 days or more) during the three months and nine months ended September 30, 2016 that were modified within the twelve months prior to such default:

(in thousands)	Three Months Ended September 30, 2016			Nine Months Ended September 30, 2016		
	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Troubled debt restructurings:						
Residential real estate	-	$	-	3	$	107
Commercial real estate	-		-	1		680
Construction, land acquisition, and development	-		-	-		-
Commercial and industrial	-		-	-		-
Consumer	-		-	-		-
State and political subdivisions	-		-	-		-
Total	-	$	-	4	$	787

For impairment determination purposes, the three residential real estate TDRs that defaulted during the nine months ended September 30, 2016 were considered collateral-dependent loans. One of the three TDRs suffered a decline in collateral value, which resulted in a charge against the ALLL of $37 thousand during the nine months ended September 30, 2016. The one commercial real estate loan with a recorded investment of $680 that defaulted during the nine months ended September 30, 2016, was foreclosed upon and transferred to OREO during the third quarter of 2016. There were no loans modified as TDRs within the previous 12 months which defaulted during the three and nine months ended September 30, 2015. There was one TDR with a recorded investment of $3.5 million that defaulted during the nine months ended September 30, 2015, however the default did not occur within 12 months of the original modification.

There were five consumer mortgage loans secured by residential real estate properties with an aggregate recorded investment of $162 thousand that were in the process of foreclosure at September 30, 2016. There was one residential real estate property with a carrying value of $237 thousand that was foreclosed upon during the nine months ended September 30, 2016. There were two residential real estate properties with an aggregate carrying value of $41 thousand included in OREO at September 30, 2016 and December 31, 2015.

Note 5. Income Taxes

The following table presents a reconciliation between the effective income tax expense (benefit) and the income tax expense that would have been provided at the federal statutory tax rate of 34.0% for the three and nine months ended September 30, 2016 and 2015.

	For the Three Months Ended September 30,				**For the Nine Months Ended September 30,**			
	2016		**2015**		**2016**		**2015**	
(in thousands)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Provision at statutory tax rates	$932	34.00 %	$795	34.00 %	$2,175	34.00 %	$2,241	34.00 %
Add (deduct):								
Tax effects of non-taxable income	(121)	(4.42%)	(116)	(4.97%)	(374)	(5.85%)	(362)	(5.49%)
Non-deductible interest expense	2	0.07 %	3	0.13 %	7	0.11 %	8	0.12 %
Bank-owned life insurance	(47)	(1.70%)	(49)	(2.11%)	(145)	(2.27%)	(141)	(2.14%)
Change in valuation allowance	-	0.00 %	-	0.00 %	(8)	(0.13%)	-	0.00 %
Other items, net	(42)	(1.54%)	(633)	(27.09%)	(44)	(0.68%)	(1,786)	(27.12%)
Income tax provision (benefit)	$724	26.41 %	$-	0.00 %	$1,611	25.19 %	$(40)	(0.61%)

As of September 30, 2016, FNCB had $55.6 million of net operating loss carryovers resulting in deferred tax assets of $18.9 million. Beginning in 2030, these net operating loss carryovers will expire if not utilized. As of December 31, 2015, FNCB also had $1.0 million of charitable contribution carryovers and $2.5 million in alternative minimum tax (“AMT”) credit carryovers resulting in gross deferred tax assets of $355 thousand and $2.5 million, respectively. Charitable contribution carryovers will begin to expire after December 31, 2016 if not utilized, while AMT credit carryovers have an indefinite life.

Management evaluates the carrying amount of its deferred tax assets on a quarterly basis, or more frequently, if necessary, in accordance with guidance set forth in ASC Topic 740 “Income Taxes,” and applies the criteria in the guidance to determine whether it is more likely than not that some portion, or all, of the deferred tax asset will not be realized within its life cycle, based on the weight of available evidence. In evaluating available evidence, management considers, among other factors, historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. In assessing the need for a valuation allowance, management carefully weighs both positive and negative evidence currently available. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which it can objectively be verified. If management determines based on available evidence, both positive and negative, that it is more likely than not that some portion or all of the deferred tax asset will not be realized in future periods, a valuation allowance is calculated and recorded. These determinations are inherently subjective and depend upon management's estimates and judgments used in their evaluation of both positive and negative evidence.

