FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
May 07, 2018
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, 2018

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 4,366,279 outstanding shares of the Registrant's common stock as of April 30, 2018.

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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, 2018 | December 31, 2017 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $ 14,148 | $ 21,433 |
| Interest-bearing deposits in other banks | 27,934 | 37,170 |
| Total cash and cash equivalents | 42,082 | 58,603 |
| Debt securities available for sale, at fair value | 133,322 | 126,971 |
| Equity securities | 410 | 365 |
| Restricted stock | 456 | 456 |
| Loans held for sale | — | 442 |
| Loans | 942,653 | 943,700 |
| Allowance for loan losses | (11,989) | (11,792) |
| Net Loans | 930,664 | 931,908 |
| Premises and equipment, net | 13,576 | 13,741 |
| Bank owned life insurance | 23,108 | 22,980 |
| Goodwill | 9,016 | 9,016 |
| Other real estate owned | 2,592 | 2,598 |
| Deferred tax asset, net | 6,062 | 5,803 |
| Other assets | 7,254 | 6,930 |
| Total assets | $ 1,168,542 | $ 1,179,813 |
| | | |
| Liabilities | | |
| Deposits | | |
| Non-interest bearing checking | $ 193,237 | $ 196,853 |
| Money management, savings and interest checking | 774,837 | 774,857 |
| Time | 66,387 | 75,471 |
| Total deposits | 1,034,461 | 1,047,181 |
| Other liabilities | 16,957 | 17,488 |
| Total liabilities | 1,051,418 | 1,064,669 |
| | | |
| Shareholders' equity | | |
| Common stock, $1 par value per share,15,000,000 shares authorized with 4,695,617 shares issued and 4,364,812 shares outstanding at March 31, 2018 and 4,689,099 shares issued and 4,354,788 shares outstanding at December 31, 2017 | 4,696 | 4,689 |
| Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding | — | — |
| Additional paid-in capital | 40,668 | 40,396 |
| Retained earnings | 84,876 | 82,218 |
| Accumulated other comprehensive loss | (7,010) | (6,028) |

| | | |
|---|---|---|
| Treasury stock, 330,805 shares at March 31, 2018 and 334,311 shares at December 31, 2017, at cost | (6,106) | (6,131) |
| Total shareholders' equity | 117,124 | 115,144 |
| Total liabilities and shareholders' equity | $ 1,168,542 | $ 1,179,813 |

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, 2018 | 2017 |
|---|---|---|
| Interest income | | |
| Loans, including fees | $ 9,577 | $ 8,639 |
| Interest and dividends on investments: | | |
| Taxable interest | 513 | 531 |
| Tax exempt interest | 274 | 301 |
| Dividend income | 6 | 13 |
| Deposits and obligations of other banks | 118 | 62 |
| Total interest income | 10,488 | 9,546 |
| Interest expense | | |
| Deposits | 795 | 566 |
| Short-term borrowings | — | 15 |
| Total interest expense | 795 | 581 |
| Net interest income | 9,693 | 8,965 |
| Provision for loan losses | 200 | 120 |
| Net interest income after provision for loan losses | 9,493 | 8,845 |
| Noninterest income | | |
| Investment and trust services fees | 1,397 | 1,295 |
| Loan service charges | 231 | 147 |
| Deposit service charges and fees | 574 | 592 |
| Other service charges and fees | 333 | 324 |
| Debit card income | 385 | 375 |
| Increase in cash surrender value of life insurance | 128 | 131 |
| Debt securities gains, net | — | 2 |
| Change in fair value of equity securities | 45 | — |
| Other | 55 | 59 |
| Total noninterest income | 3,148 | 2,925 |
| Noninterest Expense | | |
| Salaries and employee benefits | 4,986 | 4,591 |
| Occupancy, furniture and equipment, net | 815 | 815 |
| Advertising | 427 | 247 |
| Legal and professional | 329 | 290 |
| Data processing | 596 | 541 |
| Pennsylvania bank shares tax | 239 | 243 |
| FDIC Insurance | 129 | 106 |
| ATM/debit card processing | 238 | 218 |
| Foreclosed real estate | 14 | 58 |
| Telecommunications | 109 | 100 |
| Other | 766 | 748 |
| Total noninterest expense | 8,648 | 7,957 |
| Income before federal income taxes | 3,993 | 3,813 |
| Federal income tax expense | 491 | 793 |
| Net income | $ 3,502 | $ 3,020 |

| | | |
|---|---|---|
| Per share | | |
| Basic earnings per share | $ 0.80 | $ 0.70 |
| Diluted earnings per share | $ 0.80 | $ 0.70 |
| Cash dividends declared | $ 0.24 | $ 0.21 |

