FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
May 09, 2016
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2016

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

For the transition period from__________ to___________

Commission file number 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1440803
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 South Main Street, Chambersburg	PA 17201-0819
(Address of principal executive offices)	(Zip Code)

(717) 264-6116

(Registrant's telephone number, including area code)

Not Applicable

(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 Act) Yes No

There were 4,286,271 outstanding shares of the Registrant's common stock as of April 30, 2016.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets

(Dollars in thousands, except share and per share data)(unaudited)	March 31 2016	December 31 2015
Assets		
Cash and due from banks	$ 12,912	$ 20,664
Interest-bearing deposits in other banks	46,215	18,502
Total cash and cash equivalents	59,127	39,166
Investment securities available for sale, at fair value	154,691	159,473
Restricted stock	439	782
Loans held for sale	559	461
Loans	802,568	782,016
Allowance for loan losses	(10,342)	(10,086)
Net Loans	792,226	771,930
Premises and equipment, net	14,592	14,759
Bank owned life insurance	22,063	22,364
Goodwill	9,016	9,016
Other real estate owned	6,331	6,451
Deferred tax asset, net	4,288	4,758
Other assets	6,604	6,135
Total assets	$ 1,069,936	$ 1,035,295
Liabilities		
Deposits		
Noninterest-bearing checking	$ 159,829	$ 152,095
Money management, savings and interest checking	707,596	680,686
Time	83,543	85,731
Total Deposits	950,968	918,512
Other liabilities	4,655	5,407
Total liabilities	955,623	923,919
Shareholders' equity		
Common stock, $1 par value per share,15,000,000 shares authorized with 4,673,477 shares issued and 4,290,220 shares outstanding at March 31, 2016 and 4,659,319 shares issued and 4,275,879 shares outstanding at December 31, 2015	4,673	4,659
Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding	-	-
Additional paid-in capital	39,083	38,778

Retained earnings	80,430	78,517
Accumulated other comprehensive loss	(3,020)	(3,722)
Treasury stock, 383,257 shares at March 31, 2016 and 383,440 shares at December 31, 2015, at cost	(6,853)	(6,856)
Total shareholders' equity	114,313	111,376
Total liabilities and shareholders' equity	$ 1,069,936	$ 1,035,295

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

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Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended March 31	
	2016	2015
Interest income		
Loans, including fees	$ 8,088	$ 7,376
Interest and dividends on investments:		
Taxable interest	575	636
Tax exempt interest	367	408
Dividend income	6	51
Deposits and obligations of other banks	62	55
Total interest income	9,098	8,526
Interest expense		
Deposits	543	641
Short-term borrowings	2	-
Total interest expense	545	641
Net interest income	8,553	7,885
Provision for loan losses	300	325
Net interest income after provision for loan losses	8,253	7,560
Noninterest income		
Investment and trust services fees	1,253	1,263
Loan service charges	226	182
Deposit service charges and fees	578	490
Other service charges and fees	303	296
Debit card income	347	318
Increase in cash surrender value of life insurance	135	139
Net (loss) gain on sale of other real estate owned	(8)	32
OTTI losses on debt securities	(20)	(20)
Gain on conversion of investment security	-	728
Securities gains	1	-
Other	138	224
Total noninterest income	2,953	3,652
Noninterest expense		
Salaries and employee benefits	4,370	4,083
Occupancy, net	600	615
Furniture and equipment	216	231
Advertising	282	188
Legal and professional	297	296
Data processing	497	467
Pennsylvania bank shares tax	237	196
Intangible amortization	-	90
FDIC insurance	157	148
ATM/debit card processing	228	187

Foreclosed real estate	63	12
Telecommunications	118	117
Other	730	859
Total noninterest expense	7,795	7,489
Income before federal income taxes	3,411	3,723
Federal income tax expense	685	839
Net income	$ 2,726	$ 2,884
Per share		
Basic earnings per share	$ 0.64	$ 0.68
Diluted earnings per share	$ 0.64	$ 0.68
Cash dividends declared	$ 0.19	$ 0.17