Management performed an evaluation of FNCB's deferred tax assets at September 30, 2016 taking into consideration all available positive and negative evidence at that time. Based on this evaluation, management believes that FNCB's future taxable income will be sufficient to utilize deferred tax assets. Accordingly, a valuation allowance for deferred tax assets, except for the amount established for charitable contribution carryovers, was not required at September 30, 2016. Management does not believe currently that enough positive evidence exists to remove the valuation allowance associated with charitable contribution carryovers. Unlike the expiration period for net operating loss carryforwards (generally 20 years) and AMT credit carryovers (indefinite), the expiration of an excess charitable contribution carryover occurs after the 5th succeeding tax year for which a charitable contribution is made. Because FNCB is in a net deferred tax asset position, without regard to net operating loss carryovers, the reversal of existing temporary timing differences over the next 5 years makes it more likely than not that a portion of the charitable contribution carryovers will not be recognized. Accordingly, management believes a valuation allowance continues to be appropriate strictly in the case of the excess charitable contribution carryover deferred tax asset.

Note 6. Related Party Transactions

In conducting its business, FNCB has engaged in and intends to continue to engage in banking and financial transactions with directors and executive officers of FNCB and their related parties.

FNCB has granted loans, letters of credit and lines of credit to directors, executive officers and their related parties. The following table summarizes the changes in the total amounts of such outstanding loans, advances under lines of credit, net of any participations sold, as well as repayments during the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in thousands)	**2016**	**2015**	**2016**	**2015**
Balance, beginning of period	$43,664	$40,486	$52,652	$36,783
Additions, new loans and advances	3,492	20,881	10,704	52,282
Repayments	(2,115)	(9,723)	(18,294)	(37,421)
Other (1)	(28)	-	(49)	-
Balance, end of period	$45,013	$51,644	$45,013	$51,644

(1) Represents loans to related parties that ceased being related parties during the period indicated.

At September 30, 2016, there were no loans made to directors, executive officers and their related parties that were not performing in accordance with the terms of the loan agreements.

Previously included in related party loans was a commercial line of credit with a company owned by a director that was paid off during the nine months ended September 30, 2016. The aggregate balance outstanding for this loan was $11.0 million at December 31, 2015. FNCB had sold a participation interest in this line to the same director in the amount of $5.2 million, of which $4.4 million was outstanding at December 31, 2015. FNCB had received a 25 basis point annual servicing fee from this director on the participation balance.

Deposits from directors, executive officers and their related parties held by FNCB at September 30, 2016 and December 31, 2015 amounted to $98.0 million and $106.1 million, respectively. Interest paid on the deposits amounted to $143 thousand and $222 thousand for the nine months ended on September 30, 2016 and 2015, respectively.

In the course of its operations, FNCB acquires goods and services from, and transacts business with, various companies of related parties, which include, but are not limited to, employee health insurance, fidelity bond and errors and omissions insurance, legal services, and repair of repossessed automobiles for resale. FNCB recorded payments to related parties for goods and services of $1.0 million and $1.9 million for the three and nine months ended September 30, 2016, respectively, and $0.9 million and $1.7 million for the respective periods of 2015.

Subordinated notes (the "Notes") held by directors and/or their related parties totaled $8.6 million at both September 30, 2016 and December 31, 2015. For the nine months ended September 30, 2016, FNCB paid the quarterly interest payments due on the Notes for the period of December 1, 2015 through August 31, 2016, totaling $481 thousand, of which $296 thousand was paid to directors and/or their related interests. On March 1, 2016, FNCB also paid all previously deferred and accrued interest on the Notes for the period September 1, 2010 through May 31, 2015, which totaled $10.8 million, of which $3.9 million was paid to directors and/or their related interests. For the nine months ended September 30, 2015, FNCB paid the quarterly interest payment due on the Notes for the period of June 1, 2015 through August 31, 2015, totaling $293 thousand, of which $134 thousand was paid to directors and/or their related interests.