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

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Consolidated Statements of Comprehensive Income

| (Dollars in thousands) (unaudited) | For the Three Months Ended March 31, 2018 | 2017 |
|---|---|---|
| Net Income | $ 3,502 | $ 3,020 |
| | | |
| Debt Securities: | | |
| Unrealized (losses) gains arising during the period | (1,043) | 454 |
| Reclassification adjustment included in net income (1) | — | (2) |
| Net unrealized gains | (1,043) | 452 |
| Tax effect | 262 | (153) |
| Net of tax amount | (781) | 299 |
| | | |
| Total other comprehensive (loss) income | (781) | 299 |
| | | |
| Total Comprehensive Income | $ 2,721 | $ 3,319 |

| Reclassification adjustment / Statement line item | Tax expense (benefit) | |
|---|---|---|
| (1) Debt securities gains, net | $ — | $ 1 |

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

Consolidated Statements of Changes in Shareholders' Equity

For the three months ended March 31, 2018 and 2017

| (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, 2016 | $ 4,688 | $ 39,752 | $ 83,081 | $ (4,215) | $ (6,813) | $ 116,493 |
| Net income | — | — | 3,020 | — | — | 3,020 |
| Other comprehensive income | — | — | — | 299 | — | 299 |
| Cash dividends declared, $.21 per share | — | — | (907) | — | — | (907) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Treasury shares issued under employee stock purchase plan, 1,126 shares | — | 4 | — | — | 21 | 25 |
| Treasury shares issued under dividend reinvestment plan, 7,463 shares | — | 84 | — | — | 137 | 221 |
| Stock option compensation expense | — | 27 | — | — | — | 27 |
| Balance at March 31, 2017 | $ 4,688 | $ 39,867 | $ 85,194 | $ (3,916) | $ (6,655) | $ 119,178 |
| | | | | | | |
| Balance at December 31, 2017 | $ 4,689 | $ 40,396 | $ 82,218 | $ (6,028) | $ (6,131) | $ 115,144 |
| Cumulative adjustment for fair value of equity securities | — | — | 201 | (201) | — | — |
| Net income | — | — | 3,502 | — | — | 3,502 |
| Other comprehensive income | — | — | — | (781) | — | (781) |
| Cash dividends declared, $.24 per share | — | — | (1,045) | — | — | (1,045) |
| Acquisition of 2,605 shares of treasury stock | — | — | — | — | (88) | (88) |
| Treasury shares issued under employee stock purchase plan, 200 shares | — | 2 | — | — | 4 | 6 |
| Treasury shares issued under dividend reinvestment plan, 5,911 shares | — | 97 | — | — | 109 | 206 |
| Common stock issued under incentive stock option plan, 6,518 shares | 7 | 142 | — | — | — | 149 |
| Stock option compensation expense | — | 31 | — | — | — | 31 |
| Balance at March 31, 2018 | $ 4,696 | $ 40,668 | $ 84,876 | $ (7,010) | $ (6,106) | $ 117,124 |