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

Consolidated Statements of Comprehensive Income

(Dollars in thousands) (unaudited)	For the Three Months Ended March 31 2016	2015
Net Income	$ 2,726	$ 2,884
Securities:		
Unrealized gains arising during the period	1,045	703
Reclassification adjustment for losses (gains) included in net income (1)	19	(708)
Net unrealized gains (losses)	1,064	(5)
Tax effect	(362)	2
Net of tax amount	702	(3)
Derivatives:		
Unrealized losses arising during the period	-	(1)
Reclassification adjustment for losses included in net income (2)	-	96
Net unrealized gains	-	95
Tax effect	-	(33)
Net of tax amount	-	62
Total other comprehensive income	702	59
Total Comprehensive Income	$ 3,428	$ 2,943

Reclassification adjustment / Statement line item	Tax expense (benefit)	
(1) Securities / gain on conversion & securities (gains) losses, net	$ (6)	$ 241
(2) Derivatives / interest expense on deposits	-	(33)

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

Consolidated Statements of Changes in Shareholders' Equity

For the Three months March 31, 2016 and 2015:

(Dollars in thousands, except per share data) (unaudited)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2014	$ 4,607	$ 37,504	$ 71,452	$ (3,100)	$ (6,942)	$ 103,521
Net income	-	-	2,884	-	-	2,884
Other comprehensive income	-	-	-	59	-	59
Cash dividends declared, $.17 per share	-	-	(718)	-	-	(718)
Treasury shares issued under stock option plans, 205 shares	-	-	-	-	4	4
Common stock issued under dividend reinvestment plan, 9,660 shares	9	203	-	-	-	212
Balance at March 31, 2015	$ 4,616	$ 37,707	$ 73,618	$ (3,041)	$ (6,938)	$ 105,962
Balance at December 31, 2015	$ 4,659	$ 38,778	$ 78,517	$ (3,722)	$ (6,856)	$ 111,376
Net income	-	-	2,726	-	-	2,726
Other comprehensive income	-	-	-	702	-	702
Cash dividends declared, $.19 per share	-	-	(813)	-	-	(813)
Treasury shares issued under stock option plans, 183 shares	-	1	-	-	3	4
Common stock issued under dividend reinvestment plan, 14,158 shares	14	290	-	-	-	304
Stock option compensation expense	-	14	-	-	-	14
Balance at March 31, 2016	$ 4,673	$ 39,083	$ 80,430	$ (3,020)	$ (6,853)	$ 114,313

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

Consolidated Statements of Cash Flows

	Three Months Ended March 31	
	2016	2015
(Dollars in thousands) (unaudited)		
Cash flows from operating activities		
Net income	$ 2,726	$ 2,884
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	331	339
Net amortization of loans and investment securities	355	377
Amortization and net change in mortgage servicing rights valuation	14	11
Amortization of intangibles	-	90
Provision for loan losses	300	325
Gain on sales of securities	(1)	-
Impairment write-down on securities recognized in earnings	20	20
Gain on conversion of investment security	-	(728)
Loans originated for sale	(2,805)	(882)
Proceeds from sale of loans	2,707	1,116
Write-down of other real estate owned	46	-
Net loss (gain) on sale or disposal of other real estate/other repossessed assets	8	(32)
Increase in cash surrender value of life insurance	(135)	(139)
Stock option compensation	14	-
(Increase) decrease in other assets	(545)	198
(Decrease) increase in other liabilities	(684)	278
Net cash provided by operating activities	2,351	3,857
Cash flows from investing activities		
Proceeds from sales and calls of investment securities available for sale	615	-
Proceeds from maturities and pay-downs of securities available for sale	7,426	6,399
Purchase of investment securities available for sale	(2,637)	(11,146)
Net decrease in restricted stock	343	-
Net (increase) decrease in loans	(20,440)	2,982
Capital expenditures	(150)	(120)
Proceeds from surrender of life insurance policy	436	-
Proceeds from sale of other real estate	66	129
Net cash used in investing activities	(14,341)	(1,756)
Cash flows from financing activities		
Net increase in demand deposits, interest-bearing checking, and savings accounts	34,644	27,955
Net decrease in time deposits	(2,188)	(3,741)
Net decrease in repurchase agreements	-	(9,079)
Dividends paid	(813)	(718)
Cash received from option exercises	4	4
Common stock issued under dividend reinvestment plan	304	212

