

FRANKLIN FINANCIAL SERVICES CORP /PA/

Form 10-Q

May 11, 2015

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, 2015

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

(State or other jurisdiction of incorporation or organization)

25-1440803

(I.R.S. Employer Identification No.)

20 South Main Street, Chambersburg

(Address of principal executive offices)

PA17201-0819

(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

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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 4,230,122 outstanding shares of the Registrant’s common stock as of April 30, 2015.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets

	(unaudited)	
(Dollars in thousands, except share and per share data)	March 31 2015	December 31 2014
Assets		
Cash and due from banks	\$ 21,277	\$ 14,258
Interest-bearing deposits in other banks	44,050	34,335
Total cash and cash equivalents	65,327	48,593
Investment securities available for sale, at fair value	176,740	171,751
Restricted stock	438	438
Loans held for sale	155	389
Loans	722,958	726,531
Allowance for loan losses	(9,210)	(9,111)
Net Loans	713,748	717,420
Premises and equipment, net	14,843	15,046
Bank owned life insurance	22,237	22,098
Goodwill	9,016	9,016
Other intangible assets	90	181
Other real estate owned	4,018	3,666
Deferred tax asset, net	4,659	4,328
Other assets	8,066	8,522
Total assets	\$ 1,019,337	\$ 1,001,448
Liabilities		
Deposits		
Noninterest-bearing checking	\$ 147,876	\$ 136,910
Money management, savings and interest checking	662,661	645,672
Time	94,858	98,599
Total Deposits	905,395	881,181
Securities sold under agreements to repurchase	-	9,079
Other liabilities	7,980	7,667
Total liabilities	913,375	897,927
Shareholders' equity		
Common stock, \$1 par value per share, 15,000,000 shares authorized with 4,616,224 shares issued and 4,228,195 shares outstanding at March 31, 2015 and 4,606,564 shares issued and 4,218,330 shares outstanding at December 31, 2014	4,616	4,607
Capital stock without par value, 5,000,000 shares authorized with no		

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shares issued and outstanding	-	-
Additional paid-in capital	37,707	37,504
Retained earnings	73,618	71,452
Accumulated other comprehensive loss	(3,041)	(3,100)
Treasury stock, 388,029 shares at March 31, 2015 and 388,234 shares at December 31, 2014, at cost	(6,938)	(6,942)
Total shareholders' equity	105,962	103,521
Total liabilities and shareholders' equity	\$ 1,019,337	\$ 1,001,448

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

Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended	
	March 31 2015	2014
Interest income		
Loans, including fees	\$ 7,376	\$ 7,511
Interest and dividends on investments:		
Taxable interest	636	641
Tax exempt interest	408	358
Dividend income	51	25
Deposits and obligations of other banks	55	39
Total interest income	8,526	8,574
Interest expense		
Deposits	641	702
Securities sold under agreements to repurchase	-	7
Long-term debt	-	121
Total interest expense	641	830
Net interest income	7,885	7,744
Provision for loan losses	325	198
Net interest income after provision for loan losses	7,560	7,546
Noninterest income		
Investment and trust services fees	1,263	1,091
Loan service charges	174	167
Mortgage banking activities	8	12
Deposit service charges and fees	490	464
Other service charges and fees	296	267
Debit card income	318	306
Increase in cash surrender value of life insurance	139	143
Other real estate owned (losses) gains, net	32	(122)
Other	224	52
Net OTTI losses recognized in earnings	(20)	-
Gain on conversion	728	-
Total noninterest income	3,652	2,380
Noninterest expense		
Salaries and employee benefits	4,083	4,251
Net occupancy expense	615	675
Furniture and equipment expense	231	254
Advertising	188	316
Legal and professional fees	296	265
Data processing	467	391
Pennsylvania bank shares tax	196	173
Intangible amortization	90	104
FDIC insurance	148	232

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ATM/debit card processing	187	179
Other	988	848
Total noninterest expense	7,489	7,688
Income before federal income tax expense	3,723	2,238
Federal income tax expense	839	412
Net income	\$ 2,884	\$ 1,826

Per share

Basic earnings per share	\$ 0.68	\$ 0.44
Diluted earnings per share	\$ 0.68	\$ 0.44
Cash dividends declared	\$ 0.17	\$ 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	
	2015	2014
Net Income	\$ 2,884	\$ 1,826
Securities:		
Unrealized gains arising during the period	723	1,420
Reclassification adjustment for gains included in net income (1)	(728)	-
Net unrealized (losses) gains	(5)	1,420
Tax effect	2	(483)
Net of tax amount	(3)	937
Derivatives:		
Unrealized losses arising during the period	(1)	(8)
Reclassification adjustment for losses included in net income (2)	96	95
Net unrealized gains	95	87
Tax effect	(33)	(30)
Net of tax amount	62	57
Total other comprehensive income	59	994
Total Comprehensive Income	\$ 2,943	\$ 2,820
		Tax expense
Reclassification adjustment / Statement line item		(benefit)
(1) Securities / gain on conversion	\$ 248	\$ -
(2) Derivatives / interest expense on deposits	\$ (33)	\$ (32)

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

Consolidated Statements of Changes in Shareholders' Equity

For the Three months March 31, 2015 and 2014:

	Common	Additional Paid-in	Retained	Accumulated Other Comprehensive	Treasury	Total
(Dollars in thousands, except per share data) (unaudited)	Stock	Capital	Earnings	Loss	Stock	Total
Balance at December 31, 2013	\$ 4,561	\$ 36,636	\$ 65,897	\$ (4,696)	\$ (7,010)	\$ 95,388
Net income	-	-	1,826	-	-	1,826
Other comprehensive income	-	-	-	994	-	994
Cash dividends declared, \$.17 per share	-	-	(709)	-	-	(709)
Treasury shares issued under stock option plans, 223 shares	-	-	-	-	4	4
Common stock issued under dividend reinvestment plan, 9,795 shares	10	160	-	-	-	170
Balance at March 31, 2014	\$ 4,571	\$ 36,796	\$ 67,014	\$ (3,702)	\$ (7,006)	\$ 97,673
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

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

Consolidated Statements of Cash Flows

	Three Months Ended March 31	
	2015	2014
(Dollars in thousands) (unaudited)		
Cash flows from operating activities		
Net income	\$ 2,884	\$ 1,826
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	339	372
Net amortization of loans and investment securities	377	428
Amortization and net change in mortgage servicing rights valuation	11	8
Amortization of intangibles	90	104
Provision for loan losses	325	198
Gain on conversion	(728)	-
Impairment writedown on securities recognized in earnings	20	-
Loans originated for sale	(882)	(1,443)
Proceeds from sale of loans	1,116	1,636
Writedown of other real estate owned	-	120
Net (gain) loss on sale or disposal of other real estate/other repossessed assets	(32)	2
Increase in cash surrender value of life insurance	(139)	(143)
Decrease in other assets	198	91
Increase in other liabilities	278	440
Net cash provided by operating activities	3,857	3,639
Cash flows from investing activities		
Proceeds from maturities and paydowns of securities available for sale	6,399	5,844
Purchase of investment securities available for sale	(11,146)	(6,816)
Net decrease (increase) in loans	2,982	(2,787)
Capital expenditures	(120)	(218)
Proceeds from sale of other real estate/other repossessed assets	129	279
Net cash used in investing activities	(1,756)	(3,698)
Cash flows from financing activities		
Net increase in demand deposits, NOW, and savings accounts	27,955	50,762
Net decrease in time deposits	(3,741)	(3,601)
Net decrease in repurchase agreements	(9,079)	(7,929)
Long-term debt payments	-	(2)
Dividends paid	(718)	(709)
Treasury stock issued under stock option plans	4	4
Common stock issued under dividend reinvestment plan	212	170
Net cash provided by financing activities	14,633	38,695

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Increase in cash and cash equivalents	16,734	38,636
Cash and cash equivalents as of January 1	48,593	40,745
Cash and cash equivalents as of March 31	\$ 65,327	\$ 79,381

Supplemental Disclosures of Cash Flow Information

Cash paid during the year for:

Interest on deposits and other borrowed funds	\$ 611	\$ 786
Income taxes	\$ 262	\$ 20

Noncash Activities

Loans transferred to Other Real Estate	\$ 449	\$ -
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The accompanying notes are an integral part of these financial statements.