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

Consolidated Statements of Cash Flows

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| (Dollars in thousands) (unaudited) | | |
| Cash flows from operating activities | | |
| Net income | $ 3,502 | $ 3,020 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 333 | 332 |
| Net amortization of loans and investment securities | 438 | 369 |
| Amortization and net change in mortgage servicing rights valuation | — | 14 |
| Provision for loan losses | 200 | 120 |
| Equity investments recorded at fair value through income | (45) | — |
| Debt securities gains, net | — | (2) |
| Loans originated for sale | (2,527) | (1,220) |
| Proceeds from sale of loans | 2,969 | 1,312 |
| Write-down of other real estate owned | 6 | 45 |
| Write-down on premises and equipment available for sale | — | 49 |
| Loss on sale of premises | 17 | — |
| Increase in cash surrender value of life insurance | (128) | (131) |
| Stock option compensation | 31 | 27 |
| Contribution to pension plan | (1,000) | — |
| Decrease in other assets | (448) | (1,409) |
| Increase in other liabilities | 148 | 619 |
| Net cash provided by operating activities | 3,496 | 3,145 |
| Cash flows from investing activities | | |
| Proceeds from sales and calls of investment securities available for sale | — | 475 |
| Proceeds from maturities and pay-downs of securities available for sale | 5,726 | 6,246 |
| Purchase of investment securities available for sale | (13,380) | — |
| Net decrease in restricted stock | — | 1,331 |
| Net decrease (increase) in loans | 1,031 | (9,517) |
| Capital expenditures | (107) | 34 |
| Proceeds from sale of other assets | 117 | — |
| Proceeds from sale of other real estate | — | 1,751 |
| Net cash (used in) provided by investing activities | (6,613) | 320 |
| Cash flows from financing activities | | |
| Net (decrease) increase in demand deposits, interest-bearing checking, and savings accounts | (3,636) | 25,360 |
| Net decrease in time deposits | (9,084) | (886) |
| Net decrease in short-term borrowings | — | (24,270) |
| Dividends paid | (1,045) | (907) |
| Treasury shares issued under employee stock purchase plan | 6 | 25 |
| Treasury shares issued under dividend reinvestment plan | 206 | 221 |
| Common stock issued under stock option plans | 149 | — |
| Net cash used in financing activities | (13,404) | (457) |
| (Decrease) increase in cash and cash equivalents | (16,521) | 3,008 |
| Cash and cash equivalents as of January 1 | 58,603 | 39,166 |

| | | |
|---|---|---|
| Cash and cash equivalents as of March 31 | $ 42,082 | $ 42,174 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid during the year for: | | |
| Interest on deposits and other borrowed funds | $ 792 | $ 566 |
| Income taxes | $ — | $ 1,002 |

The accompanying notes are an integral part of these unaudited 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, 2018, 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 2017 Annual Report on Form 10-K. The consolidated results of operations for the three month period ended March 31, 2018 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, 2017 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) | 2018 | 2017 |
| Weighted average shares outstanding (basic) | 4,359 | 4,321 |
| Impact of common stock equivalents | 28 | 20 |
| Weighted average shares outstanding (diluted) | 4,387 | 4,341 |

| | | |
|---|---|---|
| Anti-dilutive options excluded from calculation | — | 14 |
| Net income | $ 3,502 | $ 3,020 |
| Basic earnings per share | $ 0.80 | $ 0.70 |
| Diluted earnings per share | $ 0.80 | $ 0.70 |

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Note 2. Recent Accounting Pronouncements

| Standard | Description | Effective Date | Effect on the financial statements or other significant matters |
|---|---|---|---|
| ASU 2018-02, Income Statement (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income | Under ASU 2018-02, entities are allowed, but not required, to reclassify from Accumulated Other Comprehensive Income (AOCI) to retained earnings stranded tax effects resulting from the new federal corporate income tax rate of the Tax Cuts and Jobs Act (the Act). The reclassification could include other stranded tax effects that related to the Act but do not directly related to the change in the federal rate. Tax effects that are stranded in AOCI for other reasons may not be reclassified. Entities also will have an option to adopt the standard retrospectively or in the period of adoption. | January 1, 2018 | The Corporation adopted the provisions of the ASU in the fourth quarter of 2017. The Company reclassified the disproportionate tax effect resulting from the Act by increasing retained earnings by $992 thousand and reducing AOCI by $992 thousand. |
| ASU 2016-15, Statements of Cash Flow (Topic 320): Classification of Certain Cash Receipts and Cash Payments | The standard clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are intended to reduce diversity in practice. The standard contains additional guidance clarifying when an entity should separate cash receipts and cash payments and classifies them into more than one class of cash flows (including when reasonable judgement is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance. | January 1, 2018 | The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. |
| ASU 2017-07, Employee Benefits Plan (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost | This standard requires an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The amendments in this update also allow only the service cost component to be eligible for capitalization when applicable. | January 1, 2018 | The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. The service cost is reported in Salaries and Benefits expense and the nonservice cost is included in Other Expense on the Consolidated Statement of Income, which totaled $35 thousand reclassified for the first quarter of 2017. |