Net cash provided by financing activities	31,951	14,633
Increase in cash and cash equivalents	19,961	16,734
Cash and cash equivalents as of January 1	39,166	48,593
Cash and cash equivalents as of March 31	$ 59,127	$ 65,327
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest on deposits and other borrowed funds	$ 522	$ 611
Income taxes	$ 700	$ 262
Noncash Activities		
Loans transferred to Other Real Estate	$ -	$ 449

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

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly-owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank) and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly-owned subsidiary, Franklin Financial Properties Corp. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of non-bank entities are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of March 31, 2016, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation’s 2015 Annual Report on Form 10-K. The consolidated results of operations for the period ended March 31, 2016 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2015 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in other banks and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Earnings per share are computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

	For the Three Months Ended March 31	
(Dollars and shares in thousands, except per share data)	2016	2015
Weighted average shares outstanding (basic)	4,283	4,223
Impact of common stock equivalents	2	6
Weighted average shares outstanding (diluted)	4,285	4,229

Anti-dilutive options excluded from calculation	63	29
Net income	$ 2,726	$ 2,884
Basic earnings per share	$ 0.64	$ 0.68
Diluted earnings per share	$ 0.64	$ 0.68

Note 2. Recent Accounting Pronouncements

Revenue from Contracts with Customers (Topic 606). The amendments in this Update (ASU 2014-09) establish a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The ASU is effective for public entities for annual periods beginning after December 15, 2016, including interim periods therein. Three basic transition methods are available – full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the

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third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. January 1, 2017) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. Early adoption is prohibited under U.S. GAAP. The Corporation does not believe ASU 2014-09 will have a material effect on its financial statements.

Financial Instruments – Overall (Topic 825-10). In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Topic 825-10): “Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 amends the guidance on the classification and measurement of financial instruments. Some of the amendments in ASU 2016-01 include the following: 1) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and 4) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value; among others. For public business entities, the amendments of ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Corporation does not believe ASU 2016-01 will have a material effect on its financial statements.

Leases (Topic 842). In February 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-02, Leases. From the lessee’s perspective, the new standard established a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessees. From the lessor’s perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as financing. If the lessor doesn’t convey risks and rewards or control, an operating lease results.

The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Corporation is currently evaluating the impact of the pending adoption of the new standard on its consolidated financial statements.

Note 3. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive losses included in shareholders' equity are as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015
Net unrealized gains on securities	$ 2,202	$ 1,138
Tax effect	(749)	(387)
Net of tax amount	1,453	751
Accumulated pension adjustment	(6,777)	(6,777)
Tax effect	2,304	2,304
Net of tax amount	(4,473)	(4,473)
Total accumulated other comprehensive loss	$ (3,020)	$ (3,722)

Note 4. Guarantees

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Bank generally holds collateral and/or personal guarantees supporting these commitments. The Bank had $29.1 million and $25.9 million of standby letters of credit as of March 31, 2016 and December 31, 2015, respectively. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The amount of the liability as of March 31, 2016 and December 31, 2015 for guarantees under standby letters of credit issued was not material.

Note 5. Investments

The amortized cost and estimated fair value of investment securities available for sale as of March 31, 2016 and December 31, 2015 are as follows:

(Dollars in thousands)		Gross	Gross	
	Amortized	unrealized	unrealized	Fair
March 31, 2016	cost	gains	losses	value
Equity securities	$ 164	$ 72	$ -	$ 236
U.S. Government and Agency securities	13,362	286	(26)	13,622
Municipal securities	65,022	1,937	(78)	66,881
Trust preferred securities	5,964	-	(1,000)	4,964
Agency mortgage-backed securities	66,679	1,060	(62)	67,677
Private-label mortgage-backed securities	1,261	20	(5)	1,276
Asset-backed securities	37	-	(2)	35
	$ 152,489	$ 3,375	$ (1,173)	$ 154,691

(Dollars in thousands)		Gross	Gross	
	Amortized	unrealized	unrealized	Fair
December 31, 2015	cost	gains	losses	value
Equity securities	$ 164	$ 69	$ -	$ 233

U.S. Government and Agency securities	13,705	164	(33)	13,836
Municipal securities	67,851	1,555	(218)	69,188
Trust preferred securities	5,958	-	(669)	5,289
Agency mortgage-backed securities	69,284	621	(386)	69,519
Private-label mortgage-backed securities	1,335	39	(2)	1,372
Asset-backed securities	38	-	(2)	36
	$ 158,335	$ 2,448	$ (1,310)	$ 159,473

At March 31, 2016 and December 31, 2015, the fair value of investment securities pledged to secure public funds, trust balances, deposit and other obligations totaled $69.8 million and $79.6 million, respectively.

