

FRANKLIN FINANCIAL SERVICES CORP /PA/

Form 10-Q

August 07, 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 June 30, 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 PA17201-0819

(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

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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 4,252,508 outstanding shares of the Registrant’s common stock as of July 31, 2015.

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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)	
	June 30 2015	December 31 2014
Assets		
Cash and due from banks	\$ 17,649	\$ 14,258
Interest-bearing deposits in other banks	46,754	34,335
Total cash and cash equivalents	64,403	48,593
Investment securities available for sale, at fair value	176,424	171,751
Restricted stock	439	438
Loans held for sale	1,755	389
Loans	733,212	726,531
Allowance for loan losses	(9,450)	(9,111)
Net Loans	723,762	717,420
Premises and equipment, net	14,531	15,046
Bank owned life insurance	22,377	22,098
Goodwill	9,016	9,016
Other intangible assets	-	181
Other real estate owned	4,018	3,666
Deferred tax asset, net	4,690	4,328
Other assets	7,124	8,522
Total assets	\$ 1,028,539	\$ 1,001,448
Liabilities		
Deposits		
Noninterest-bearing checking	\$ 143,564	\$ 136,910
Money management, savings and interest checking	680,424	645,672
Time	92,071	98,599
Total Deposits	916,059	881,181
Repurchase Agreements	-	9,079
Other liabilities	5,302	7,667
Total liabilities	921,361	897,927
Shareholders' equity		
Common stock, \$1 par value per share, 15,000,000 shares authorized with 4,625,071 shares issued and 4,241,355 shares outstanding at June 30, 2015 and 4,606,564 shares issued and 4,218,330 shares outstanding at December 31, 2014	4,625	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	37,926	37,504
Retained earnings	75,288	71,452
Accumulated other comprehensive loss	(3,800)	(3,100)
Treasury stock, 383,716 shares at June 30, 2015 and 388,234 shares at December 31, 2014, at cost	(6,861)	(6,942)
Total shareholders' equity	107,178	103,521
Total liabilities and shareholders' equity	\$ 1,028,539	\$ 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		For the Six Months Ended	
	June 30 2015	2014	June 30 2015	2014
Interest income				
Loans, including fees	\$ 7,477	\$ 7,648	\$ 14,853	\$ 15,159
Interest and dividends on investments:				
Taxable interest	613	661	1,248	1,302
Tax exempt interest	408	376	817	734
Dividend income	8	31	60	56
Deposits and obligations of other banks	72	45	127	84
Total interest income	8,578	8,761	17,105	17,335
Interest expense				
Deposits	619	694	1,260	1,396
Securities sold under agreements to repurchase	-	2	-	9
Long-term debt	-	121	-	242
Total interest expense	619	817	1,260	1,647
Net interest income	7,959	7,944	15,845	15,688
Provision for loan losses	310	266	635	464
Net interest income after provision for loan losses	7,649	7,678	15,210	15,224
Noninterest income				
Investment and trust services fees	1,388	1,101	2,651	2,192
Loan service charges	297	250	471	418
Mortgage banking activities	17	19	25	32
Deposit service charges and fees	586	525	1,077	990
Other service charges and fees	311	317	607	584
Debit card income	356	337	675	643
Increase in cash surrender value of life insurance	140	144	279	286
Other real estate owned (losses) gains, net	-	(62)	32	(185)
Other	13	10	237	62
OTTI losses recognized in earnings	-	-	(20)	-
Gain on conversion	-	-	728	-
Securities gains, net	8	221	8	221
Total noninterest income	3,116	2,862	6,770	5,243
Noninterest expense				
Salaries and employee benefits	4,203	4,107	8,286	8,357
Net occupancy expense	556	586	1,172	1,262
Furniture and equipment expense	239	237	470	491
Advertising	283	270	471	586
Legal and professional fees	203	353	499	618
Data processing	556	493	1,023	884
Pennsylvania bank shares tax	206	173	402	347
Intangible amortization	90	104	181	207

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FDIC insurance	160	222	308	454
ATM/debit card processing	186	178	373	357
Other	977	892	1,965	1,741
Total noninterest expense	7,659	7,615	15,150	15,304
Income before federal income taxes	3,106	2,925	6,830	5,163
Federal income tax expense	632	606	1,472	1,018
Net income	\$ 2,474	\$ 2,319	\$ 5,358	\$ 4,145