| | | | |
|---|---|---|---|
| ASU 2014-09, Revenue from Contracts with Customers (Topic 606) | The amendments in this Update (ASU 2014-09) establish a comprehensive revenue recognition standard. 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. Three basic transition methods are available – full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. | January 1, 2018 | The Corporation adopted this ASU on January 1, 2018, on a modified retrospective approach, and it did not have a material effect on the Corporation's consolidated financial statements. See Note 11. Revenue Recognition for more information. |

| | | | |
|---|---|---|---|
| ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities | The standard amends the guidance on the classification and measurement of financial instruments. Some of the amendments include the following: 1) requires equity investments 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. | January 1, 2018 | The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. The Corporation reclassified the fair value of equity securities by increasing retained earnings by $201 thousand and decreasing AOCI by $201 thousand. In addition, according to the standard, the Corporation measured the fair value of the loan portfolio as of March 31, 2018 using an exit price notion. See Note 9. Fair Value Measurements and Fair Values of Financial Instruments for more information. |
| ASU 2016-02, Leases (Topic 842) | 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. | January 1, 2019 | The Corporation currently has real estate and equipment leases that it classifies as operating leases that are not recognized on the balance sheet. Under the new standard, these leases will move onto the balance sheet in the form of a lease liability (the present value of a lessee's obligation to make lease payments) and a right-of-use asset (an asset that represents the lessee's right to use a specified asset for the lease term). The offsetting transactions will gross-up the Consolidated Balance Sheet, but the Corporation has not yet determined this amount. The Corporation has acquired a lease accounting model to implement the standard. The model has been installed and will be used in a test mode during 2018, but the Corporation does not plan to early adopt the standard. The Corporation currently expects that the new standard will not have a material effect on its consolidated results of operations. |
| ASU 2017-04, Goodwill (Topic 350) | This guidance, among other things, removes step 2 of the goodwill impairment test thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting | January 1, 2020 | We do not currently expect this guidance to have a material effect on the Corporation's consolidated financial statements based upon the most recent goodwill impairment analysis. |

unit. Upon adoption of this standard, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under the current guidance.

| | | | |
|---|---|---|---|
| ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments | This standard requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. The ASU replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination ("PCD assets"), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price ("gross up approach") to determine the initial amortized cost basis. The subsequent account for PCD financial assets is the same expected loss model described above. | January 1, 2020 | We have formed an implementation team led by the Corporation's Risk Management function. The team is reviewing the requirements of the ASU and evaluating methods and models for implementation. The new standard will result in earlier recognition of additions to the allowance for loan losses and possibly a larger allowance for loan loss balance with a corresponding increase in the provision for loan losses in results of operations; however, the Corporation is continuing to evaluate the impact of the pending adoption of the new standard on its consolidated financial statements. The Corporation expects to have its methodology and process complete by the end of 2018 so that it can run the new CECL model during 2019 in test mode, prior to the 2020 implementation. |

Note 3. Accumulated Other Comprehensive Loss

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

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| (Dollars in thousands) | | |
| Net unrealized (losses) gains on debt securities | $ (1,090) | $ 154 |
| Tax effect | 229 | (33) |
| Net of tax amount | (861) | 121 |
| | | |
| Accumulated pension adjustment | (7,784) | (7,784) |
| Tax effect | 1,635 | 1,635 |
| Net of tax amount | (6,149) | (6,149) |

| | | |
|---|---|---|
| Total accumulated other comprehensive loss | $ (7,010) | $ (6,028) |