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The amortized cost and estimated fair value of debt securities at March 31, 2016, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities.

(Dollars in thousands)	Amortized cost	Fair value
Due in one year or less	$ 1,673	$ 1,682
Due after one year through five years	12,879	13,215
Due after five years through ten years	27,472	28,425
Due after ten years	42,361	42,180
	84,385	85,502
Mortgage-backed securities	67,940	68,953
	$ 152,325	$ 154,455

The composition of the net realized securities gains for the three months ended are as follows:

	For the Three Months Ended March 31	
(Dollars in thousands)	2016	2015
Gross gains realized	$ 1	$ -
Gross losses realized	-	-
Conversion gain	-	728
Net gains realized	$ 1	$ 728

The following table provides additional detail about trust preferred securities as of March 31, 2016:

Trust Preferred Securities

(Dollars in thousands)

Deal Name	Maturity	Single Issuer or Pooled	Class	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Lowest Credit Rating Assigned
	1/15/2027	Single		$ 965	$ 772	$ (193)	BB+

BankAmerica Cap III			Preferred Stock				
Wachovia Cap Trust II	1/15/2027	Single	Preferred Stock	278	241	(37)	BBB
Huntington Cap Trust	2/1/2027	Single	Preferred Stock	944	803	(141)	BB
Corestates Captl Tr II	2/15/2027	Single	Preferred Stock	940	802	(138)	BBB+
Huntington Cap Trust II	6/15/2028	Single	Preferred Stock	896	776	(120)	BB
Chase Cap VI JPM	8/1/2028	Single	Preferred Stock	965	786	(179)	BBB-
Fleet Cap Tr V	12/18/2028	Single	Preferred Stock	976	784	(192)	BB+
				$ 5,964	$ 4,964	$ (1,000)	

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The following table provides additional detail about private label mortgage-backed securities as of March 31, 2016:

Private Label Mortgage Backed Securities

(Dollars in thousands) Description	Origination Date	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Collateral Type	Lowest Credit Rating Assigned	Credit Support %	Cumulative OTTI Charges
MALT 2004-6 7A1	6/1/2004	$ 334	$ 337	$ 3	ALT A	CCC	14.83	$ -
RALI 2005-QS2 A1	2/1/2005	195	206	11	ALT A	CC	4.96	10
RALI 2006-QS4 A2	4/1/2006	442	441	(1)	ALT A	D	-	323
GSR 2006-5F 2A1	5/1/2006	57	63	6	Prime	D	-	15
RALI 2006-QS8 A1	7/28/2006	233	229	(4)	ALT A	D	-	227
		$ 1,261	$ 1,276	$ 15				$ 575

Impairment:

The investment portfolio contained forty-seven securities with $25.8 million of temporarily impaired fair value and $1.2 million in unrealized losses at March 31, 2016. The total unrealized loss position has decreased from $1.3 million at year-end 2015.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. Equity securities are assessed for other-than-temporary impairment based on the length of time of impairment, dollar amount of the impairment and general market and financial conditions relating to specific issues. The impairment identified on debt and equity securities and subject to assessment at March 31, 2016, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the investment portfolio (excluding restricted stock), aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of March 31, 2016 and December 31, 2015:

	March 31, 2016								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ 1,308	$ (1)	4	$ 3,363	$ (25)	9	$ 4,671	$ (26)	13
Municipal securities	-	-	-	3,926	(78)	6	3,926	(78)	6
Trust preferred securities	-	-	-	4,964	(1,000)	7	4,964	(1,000)	7
Agency mortgage-backed securities	3,845	(15)	6	7,749	(47)	12	11,594	(62)	18
Private-label mortgage-backed securities	-	-	-	670	(5)	2	670	(5)	2
Asset-backed securities	-	-	-	5	(2)	1	5	(2)	1
Total temporarily impaired securities	$ 5,153	$ (16)	10	$ 20,677	$ (1,157)	37	$ 25,830	$ (1,173)	47