Note 7. Contingencies

On May 24, 2012, a putative shareholder filed a complaint in the Court of Common Pleas for Lackawanna County ("Shareholder Derivative Suit") against certain present and former directors and officers of FNCB (the "Individual Defendants") alleging, inter alia, breach of fiduciary duty, abuse of control, corporate waste, and unjust enrichment. FNCB was named as a nominal defendant. The parties to the Shareholder Derivative Suit commenced settlement discussions and on December 18, 2013, the Court entered an Order Granting Preliminary Approval of Proposed Settlement subject to notice to shareholders. On February 4, 2014, the Court issued a Final Order and Judgment for the matter granting approval of a Stipulation of Settlement (the "Settlement") and dismissing all claims against FNCB and the Individual Defendants. As part of the Settlement, there was no admission of liability by the Individual Defendants. Pursuant to the Settlement, the Individual Defendants, without admitting any fault, wrongdoing or liability, agreed to settle the derivative litigation for $5.0 million. The $5.0 million Settlement payment was made to FNCB on March 28, 2014. The Individual Defendants reserved their rights to indemnification under FNCB's Articles of Incorporation and Bylaws, resolutions adopted by the Board, the Pennsylvania Business Corporation Law and any and all rights they have against the Company's and the Bank's insurance carriers. In addition, in conjunction with the Settlement, FNCB accrued $2.5 million related to fees and costs of the plaintiff's attorneys, which was included in non-interest expense in the Consolidated Statements of Income for the year ended December 31, 2013. On April 1, 2014, FNCB paid the $2.5 million related to fees and costs of the plaintiff's attorneys and partial indemnification of the Individual Defendants in the amount of $2.5 million, and as such, as of September 30, 2016, $2.5 million plus accrued interest remains accrued in other liabilities related to the potential indemnification of the Individual Defendants.

On September 5, 2012, Fidelity and Deposit Company of Maryland ("F&D") filed an action against the Company and the Bank, as well as several current and former officers and directors of FNCB, in the United States District Court for the Middle District of Pennsylvania. F&D has asserted a claim for the rescission of a directors' and officers' insurance policy and a bond that it had issued to FNCB. On November 9, 2012, the Company and the Bank answered the claim and asserted counterclaims for the losses and expenses already incurred by the Company and the Bank. FNCB and the other defendants are defending the claims and have opposed F&D's requested relief by way of counterclaims, breaches of contract and bad faith claims against F&D for its failure to fulfill its obligations to the Company and the Bank under the insurance policy. At this time, the matter is in the discovery stage and FNCB cannot reasonably determine the outcome or potential range of loss, if any, in connection with this matter.

On August 13, 2013, Steven Antonik, individually, as Administrator of the Estate of Linda Kluska, William R. Howells, and Louise A. Howells, on behalf of themselves and others similarly situated, filed a consumer protection class action against the Company and Bank in the Lackawanna County Court of Common Pleas, seeking equitable, injunction and monetary relief to address an alleged pattern and practice of wrong doing by the Bank relating to the repossession and sale of the Plaintiffs' and class members' financed motor vehicles. On December 17, 2015, the Honorable Margaret Moyle entered an Order outlining the primary terms of a tentative agreement to settle this matter, pending a finalized, more-detailed settlement agreement, class notice and a class fairness hearing, said Order covering both this matter and the matter involving Plaintiff Charles Saxe, III individually and on behalf of all others similarly situated. The primary terms of the tentative agreement to settle are 1) Defendants to pay the Plaintiffs' class members, which the Defendants have stated are approximately 430 members, the total sum of $750,000; 2) Plaintiffs will release all claims against Defendants; 3) Defendants will remove to vacate any judgements against any class members arising from the vehicle loans that are the subject of these actions; 4) Defendants will remove the trade line on each class member's credit report associated with the subject vehicle loans that are at issue in these actions for Experian, Equifax and TransUnion, providing Plaintiffs' counsel with verification of such; 5) Defendants will verify that the aggregate amount received from class members by Defendants and its agents during the alleged unjust enrichment class period does not exceed $45,000; and 6) Defendants will waive the disputed deficiency balances relating to the subject loans of each class member and agree not to issue IRS Forms 1099-C in connection with these deficiency waivers or to sell, assign , or otherwise collect on the alleged deficiencies. The parties are currently negotiating a Class Action Agreement and Release to be submitted to the Court for preliminary approval.