Note 4. Investments

Available for Sale (AFS) Securities

The amortized cost and estimated fair value of AFS securities available for sale as of March 31, 2018 and December 31, 2017 are as follows:

| (Dollars in thousands) March 31, 2018 | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| U.S. Government and Agency securities | $ 10,534 | $ 22 | $ (74) | $ 10,482 |
| Municipal securities | 63,520 | 409 | (619) | 63,310 |
| Trust preferred securities | 6,007 | 1 | (159) | 5,849 |
| Agency mortgage-backed securities | 53,494 | 105 | (852) | 52,747 |
| Private-label mortgage-backed securities | 830 | 79 | — | 909 |
| Asset-backed securities | 27 | — | (2) | 25 |
| | $ 134,412 | $ 616 | $ (1,706) | $ 133,322 |

| (Dollars in thousands)<br>December 31, 2017 | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| Equity securities | $ 164 | $ 201 | $ — | $ 365 |
| U.S. Government and Agency securities | 11,451 | 64 | (43) | 11,472 |
| Municipal securities | 57,374 | 650 | (252) | 57,772 |
| Trust preferred securities | 6,000 | — | (183) | 5,817 |
| Agency mortgage-backed securities | 51,307 | 197 | (567) | 50,937 |
| Private-label mortgage-backed securities | 858 | 88 | — | 946 |
| Asset-backed securities | 28 | — | (1) | 27 |
| | $ 127,182 | $ 1,200 | $ (1,046) | $ 127,336 |

At March 31, 2018 and December 31, 2017, the fair value of AFS securities pledged to secure public funds and trust deposits totaled $78.9 million and $84.1 million, respectively.

The amortized cost and estimated fair value of debt securities at March 31, 2018, 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 | $ 5,174 | $ 5,199 |
| Due after one year through five years | 45,530 | 45,705 |
| Due after five years through ten years | 25,583 | 25,062 |
| Due after ten years | 3,801 | 3,700 |
| | 80,088 | 79,666 |
| Mortgage-backed securities | 54,324 | 53,656 |
| | $ 134,412 | $ 133,322 |

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

| | For the Three Months Ended March 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Gross gains realized | $ — | $ 2 |
| Gross losses realized | — | — |
| Net gains realized | $ — | $ 2 |

Impairment:

The AFS investment portfolio contained 166 securities with $92.1 million of temporarily impaired fair value and $1.7 million in unrealized losses at March 31, 2018. The total unrealized loss position has increased from a $1.0 million unrealized loss at year-end 2017.

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, 2018, 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 AFS portfolio, 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, 2018 and December 31, 2017:

| | March 31, 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 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 | $ 5,588 | $ (37) | 7 | $ 3,331 | $ (37) | 10 | $ 8,919 | $ (74) | 17 |
| Municipal securities | 26,203 | (339) | 41 | 7,365 | (280) | 14 | 33,568 | (619) | 55 |
| Trust preferred securities | 1,867 | (50) | 2 | 3,700 | (109) | 4 | 5,567 | (159) | 6 |
| Agency mortgage-backed securities | 25,164 | (337) | 46 | 18,900 | (515) | 40 | 44,064 | (852) | 86 |
| Asset-backed securities | 18 | (1) | 1 | 5 | (1) | 1 | 23 | (2) | 2 |
| Total temporarily impaired securities | $ 58,840 | $ (764) | 97 | $ 33,301 | $ (942) | 69 | $ 92,141 | $ (1,706) | 166 |

| | December 31, 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 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 | $ 2,315 | $ (11) | 5 | $ 3,528 | $ (32) | 10 | $ 5,843 | $ (43) | 15 |
| Municipal securities | 13,767 | (89) | 22 | 7,507 | (163) | 14 | 21,274 | (252) | 36 |
| Trust preferred securities | 1,216 | (12) | 2 | 4,601 | (171) | 5 | 5,817 | (183) | 7 |
| Agency mortgage-backed securities | 16,287 | (129) | 29 | 20,563 | (438) | 39 | 36,850 | (567) | 68 |
| Asset-backed securities | — | — | — | 4 | (1) | 1 | 4 | (1) | 1 |
| Total temporarily impaired | $ 33,585 | $ (241) | 58 | $ 36,203 | $ (805) | 69 | $ 69,788 | $ (1,046) | 127 |

securities

The following table represents the cumulative credit losses on AFS securities recognized in earnings for:

| (Dollars in thousands) | Three Months Ended March 31, 2018 | 2017 |
|---|---|---|
| Balance of cumulative credit-related OTTI at January 1 | $ 595 | $ 595 |
| Additions for credit-related OTTI not previously recognized | — | — |
| 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 | $ 595 | $ 595 |

Equity Securities at fair value

The Corporation owns one equity investment. At March 31, 2018, this investment was reported at fair value ($410 thousand) with changes in value report through income. At December 31, 2017, this investment was reported at fair value with changes in value recorded through other comprehensive income and was included in the Available for Sale Securities table of this note.