Per share

Basic earnings per share	\$ 0.58	\$ 0.55	\$ 1.27	\$ 0.99
Diluted earnings per share	\$ 0.58	\$ 0.55	\$ 1.26	\$ 0.99
Cash dividends declared	\$ 0.19	\$ 0.17	\$ 0.36	\$ 0.34

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

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Consolidated Statements of Comprehensive Income

	For the Three Months Ended June 30		For the Six Months Ended June 30	
(Dollars in thousands) (unaudited)	2015	2014	2015	2014
Net Income	\$ 2,474	\$ 2,319	\$ 5,358	\$ 4,145
Securities:				
Unrealized (losses) gains arising during the period	(1,239)	774	(536)	2,194
Reclassification adjustment for gains included in net income (1)	(8)	(221)	(716)	(221)
Net unrealized (losses) gains	(1,247)	553	(1,252)	1,973
Tax effect	424	(188)	426	(671)
Net of tax amount	(823)	365	(826)	1,302
Derivatives:				
Unrealized gains (losses) arising during the period	32	(4)	31	(12)
Reclassification adjustment for losses included in net income (2)	64	94	160	189
Net unrealized gains	96	90	191	177
Tax effect	(32)	(30)	(65)	(60)
Net of tax amount	64	60	126	117
Total other comprehensive (loss) income	(759)	425	(700)	1,419
Total Comprehensive Income	\$ 1,715	\$ 2,744	\$ 4,658	\$ 5,564
			Tax expense	Tax expense
Reclassification adjustment / Statement line item			(benefit)	(benefit)
(1) Securities / gain on conversion & securities (gains) losses, net	\$ 3	\$ 75	\$ 243	\$ 75
(2) Derivatives / interest expense on deposits	(22)	(32)	(54)	(64)

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

Consolidated Statements of Changes in Shareholders' Equity

For the Six months June 30, 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	-	-	4,145	-	-	4,145
Other comprehensive income	-	-	-	1,419	-	1,419
Cash dividends declared, \$.34 per share	-	-	(1,419)	-	-	(1,419)
Treasury shares issued under stock option plans, 3,476 shares	-	(10)	-	-	62	52
Common stock issued under dividend reinvestment plan, 20,642 shares	20	354	-	-	-	374
Balance at June 30, 2014	\$ 4,581	\$ 36,980	\$ 68,623	\$ (3,277)	\$ (6,948)	\$ 99,959
Balance at December 31, 2014	\$ 4,607	\$ 37,504	\$ 71,452	\$ (3,100)	\$ (6,942)	\$ 103,521
Net income	-	-	5,358	-	-	5,358
Other comprehensive loss	-	-	-	(700)	-	(700)
Cash dividends declared, \$.36 per share	-	-	(1,522)	-	-	(1,522)
Treasury shares issued under stock option plans, 4,518 shares	-	5	-	-	81	86
Common stock issued under dividend reinvestment plan, 18,507 shares	18	417	-	-	-	435
Balance at June 30, 2015	\$ 4,625	\$ 37,926	\$ 75,288	\$ (3,800)	\$ (6,861)	\$ 107,178

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

Consolidated Statements of Cash Flows

	Six Months Ended June 30	
	2015	2014
(Dollars in thousands)		
(unaudited)		
Cash flows from operating activities		
Net income	\$ 5,358	\$ 4,145
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	675	732
Net amortization of loans and investment securities	796	893
Amortization and net change in mortgage servicing rights valuation	9	8
Amortization of intangibles	181	207
Provision for loan losses	635	464
Net realized gains on sales of securities	(8)	(221)
Impairment writedown on securities recognized in earnings	20	-
Gain on conversion	(728)	-
Loans originated for sale	(3,812)	(3,554)
Proceeds from sale of loans	2,446	3,303
Writedown on premises and equipment	60	-
Writedown of other real estate owned	-	200
Net gain on sale or disposal of other real estate/other repossessed assets	(32)	(15)
Increase in cash surrender value of life insurance	(279)	(286)
	1,380	(118)