On September 17, 2013, Charles Saxe, III individually and on behalf of all others similarly situated filed a consumer class action against the Bank in the Lackawanna County Court of Common Pleas alleging violations of the Pennsylvania Uniform Commercial Code in connection with the repossession and resale of financed vehicles. On December 17, 2015 the Honorable Margaret Moyle entered an Order outlining the primary terms of a tentative agreement to settle this matter, pending a finalized, more-detailed settlement agreement, class notice and a class fairness hearing, said Order covering both this matter and the matter involving Plaintiffs Steven Antonik, individually, as Administrator of the Estate of Linda Kluska, William R. Howells, and Louise A. Howells, on behalf of themselves and all others similarly situated. The primary terms of the tentative agreement to settle are 1) Defendants to pay the Plaintiffs' class members, which the Defendants have stated are approximately 430 members, the total sum of $750,000; 2) Plaintiffs will release all claims against Defendants; 3) Defendants will remove to vacate any judgements against any class members arising from the vehicle loans that are the subject of these actions; 4) Defendants will remove the trade line on each class member's credit report associated with the subject vehicle loans that are at issue in these actions for Experian, Equifax and TransUnion, providing Plaintiffs' counsel with verification of such; 5) Defendants will verify that the aggregate amount received from class members by Defendants and its agents during the alleged unjust enrichment class period does not exceed $45,000; and 6) Defendants will waive the disputed deficiency balances relating to the subject loans of each class member and agree not to issue IRS Forms 1099-C in connection with these deficiency waivers or to sell, assign , or otherwise collect on the alleged deficiencies. The parties are currently negotiating a Class Action Agreement and Release to be submitted to the Court for preliminary approval. In conjunction with the primary terms of the tentative agreement to settle, FNCB recorded a liability in the amount of $750 thousand, which was included in its 2015 operating results and remains accrued and unpaid as of September 30, 2016.

FNCB has been subject to tax audits and is also a party to routine litigation involving various aspects of its business, such as employment practice claims, workers compensation claims, claims to enforce liens, condemnation proceedings on properties in which FNCB holds security interests, claims involving the making and servicing of real property loans and other issues incident to its business, none of which has or is expected to have a material adverse impact on the consolidated financial condition, results of operations or liquidity of FNCB.

There have been no changes in the status of the other litigation disclosed in FNCB’s Annual Report on Form 10-K for the year ended December 31, 2015.

Note 8. Stock Compensation Plans

On August 30, 2000, FNCB's Board of Directors adopted the 2000 Employee Stock Incentive Plan (the "Stock Incentive Plan"). Under the Stock Incentive Plan, options were granted to key officers and other employees of FNCB. The aggregate number of shares authorized to be issued upon exercise of the options under the Stock Incentive Plan could not exceed 1,100,000 shares. Options and rights granted under the Stock Incentive Plan became exercisable six months after the date the options are awarded and expire ten years after the award date. Upon exercise, the shares are issued from FNCB's authorized but unissued stock. The Stock Incentive Plan expired on August 30, 2010. Accordingly, no further grants will be made under the Stock Incentive Plan. No compensation expense related to options under the Stock Incentive Plan was required to be recorded in the nine months ended September 30, 2016 and 2015. Stock options outstanding at September 30, 2016 and December 31, 2015 were 47,459 and 50,746, respectively.

There have been no changes to the status of FNCB's Stock Incentive Plan as of or for the nine months ended September 30, 2016. For additional information related to the Stock Incentive Plan refer to Note 16 to the consolidated financial statements included in FNCB's Annual Report on Form 10-K for the year ended December 31, 2015.

On October 23, 2013, the Board of Directors adopted a Long Term Incentive Compensation Plan ("LTIP") that is designed to reward executives and key employees for their contributions to the long-term success of FNCB, primarily as measured by the increase in FNCB's stock price. The LTIP authorizes up to 1,200,000 shares of common stock for issuance and provides the Board of Directors with the authority to offer several different types of long-term incentives, including stock options, stock appreciation rights, restricted stock, restricted stock units, performance units and performance shares. There were no awards granted during the three months ended September 30, 2016. Awards granted under the LTIP during the nine months ended September 30, 2016 were comprised of 67,600 shares of restricted stock. At September 30, 2016, there were 1,026,127 shares of common stock available for award under the LTIP. For the nine months ended September 30, 2016 and 2015, stock-based compensation expense, which is included in salaries and employee benefits expense in the Consolidated Statements of Income, totaled $195 thousand and $179 thousand, respectively. Total unrecognized compensation expense related to unvested restricted stock awards was $468 thousand and $522 thousand at September 30, 2016 and 2015, respectively.

The following table summarizes the activity related to FNCB's unvested restricted stock awards during the three and nine months ended September 30, 2016 and 2015:

Three Months Ended September 30,	Nine Months Ended September 30,

2016 **2015**