	December 31, 2015								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ 479	$ (1)	3	$ 4,364	$ (32)	10	$ 4,843	$ (33)	13
Municipal securities	5,806	(35)	8	4,785	(183)	7	10,591	(218)	15
Trust preferred securities	-	-	-	5,289	(669)	7	5,289	(669)	7
Agency mortgage-backed securities	18,977	(215)	29	7,394	(171)	13	26,371	(386)	42
Private-label mortgage-backed securities	-	-	-	246	(2)	1	246	(2)	1

Asset-backed securities	-	-	-	5	(2)	1	5	(2)	1
Total temporarily impaired securities	$ 25,262	$ (251)	40	$ 22,083	$ (1,059)	39	$ 47,345	$ (1,310)	79

The unrealized loss in the municipal bond portfolio decreased to $78 thousand from $218 thousand at December 31, 2015 as market prices improved during the quarter. There are six securities in this portfolio with an unrealized loss and the loss in this portfolio is deemed to be non-credit related and no other-than-temporary impairment charges have been recorded.

The trust preferred portfolio contains seven securities with a fair value of $5.0 million and an unrealized loss of $1.0 million. The trust-preferred securities held by the Bank are single entity issues, not pooled trust preferred securities. Therefore, the impairment review of these securities is based only on the issuer and the security cannot be impaired by the performance of other issuers as if it was a pooled trust-preferred bond. All of the Bank's trust preferred securities are single issue, variable rate notes with long maturities (2027 – 2028). None of these bonds have suspended or missed a dividend payment. At March 31, 2016, the Bank believes it will be able to collect all interest and principal due on these bonds and no other-than-temporary-impairment charges were recorded.

There are two PLMBS bonds showing a small unrealized loss of $5 thousand. However, the PLMBS sector as a whole is showing an unrealized gain of $15 thousand at quarter end. This is primarily a result of the cumulative OTTI charges recorded on this portfolio. Due to the nature of these bonds, they are evaluated closely. These bonds were all rated AAA at time of purchase, but have since experienced rating declines. Some have experienced increased delinquencies and defaults, while others have seen the credit support increase as the bonds paid-down. The Bank monitors the performance of the PLMBS investments on a regular basis and reviews delinquencies, default rates, credit support levels and various cash flow stress test scenarios. In determining the credit related loss, Management considers all principal past due 60 days or more as a loss. If additional principal moves beyond 60 days past due, it will also be considered a loss. As a result of the analysis on PLMBS it was determined that a $20 thousand impairment charge was required at the end of the first quarter. The Bank has recorded $575 thousand of cumulative impairment charges on this portfolio. Management continues to monitor these securities and it is possible that additional write-downs may occur if current loss trends continue.

The following table represents the cumulative credit losses on debt securities recognized in earnings as of March 31:

(Dollars in thousands)	Three Months Ended	
	2016	2015
Balance of cumulative credit-related OTTI at January 1	$ 555	$ 535
Additions for credit-related OTTI not previously recognized	20	20
Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	-	-
Decreases for previously recognized credit-related OTTI because there was an intent to sell	-	-
Reduction for increases in cash flows expected to be collected	-	-
Balance of credit-related OTTI at March 31	$ 575	$ 555

The Bank held $439 thousand of restricted stock at March 31, 2016. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

Note 6. Loans

The Bank reports its loan portfolio based on the primary collateral of the loan. It further classifies these loans by the primary purpose, either consumer or commercial. The Bank's residential real estate loans include long-term loans to individuals and businesses secured by mortgages on the borrower's real property and include home equity loans. Construction loans are made to finance the purchase of land and the construction of residential and commercial buildings thereon, and are secured by mortgages on real estate. Commercial real estate loans include construction, owner and non-owner occupied properties and farm real estate. Commercial loans are made to businesses of various sizes for a variety of purposes including property, plant and equipment, working capital and loans to government municipalities. Commercial lending is concentrated in the Bank's primary market, but also includes purchased loan participations. Consumer loans are comprised of installment loans and unsecured personal lines of credit.