Decrease (increase) in other assets		
(Decrease) increase in other liabilities	(2,195)	613
Net cash provided by operating activities	4,506	6,371
Cash flows from investing activities		
Proceeds from sales and calls of investment securities available for sale	1,381	1,582
Proceeds from maturities and paydowns of securities available for sale	14,132	12,313
Purchase of investment securities available for sale	(21,689)	(28,362)
Net increase in restricted stock	(1)	(32)
Net increase in loans	(7,256)	(10,012)
Capital expenditures	(190)	(321)
Proceeds from sale of other real estate/other repossessed assets	129	493
Net cash used in investing activities	(13,494)	(24,339)
Cash flows from financing activities		
Net increase in demand deposits, NOW, and savings accounts	41,406	63,087
Net decrease in time deposits	(6,528)	(8,107)
Net decrease in repurchase agreements	(9,079)	(21,570)
Long-term debt payments	-	(403)
Dividends paid	(1,522)	(1,419)
Treasury stock issued under stock option plans	86	52
Common stock issued under dividend reinvestment plan	435	374
Net cash provided by financing activities	24,798	32,014
Increase in cash and cash equivalents	15,810	14,046

Cash and cash equivalents as of January 1	48,593		40,745
Cash and cash equivalents as of June 30	\$ 64,403	\$	54,791

Supplemental Disclosures
of Cash Flow Information

Cash paid during the year
for:

Interest on deposits and other borrowed funds	\$ 1,304	\$	1,670
Income taxes	\$ 1,513	\$	236

Noncash Activities

Loans transferred to Other Real Estate	\$ 449	\$	82
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The accompanying notes
are an integral part of
these 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 June 30, 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 June 30, 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:

	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2015	2014	2015	2014
(Dollars and shares in thousands, except per share data)				
Weighted average shares outstanding (basic)	4,234	4,184	4,228	4,178
Impact of common stock equivalents	11	7	8	6
Weighted average shares outstanding (diluted)	4,245	4,191	4,236	4,184
Anti-dilutive options excluded from calculation	13	34	28	37
Net income	\$ 2,474	\$ 2,319	\$ 5,358	\$ 4,145
Basic earnings per share	\$ 0.58	\$ 0.55	\$ 1.27	\$ 0.99
Diluted earnings per share	\$ 0.58	\$ 0.55	\$ 1.26	\$ 0.99

Note 2. Recent Accounting Pronouncements

Customer's Accounting for Fees Paid in a Cloud Computing Arrangement . ASU 2015-05 "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, revises the scope of Subtopic 350-40 to include internal-use software accessed through a hosting arrangement (e.g., cloud computing, software as a service, etc.) only if both of the following criteria are met: (1) the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty (there is no significant penalty if the customer has the ability to take delivery of the software without incurring significant cost and the ability to use the software separately without significant loss of utility or value); and (2) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software. If both of the criteria are present in a hosting arrangement, then the arrangement contains a software license and the customer should account for that element in accordance with Subtopic 350-40 (i.e., expense fees as incurred). The ASU is effective for public business entities for fiscal years beginning after

December 15, 2015, and interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2015, and interim periods within fiscal year beginning after December 15, 2016. Early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date, or (2) retrospectively. The Corporation does not believe ASU 350-40 will have a material effect on its financial statements.

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:

	December
June 30	31

	2015	2014
(Dollars in thousands)		
Net unrealized gains on securities	\$ 1,100	\$ 2,352
Tax effect	(374)	(800)
Net of tax amount	726	1,552
Net unrealized losses on derivatives	-	(191)
Tax effect	-	65
Net of tax amount	-	(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	\$ (3,800)	\$ (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 \$26.0 million and \$22.7 million of standby letters of credit as of June 30, 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 June 30, 2015 and December 31, 2014 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 June 30, 2015 and December 31, 2014 are as follows:

(Dollars in thousands)	Amortized	Gross	Gross	Fair
	cost	unrealized	unrealized	value
June 30, 2015		gains	losses	
Equity securities	\$ 164	\$ 78	\$ -	\$ 242
U.S. Government agency securities	16,245	168	(29)	16,384
Municipal securities	71,277	1,459	(604)	72,132
Trust preferred securities	5,949	-	(621)	5,328
Agency mortgage-backed securities	80,145	917	(323)	80,739
Private-label mortgage-backed securities	1,502	58	-	1,560
Asset-backed securities	42	-	(3)	39
	\$ 175,324	\$ 2,680	\$ (1,580)	\$ 176,424

(Dollars in thousands)	Amortized	Gross	Gross	Fair
	cost	unrealized	unrealized	value
December 31, 2014		gains	losses	
Equity securities	\$ 274	\$ 779	\$ -	\$ 1,053

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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 June 30, 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 \$69.3 million and \$91.6 million, respectively.