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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, 2015, 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 2014 Annual Report on Form 10-K. The consolidated results of operations for the period ended March 31, 2015 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, 2014 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:

(Dollars and shares in thousands, except per share data)	For the Three Months Ended March 31	
	2015	2014
Weighted average shares outstanding (basic)	4,223	4,172
Impact of common stock equivalents	6	5
Weighted average shares outstanding (diluted)	4,229	4,177
Anti-dilutive options excluded from calculation	29	40
Net income	\$ 2,884	\$ 1,826
Basic earnings per share	\$ 0.68	\$ 0.44
Diluted earnings per share	\$ 0.68	\$ 0.44

Note 2. Recent Accounting Pronouncements

Receivables (Topic 310): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. ASU 2014-04 “Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure” clarifies that a creditor is considered to have physical possession of residential real estate that is collateral for a residential mortgage loan when it obtains legal title to the collateral or a deed in lieu of foreclosure or similar legal agreement is completed. Consequently, it should reclassify the loan to other real estate owned at that time. ASU 2014-04 applies to all creditors who obtain physical possession resulting from an in substance repossession or foreclosure of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The ASU does not apply to commercial real estate loans, as the foreclosure process and applicable laws for those assets are significantly different from residential real estate. The ASU is effective for public business entities for annual periods, and interim

periods within those annual periods, beginning after December 15, 2014. ASU 2014-04 did not have a material effect on the Corporation's financial statements.

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 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.

Note 3. Accumulated Other Comprehensive Loss

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

	March 31, 2015	December 31, 2014
(Dollars in thousands)		
Net unrealized gains on securities	\$ 2,347	\$ 2,352
Tax effect	(798)	(800)
Net of tax amount	1,549	1,552
Net unrealized losses on derivatives	(96)	(191)
Tax effect	32	65
Net of tax amount	(64)	(126)
Accumulated pension adjustment	(6,858)	(6,858)
Tax effect	2,332	2,332
Net of tax amount	(4,526)	(4,526)
Total accumulated other comprehensive loss	\$ (3,041)	\$ (3,100)

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 \$24.0 million and \$22.7 million of standby letters of credit as of March 31, 2015 and December 31, 2014, 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, 2015 and December 31, 2014 for guarantees under standby letters of credit issued was not material.

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Note 5. Investments

The amortized cost and estimated fair value of investment securities available for sale as of March 31, 2015 and December 31, 2014 is as follows:

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
March 31, 2015				
Equity securities	\$ 1,002	\$ 55	\$ (14)	\$ 1,043
U.S. Government and Agency securities	16,435	228	(35)	16,628
Municipal securities	71,333	1,972	(241)	73,064
Trust preferred securities	5,946	-	(756)	5,190
Agency mortgage-backed securities	78,051	1,218	(121)	79,148
Private-label mortgage-backed securities	1,583	44	-	1,627
Asset-backed securities	43	-	(3)	40
	\$ 174,393	\$ 3,517	\$ (1,170)	\$ 176,740

(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2014				
Equity securities	\$ 274	\$ 779	\$ -	\$ 1,053
U.S. Government and Agency securities	15,854	173	(64)	15,963
Municipal securities	66,832	1,826	(292)	68,366
Trust preferred securities	5,940	-	(803)	5,137
Agency mortgage-backed securities	78,779	932	(217)	79,494
Private-label mortgage-backed securities	1,675	35	(15)	1,695
Asset-backed securities	45	-	(2)	43
	\$ 169,399	\$ 3,745	\$ (1,393)	\$ 171,751

At March 31, 2015 and December 31, 2014, the fair value of investment securities pledged to secure public funds, trust balances, repurchase agreements, deposit and other obligations totaled \$75.6 million and \$91.6 million, respectively.

The amortized cost and estimated fair value of debt securities at March 31, 2015, 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	\$ 5,885	\$ 5,950
Due after one year through five years	10,828	11,091
Due after five years through ten years	30,857	31,751
Due after ten years	46,187	46,130
	93,757	94,922
Mortgage-backed securities	79,634	80,775
	\$ 173,391	\$ 175,697

The following table provides additional detail about trust preferred securities as of March 31, 2015:

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
BankAmerica Cap III	1/15/2027	Single	Preferred Stock	\$ 963	\$ 821	\$ (142)	BB
Wachovia Cap Trust II	1/15/2027	Single	Preferred Stock	277	258	(19)	BBB
Huntington Cap Trust	2/1/2027	Single	Preferred Stock	940	802	(138)	BB
Corestates Captl Tr II	2/15/2027	Single	Preferred Stock	937	870	(67)	BBB+
Huntington Cap Trust II	6/15/2028	Single	Preferred Stock	891	771	(120)	BB
Chase Cap VI JPM	8/1/2028	Single	Preferred Stock	963	850	(113)	BBB-
Fleet Cap Tr V	12/18/2028	Single	Preferred Stock	975	818	(157)	BB
				\$ 5,946	\$ 5,190	\$ (756)	

The following table provides additional detail about private label mortgage-backed securities as of March 31, 2015:

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
RALI 2004-QS4 A7	3/1/2004	\$ 64	\$ 66	\$ 2	ALT A	BBB+	12.21	\$ -
MALT 2004-6 7A1	6/1/2004	396	405	9	ALT A	CCC	13.87	-
RALI 2005-QS2 A1	2/1/2005	250	265	15	ALT A	CC	5.16	10
RALI 2006-QS4 A2	4/1/2006	521	524	3	ALT A	D	-	313

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GSR 2006-5F 2A1	5/1/2006	79	86	7	Prime	D	-	15
RALI 2006-QS8								
A1	7/28/2006	273	281	8	ALT A	D	-	217
		\$ 1,583	\$ 1,627	\$ 44				\$ 555

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Impairment:

The investment portfolio contained 68 securities with \$41.8 million of temporarily impaired fair value and \$1.2 million in unrealized losses at March 31, 2015. The total unrealized loss position has improved slightly from \$1.4 million since year-end 2014.

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, 2015, 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, 2015 and December 31, 2014:

(Dollars in thousands)	March 31, 2015			12 months or more			Total		
	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
Equity securities	\$ 824	\$ (14)	1	\$ -	\$ -	-	\$ 824	\$ (14)	1
U.S. Government and Agency securities	1,806	(6)	3	5,248	(29)	12	7,054	(35)	15
Municipal securities	9,196	(111)	15	4,875	(130)	7	14,071	(241)	22
Trust preferred securities	-	-	-	5,190	(756)	7	5,190	(756)	7
Agency mortgage-backed securities	8,832	(31)	14	5,807	(90)	8	14,639	(121)	22
Asset-backed securities	-	-	-	4	(3)	1	4	(3)	1
Total temporarily impaired securities	\$ 20,658	\$ (162)	33	\$ 21,124	\$ (1,008)	35	\$ 41,782	\$ (1,170)	68

(Dollars in thousands)	December 31, 2014								
	Less than 12 months			12 months or more			Total		
	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	4	-	1	7,207	(64)	14	7,211	(64)	15
Municipal securities	5,651	(33)	9	9,441	(259)	14	15,092	(292)	23
Trust preferred securities	-	-	-	5,137	(803)	7	5,137	(803)	7
Agency mortgage-backed securities	9,304	(60)	13	8,199	(157)	10	17,503	(217)	23
Private-label mortgage-backed securities	-	-	-	540	(15)	1	540	(15)	1
Asset-backed securities	-	-	-	5	(2)	1	5	(2)	1
Total temporarily impaired securities	\$ 14,959	\$ (93)	23	\$ 30,529	\$ (1,300)	47	\$ 45,488	\$ (1,393)	70

The municipal bond portfolio has an unrealized loss of \$241 thousand at quarter end which is approximately \$50 thousand less than at year-end 2014. The unrealized 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 \$5.2 million and an unrealized loss of \$756 thousand. 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, 2015, 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.

The PLMBS sector shows a net unrealized gain \$44 thousand with all bonds showing an unrealized gain. Even though there is no unrealized loss, 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 quarter end. It is primarily a result of the cumulative OTTI charges that these bonds are showing an unrealized gain at quarter end. The Bank has recorded \$555 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 Bank is currently participating in a class-action lawsuit against one PLMBS servicer that centers on defective warranties and representations made as part of the underwriting process.

(Dollars in thousands)	Three Months Ended	
	2015	2014
Balance of cumulative credit-related OTTI at January 1	\$ 535	\$ 515
Additions for credit-related OTTI not previously recognized	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	\$ 555	\$ 515

The Bank held \$438 thousand of restricted stock at March 31, 2015. 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. 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, 2015	December 31, 2014	Change	
			Amount	%
Residential Real Estate 1-4 Family				
Consumer first liens	\$ 104,949	\$ 105,014	\$ (65)	(0.1)
Consumer junior liens and lines of credit	37,699	38,132	(433)	(1.1)
Total consumer	142,648	143,146	(498)	(0.3)
Commercial first lien	56,345	56,300	45	0.1
Commercial junior liens and lines of credit	5,556	5,663	(107)	(1.9)
Total commercial	61,901	61,963	(62)	(0.1)
Total residential real estate 1-4 family	204,549	205,109	(560)	(0.3)
Residential real estate - construction				
Consumer	1,312	1,627	(315)	(19.4)
Commercial	8,371	8,088	283	3.5
Total residential real estate construction	9,683	9,715	(32)	(0.3)
Commercial real estate	323,675	326,482	(2,807)	(0.9)
Commercial	179,408	179,071	337	0.2
Total commercial	503,083	505,553	(2,470)	(0.5)
Consumer	5,643	6,154	(511)	(8.3)
	722,958	726,531	(3,573)	(0.5)
Less: Allowance for loan losses	(9,210)	(9,111)	(99)	1.1
Net Loans	\$ 713,748	\$ 717,420	\$ (3,672)	(0.5)
Included in the loan balances are the following:				
Net unamortized deferred loan costs (fees)	\$ 42	\$ (76)		

Loans pledged as collateral for borrowings and commitments from:

FHLB	\$ 604,784	\$ 602,633
Federal Reserve Bank	55,657	56,367
	\$ 660,441	\$ 659,000

Note 7. Loan Quality

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

(Dollars in thousands)	Residential Real Estate 1-4 Family			Commercial			Total
	First Liens	Junior Liens & Lines of Credit	Construction	Real Estate	Commercial	Consumer	
Allowance at December 31, 2014	\$ 1,225	\$ 334	\$ 226	\$ 5,417	\$ 1,773	\$ 136	\$ 9,111
Charge-offs	-	-	-	-	(201)	(52)	(253)
Recoveries	2	-	-	-	6	19	27
Provision	33	-	37	183	50	22	325
Allowance at March 31, 2015	\$ 1,260	\$ 334	\$ 263	\$ 5,600	\$ 1,628	\$ 125	\$ 9,210
Allowance at December 31, 2013	\$ 1,108	\$ 278	\$ 291	\$ 5,571	\$ 2,306	\$ 148	\$ 9,702
Charge-offs	(16)	-	(27)	(114)	(1)	(43)	(201)
Recoveries	3	-	-	-	20	23	46
Provision	38	(2)	110	52	(16)	16	198
Allowance at March 31, 2014	\$ 1,133	\$ 276	\$ 374	\$ 5,509	\$ 2,309	\$ 144	\$ 9,745

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, 2015 and December 31, 2014:

(Dollars in thousands)	Residential Real Estate 1-4 Family			Commercial		Consumer	Total
	First Liens	Junior Liens & Lines of Credit	Construction	Real Estate	Commercial		
March 31, 2015							
Loans evaluated for allowance:							
Individually	\$ 1,254	\$ 51	\$ 930	\$ 21,927	\$ 1,073	\$ -	\$ 25,235
Collectively	160,040	43,204	8,753	301,748	178,335	5,643	697,723
Total	\$ 161,294	\$ 43,255	\$ 9,683	\$ 323,675	\$ 179,408	\$ 5,643	\$ 722,958
Allowance established for loans evaluated:							
Individually	\$ 23	\$ -	\$ 21	\$ 39	\$ 9	\$ -	\$ 92
Collectively	1,237	334	242	5,561	1,619	125	9,118
Allowance at March 31, 2015	\$ 1,260	\$ 334	\$ 263	\$ 5,600	\$ 1,628	\$ 125	\$ 9,210
March 31, 2014							
Loans evaluated for allowance:							
Individually	\$ 2,310	\$ 51	\$ 530	\$ 25,029	\$ 1,953	\$ -	\$ 29,873
Collectively	162,799	39,893	11,223	297,421	177,033		