A summary of loans outstanding, by primary collateral, at the end of the reporting periods is as follows:

(Dollars in thousands)	March 31, 2016	December 31, 2015	Change Amount	%
Residential Real Estate 1-4 Family				
Consumer first liens	$ 101,412	$ 103,698	$ (2,286)	(2.2)
Commercial first lien	60,394	57,780	2,614	4.5
Total first liens	161,806	161,478	328	0.2
Consumer junior liens and lines of credit	46,479	44,996	1,483	3.3
Commercial junior liens and lines of credit	5,936	5,917	19	0.3
Total junior liens and lines of credit	52,415	50,913	1,502	3.0
Total residential real estate 1-4 family	214,221	212,391	1,830	0.9
Residential real estate - construction				
Consumer	514	545	(31)	(5.7)
Commercial	7,593	7,343	250	3.4
Total residential real estate construction	8,107	7,888	219	2.8
Commercial real estate	359,642	340,695	18,947	5.6
Commercial	215,671	215,942	(271)	(0.1)
Total commercial	575,313	556,637	18,676	3.4
Consumer	4,927	5,100	(173)	(3.4)
	802,568	782,016	20,552	2.6
Less: Allowance for loan losses	(10,342)	(10,086)	(256)	2.5
Net Loans	$ 792,226	$ 771,930	$ 20,296	2.6
Included in the loan balances are the following:				
Net unamortized deferred loan fees (costs)	$ 547	$ 436		
Loans pledged as collateral for borrowings and commitments from:				
FHLB	$ 665,635	$ 643,449		
Federal Reserve Bank	42,932	45,111		
	$ 708,567	$ 688,560		

Note 7. Loan Quality

The following table presents, by class, the activity in the Allowance for Loan Losses (ALL) for the periods ended:

	Residential Real Estate 1-4 Family			Commercial				
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Real Estate	Commercial	Consumer	Unallocated	Total
ALL at December 31, 2015	$ 989	$ 308	$ 194	$ 5,649	$ 1,519	$ 102	$ 1,325	$ 10,086
Charge-offs	(3)	-	-	(3)	(63)	(42)	-	(111)
Recoveries	32	-	-	-	15	20	-	67
Provision	(21)	8	5	535	39	19	(285)	300
ALL at March 31, 2016	$ 997	$ 316	$ 199	$ 6,181	$ 1,510	$ 99	$ 1,040	$ 10,342
ALL at December 31, 2014	$ 994	$ 271	$ 214	$ 4,978	$ 1,515	$ 127	$ 1,012	$ 9,111
Charge-offs	-	-	-	-	(201)	(52)	-	(253)
Recoveries	2	-	-	-	6	19	-	27
Provision	20	(3)	35	159	32	23	59	325
ALL at March 31, 2015	$ 1,016	$ 268	$ 249	$ 5,137	$ 1,352	$ 117	$ 1,071	$ 9,210

The following table presents, by class, loans that were evaluated for the ALL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) and the amount of the ALL established in each class as of March 31, 2016 and December 31, 2015:

	Residential Real Estate 1-4 Family			Commercial				
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Real Estate	Commercial	Consumer	Unallocated	Total
March 31, 2016								

Loans evaluated for ALL:								
Individually	$ 398	$ 52	$ 501	$ 19,415	$ -	$ -	$ -	$ 20,366
Collectively	161,408	52,363	7,606	340,227	215,671	4,927	-	782,202
Total	$ 161,806	$ 52,415	$ 8,107	$ 359,642	$ 215,671	$ 4,927	$ -	$ 802,568
ALL established for loans evaluated:								
Individually	$ -	$ -	$ -	$ 74	$ -	$ -	$ -	$ 74
Collectively	997	316	199	6,107	1,510	99	1,040	10,268
ALL at March 31, 2016	$ 997	$ 316	$ 199	$ 6,181	$ 1,510	$ 99	$ 1,040	$ 10,342
December 31, 2015								
Loans evaluated for ALL:								
Individually	$ 930	$ 51	$ 502	$ 14,309	$ 230	$ -	$ -	$ 16,022
Collectively	160,548	50,862	7,386	326,386	215,712	5,100	-	765,994
Total	$ 161,478	$ 50,913	$ 7,888	$ 340,695	$ 215,942	$ 5,100	$ -	$ 782,016
ALL established for loans evaluated:								
Individually	$ -	$ -	$ -	$ -	$ 9	$ -	$ -	$ 9
Collectively	989	308	194	5,649	1,510	102	1,325	10,077
ALL at December 31, 2015	$ 989	$ 308	$ 194	$ 5,649	$ 1,519	$ 102	$ 1,325	$ 10,086

The following table shows additional information about those loans considered to be impaired at March 31, 2016 and December 31, 2015:

	Impaired Loans				
	With No Allowance		With Allowance		
(Dollars in thousands)		Unpaid		Unpaid	
	Recorded	Principal	Recorded	Principal	Related
March 31, 2016	Investment	Balance	Investment	Balance	Allowance
Residential Real Estate 1-4 Family					
First liens	$ 1,067	$ 1,140	$ -	$ -	$ -
Junior liens and lines of credit	65	101	-	-	-
Total	1,132	1,241	-	-	-
Residential real estate - construction	501	545	-	-	-
Commercial real estate	14,312	15,044	5,376	5,376	74
Commercial	42	54	-	-	-
Total	$ 15,987	$ 16,884	$ 5,376	$ 5,376	$ 74

December 31, 2015					
Residential Real Estate 1-4 Family					
First liens	$ 1,523	$ 1,725	$ -	$ -	$ -
Junior liens and lines of credit	105	133	-	-	-
Total	1,628	1,858	-	-	-
Residential real estate - construction	502	546	-	-	-
Commercial real estate	14,431	15,007		-	-
Commercial	267	330	9	10	9
Total	$ 16,828	$ 17,741	$ 9	$ 10	$ 9

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The following table shows the average of impaired loans and related interest income for the three months ended March 31, 2016 and 2015:

(Dollars in thousands)	Three Months Ended March 31, 2016 Average Recorded Investment	Three Months Ended March 31, 2016 Interest Income Recognized
Residential Real Estate 1-4 Family		
First liens	$ 1,069	$ 6
Junior liens and lines of credit	70	-
Total	1,139	6
Residential real estate - construction	502	-
Commercial real estate	14,372	121
Commercial	44	-
Total	$ 16,057	$ 127

(Dollars in thousands)	Three Months Ended March 31, 2015 Average Recorded Investment	Three Months Ended March 31, 2015 Interest Income Recognized
Residential Real Estate 1-4 Family		
First liens	$ 1,829	$ 8
Junior liens and lines of credit	145	-
Total	1,974	8
Residential real estate - construction	931	84
Commercial real estate	22,187	69
Commercial	1,325	-
Total	$ 26,417	$ 161

The following table presents the aging of payments of the loan portfolio:

(Dollars in thousands)		Loans Past Due and Still Accruing					Total
	Current	30-59 Days	60-89 Days	90 Days+	Total	Non-Accrual	Loans
March 31, 2016							
Residential Real Estate 1-4 Family							
First liens	$ 160,652	$ 470	$ 76	$ 109	$ 655	$ 499	$ 161,806
Junior liens and lines of credit	52,085	240	25	-	265	65	52,415
Total	212,737	710	101	109	920	564	214,221
Residential real estate - construction	7,488	-	-	118	118	501	8,107
Commercial real estate	350,024	595	-	-	595	9,023	359,642
Commercial	215,369	260	-	-	260	42	215,671
Consumer	4,901	22	2	2	26	-	4,927
Total	$ 790,519	$ 1,587	$ 103	$ 229	$ 1,919	$ 10,130	$ 802,568
December 31, 2015							
Residential Real Estate 1-4 Family							
First liens	$ 159,998	$ 44	$ 416	$ 214	$ 674	$ 806	$ 161,478
Junior liens and lines of credit	50,541	217	50	-	267	105	50,913
Total	210,539	261	466	214	941	911	212,391
Residential real estate - construction	7,209	177	-	-	177		