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The amortized cost and estimated fair value of debt securities at June 30, 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	\$ 4,570	\$ 4,609
Due after one year through five years	10,483	10,680
Due after five years through ten years	32,927	33,512
Due after ten years	45,533	45,082
	93,513	93,883
Mortgage-backed securities	81,647	82,299
	\$ 175,160	\$ 176,182

The following table provides additional detail about trust preferred securities as of June 30, 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	\$ 964	\$ 906	\$ (58)	BB
Wachovia Cap Trust II	1/15/2027	Single	Preferred Stock	277	261	(16)	BBB
Huntington Cap Trust	2/1/2027	Single	Preferred Stock	941	816	(125)	BB
Corestates Captl Tr II	2/15/2027	Single	Preferred Stock	937	871	(66)	BBB+
Huntington Cap Trust II	6/15/2028	Single	Preferred Stock	892	790	(102)	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	834	(141)	BB
				\$ 5,949	\$ 5,328	\$ (621)	

The following table provides additional detail about private label mortgage-backed securities as of June 30, 2015:

Private Label Mortgage Backed Securities

(Dollars in thousands)	Origination	Amortized	Fair	Gross	Collateral	Lowest Credit	Credit	Cumulative
Description	Date	Cost	Value	Unrealized Gain (Loss)	Type	Rating Assigned	Support %	OTTI Charges
RALI 2004-QS4 A7	3/1/2004	\$ 43	\$ 43	\$ -	ALT A	BBB+	11.84	\$ -
MALT 2004-6 7A1	6/1/2004	385	393	8	ALT A	CCC	14.11	-
RALI 2005-QS2 A1	2/1/2005	236	251	15	ALT A	CC	5.20	10
RALI 2006-QS4 A2	4/1/2006	502	523	21	ALT A	D	-	313
GSR 2006-5F 2A1	5/1/2006	72	80	8	Prime	D	-	15
RALI 2006-QS8 A1	7/28/2006	264	270	6	ALT A	D	-	217
		\$ 1,502	\$ 1,560	\$ 58				\$ 555

Impairment:

The investment portfolio contained 91 securities with \$59.9 million of temporarily impaired fair value and \$1.6 million in unrealized losses at June 30, 2015. The total unrealized loss position has increased slightly from \$1.4 million at 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 June 30, 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 June 30, 2015 and December 31, 2014:

(Dollars in thousands)	June 30, 2015								
	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	\$ 1,498	\$ (7)	3	\$ 4,617	\$ (22)	10	\$ 6,115	\$ (29)	13
Municipal securities	20,359	(386)	33	4,775	(218)	7	25,134	(604)	40
Trust preferred securities	-	-	-	5,328	(621)	7	5,328	(621)	7
Agency mortgage-backed securities	18,002	(179)	22	5,346	(144)	8	23,348	(323)	30
Asset-backed securities	-	-	-	4	(3)	1	4	(3)	1
Total temporarily impaired securities	\$ 39,859	\$ (572)	58	\$ 20,070	\$ (1,008)	33	\$ 59,929	\$ (1,580)	91

(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
	-	-	-	5,137	(803)	7	5,137	(803)	7

Trust preferred securities									
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 \$604 thousand at June 30, 2015 compared to \$292 thousand at year-end 2014. This number of securities in this portfolio with an unrealized loss increased from 23 to 40 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 7 securities with a fair value of \$5.3 million and an unrealized loss of \$621 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 June 30, 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 \$58 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 the end of the first

quarter; however, no additional impairment charge was required at June 30, 2015. 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. The following table represents the cumulative credit losses on securities recognized in earnings as of June 30, 2015 and 2014.

(Dollars in thousands)	Six 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 June 30	\$ 555	\$ 515

The Bank held \$439 thousand of restricted stock at June 30, 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)	June 30, 2015	December 31, 2014	Change	
			Amount	%
Residential Real Estate 1-4 Family				
Consumer first liens	\$ 103,852	\$ 105,014	\$ (1,162)	(1.1)
Consumer junior liens and lines of credit	39,915	38,132	1,783	4.7
Total consumer	143,767	143,146	621	0.4
Commercial first lien	60,438	56,300	4,138	7.3
Commercial junior liens and lines of credit	5,637	5,663	(26)	(0.5)
Total commercial	66,075	61,963	4,112	6.6
Total residential real estate 1-4 family	209,842	205,109	4,733	2.3
Residential real estate - construction				
Consumer	1,736	1,627	109	6.7
Commercial	6,676	8,088	(1,412)	(17.5)
Total residential real estate construction	8,412	9,715	(1,303)	(13.4)
Commercial real estate	317,329	326,482	(9,153)	(2.8)
Commercial	192,224	179,071	13,153	7.3
Total commercial	509,553	505,553	4,000	0.8
Consumer	5,405	6,154	(749)	(12.2)
	733,212	726,531	6,681	0.9
Less: Allowance for loan losses	(9,450)	(9,111)	(339)	(3.7)
Net Loans	\$ 723,762	\$ 717,420	\$ 6,342	0.9
Included in the loan balances are the following:				
Net unamortized deferred loan costs	\$ 169	\$ (76)		