Restricted Stock at Cost

The Bank held $456 thousand of restricted stock at March 31, 2018. 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 5. 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 class, at the end of the reporting periods is as follows:

| (Dollars in thousands) | March 31, 2018 | December 31, 2017 |
|---|---|---|
| Residential Real Estate 1-4 Family | | |
| Consumer first liens | $ 93,897 | $ 97,159 |
| Commercial first lien | 61,790 | 61,275 |
| Total first liens | 155,687 | 158,434 |
| | | |
| Consumer junior liens and lines of credit | 43,842 | 45,043 |
| Commercial junior liens and lines of credit | 5,014 | 5,328 |
| Total junior liens and lines of credit | 48,856 | 50,371 |
| Total residential real estate 1-4 family | 204,543 | 208,805 |
| | | |
| Residential real estate - construction | | |
| Consumer | 2,756 | 1,813 |
| Commercial | 8,735 | 8,088 |
| Total residential real estate construction | 11,491 | 9,901 |
| | | |
| Commercial real estate | 433,821 | 428,428 |
| Commercial | 287,680 | 291,519 |
| Total commercial | 721,501 | 719,947 |
| | | |
| Consumer | 5,118 | 5,047 |
| | 942,653 | 943,700 |
| Less: Allowance for loan losses | (11,989) | (11,792) |
| Net Loans | $ 930,664 | $ 931,908 |
| | | |
| Included in the loan balances are the following: | | |
| Net unamortized deferred loan costs | $ 40 | $ 98 |

| | | |
|---|---|---|
| Loans pledged as collateral for borrowings and commitments from: | | |
| FHLB | $ 735,979 | $ 737,313 |
| Federal Reserve Bank | 35,137 | 35,740 |
| | $ 771,116 | $ 773,053 |

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Note 6. Loan Quality and Allowance for Loan Losses

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, 2017 | $ 1,060 | $ 330 | $ 224 | $ 6,526 | $ 2,110 | $ 105 | $ 1,437 | $ 11,792 |
| Charge-offs | — | — | — | — | — | (26) | — | (26) |
| Recoveries | 1 | — | — | — | 8 | 14 | — | 23 |
| Provision | (18) | (10) | 36 | 172 | (45) | 11 | 54 | 200 |
| ALL at March 31, 2018 | $ 1,043 | $ 320 | $ 260 | $ 6,698 | $ 2,073 | $ 104 | $ 1,491 | $ 11,989 |
| ALL at December 31, 2016 | $ 1,105 | $ 323 | $ 224 | $ 6,109 | $ 1,893 | $ 100 | $ 1,321 | $ 11,075 |
| Charge-offs | (8) | — | — | — | — | (28) | — | (36) |
| Recoveries | 1 | — | — | — | 102 | 16 | — | 119 |
| Provision | 2 | (2) | 50 | 17 | (11) | 11 | 53 | 120 |
| ALL at March 31, 2017 | $ 1,100 | $ 321 | $ 274 | $ 6,126 | $ 1,984 | $ 99 | $ 1,374 | $ 11,278 |

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, 2018 and December 31, 2017:

| | Residential Real Estate 1-4 Family | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | First Liens | Junior Liens & Lines of Credit | Construction | Commercial Real Estate | Commercial | Consumer | Unallocated | Total |
| March 31, 2018 | | | | | | | | |
| Loans evaluated for ALL: | | | | | | | | |
| Individually | $ 454 | $ — | $ 466 | $ 10,878 | $ — | $ — | $ — | $ 11,798 |
| Collectively | 155,233 | 48,856 | 11,025 | 422,943 | 287,680 | | | |