Loans pledged as collateral for borrowings and commitments from:

FHLB	\$ 612,011	\$ 602,633
Federal Reserve Bank	54,844	56,367
	\$ 666,855	\$ 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 March 31, 2015	\$ 1,260	\$ 334	\$ 263	\$ 5,600	\$ 1,628	\$ 125	\$ 9,210
Charge-offs	(43)	-	(21)	-	(17)	(26)	(107)
Recoveries	1	-	-	14	8	14	37
Provision	75	25	(22)	72	152	8	310
Allowance at June 30, 2015	\$ 1,293	\$ 359	\$ 220	\$ 5,686	\$ 1,771	\$ 121	\$ 9,450
Allowance at December 31, 2014	\$ 1,225	\$ 334	\$ 226	\$ 5,417	\$ 1,773	\$ 136	\$ 9,111
Charge-offs	(43)	-	(21)	-	(218)	(78)	(360)
Recoveries	3	-	-	14	14	33	64
Provision	108	25	15	255	202	30	635
Allowance at June 30, 2015	\$ 1,293	\$ 359	\$ 220	\$ 5,686	\$ 1,771	\$ 121	\$ 9,450
Allowance at March 31, 2014	\$ 1,133	\$ 276	\$ 374	\$ 5,509	\$ 2,309	\$ 144	\$ 9,745
Charge-offs	(241)	-	-	(234)	(11)	(37)	(523)
Recoveries	-	-	-	-	13	18	31
Provision	187	(10)	(113)	137	55	10	266
Allowance at June 30, 2014	\$ 1,079	\$ 266	\$ 261	\$ 5,412	\$ 2,366	\$ 135	\$ 9,519
Allowance at December 31, 2013	\$ 1,108	\$ 278	\$ 291	\$ 5,571	\$ 2,306	\$ 148	\$ 9,702
Charge-offs	(257)	-	(27)	(348)	(12)	(80)	(724)
Recoveries	3	-	-	-	33	41	77
Provision	225	(12)	(3)	189	39	26	464
Allowance at June 30, 2014	\$ 1,079	\$ 266	\$ 261	\$ 5,412	\$ 2,366	\$ 135	\$ 9,519

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 June 30, 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		
June 30, 2015							
Loans evaluated for allowance:							
Individually	\$ 1,083	\$ 51	\$ 513	\$ 21,512	\$ 237	\$ -	\$ 23,396
Collectively	163,207	45,501	7,899	295,817	191,987	5,405	709,816
Total	\$ 164,290	\$ 45,552	\$ 8,412	\$ 317,329	\$ 192,224	\$ 5,405	\$ 733,212
Allowance established for loans evaluated:							
Individually	\$ -	\$ -	\$ -	\$ 2	\$ 8	\$ -	\$ 10
Collectively	1,293	359	220	5,684	1,763	121	9,440
Allowance at June 30, 2015	\$ 1,293	\$ 359	\$ 220	\$ 5,686	\$ 1,771	\$ 121	\$ 9,450
December 31, 2014							
Loans evaluated for allowance:							
Individually	\$ 1,171	\$ 51	\$ 931	\$ 22,307	\$ 1,298	\$ -	\$ 25,758
Collectively	160,143	43,744	8,784	304,175	177,773	6,154	700,773
Total	\$ 161,314	\$ 43,795	\$ 9,715	\$ 326,482	\$ 179,071	\$ 6,154	\$ 726,531
Allowance established for loans evaluated:							
Individually	\$ -	\$ -	\$ -	\$ 60	\$ 171	\$ -	\$ 231
Collectively	1,225	334	226	5,357	1,602	136	8,880
Allowance at December 31, 2014	\$ 1,225	\$ 334	\$ 226	\$ 5,417	\$ 1,773	\$ 136	\$ 9,111

The following table shows additional information about those loans considered to be impaired at June 30, 2015 and December 31, 2014: