FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
November 07, 2016
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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

For the transition period from__________ to___________

Commission file number 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(717) 264-6116

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

There were 4,299,317 outstanding shares of the Registrant's common stock as of October 31, 2016.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets

(Dollars in thousands, except share and per share data)(unaudited)	September 30 2016	December 31 2015
Assets		
Cash and due from banks	$ 16,770	$ 20,664
Interest-bearing deposits in other banks	23,824	18,502
Total cash and cash equivalents	40,594	39,166
Investment securities available for sale, at fair value	155,345	159,473
Restricted stock	1,118	782
Loans held for sale	367	461
Loans	858,576	782,016
Allowance for loan losses	(10,685)	(10,086)
Net Loans	847,891	771,930
Premises and equipment, net	14,322	14,759
Bank owned life insurance	22,327	22,364
Goodwill	9,016	9,016
Other real estate owned	5,872	6,451
Deferred tax asset, net	4,044	4,758
Other assets	6,224	6,135
Total assets	$ 1,107,120	$ 1,035,295
Liabilities		
Deposits		
Noninterest-bearing checking	$ 174,390	$ 152,095
Money management, savings and interest checking	726,845	680,686
Time	77,317	85,731
Total Deposits	978,552	918,512
Short-term borrowings	8,530	-
Other liabilities	3,159	5,407
Total liabilities	990,241	923,919
Shareholders' equity		
Common stock, $1 par value per share,15,000,000 shares authorized with 4,688,149 shares issued and 4,299,223 shares outstanding at September 30, 2016 and 4,659,319 shares issued and 4,275,879 shares outstanding at December 31, 2015	4,688	4,659
Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding	-	-
Additional paid-in capital	39,584	38,778
Retained earnings	82,262	78,517

Accumulated other comprehensive loss	(2,547)	(3,722)
Treasury stock, 388,926 shares at September 30, 2016 and 383,440 shares at December 31, 2015, at cost	(7,108)	(6,856)
Total shareholders' equity	116,879	111,376
Total liabilities and shareholders' equity	$ 1,107,120	$ 1,035,295

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

Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2016	2015	2016	2015
Interest income				
Loans, including fees	$ 8,343	$ 7,665	$ 24,394	$ 22,518
Interest and dividends on investments:				
Taxable interest	569	584	1,729	1,832
Tax exempt interest	355	402	1,079	1,218
Dividend income	2	3	12	63
Deposits and obligations of other banks	79	66	220	192
Total interest income	9,348	8,720	27,434	25,823
Interest expense				
Deposits	559	554	1,650	1,813
Short-term borrowings	4	1	6	1
Total interest expense	563	555	1,656	1,814
Net interest income	8,785	8,165	25,778	24,009
Provision for loan losses	1,150	400	3,325	1,035
Net interest income after provision for loan losses	7,635	7,765	22,453	22,974
Noninterest income				
Investment and trust services fees	1,211	1,154	3,683	3,805
Loan service charges	102	288	518	784
Deposit service charges and fees	635	623	1,815	1,700
Other service charges and fees	325	309	941	916
Debit card income	373	346	1,095	1,021
Increase in cash surrender value of life insurance	131	137	399	416
Net (loss) gain on sale of other real estate owned	(20)	-	(31)	32
OTTI losses on debt securities	(10)	-	(30)	(20)
Gain on conversion of investment security	-	-	-	728
Securities gains, net	-	-	4	8
Other	56	126	219	363
Total noninterest income	2,803	2,983	8,613	9,753
Noninterest expense				
Salaries and employee benefits	4,566	4,214	13,282	12,500
Occupancy, net	556	535	1,708	1,706
Furniture and equipment	221	232	655	702
Advertising	296	336	839	807
Legal and professional	423	311	1,114	811
Data processing	539	524	1,540	1,547
Pennsylvania bank shares tax	203	206	699	608
Intangible amortization	-	-	-	181
FDIC insurance	188	170	514	479
ATM/debit card processing	214	193	642	566

Foreclosed real estate	18	322	93	341
Telecommunications	91	145	300	379
Other	665	675	2,119	2,385
Total noninterest expense	7,980	7,863	23,505	23,012
Income before federal income tax expense	2,458	2,885	7,561	9,715
Federal income tax expense	383	306	1,198	1,778
Net income	$ 2,075	$ 2,579	$ 6,363	$ 7,937
Per share				
Basic earnings per share	$ 0.48	$ 0.61	$ 1.48	$ 1.87
Diluted earnings per share	$ 0.48	$ 0.61	$ 1.48	$ 1.87
Cash dividends declared	$ 0.21	$ 0.19	$ 0.61	$ 0.55

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 September 30 2016	2015	For the Nine Months Ended September 30 2016	2015
Net Income	$ 2,075	$ 2,579	$ 6,363	$ 7,937
Securities:				
Unrealized (losses) gains arising during the period	(524)	1,097	1,528	561
Reclassification adjustment for losses (gains) included in net income (1)	10	-	26	(716)
Net unrealized (losses) gains	(514)	1,097	1,554	(155)
Tax effect	174	(373)	(528)	53
Net of tax amount	(340)	724	1,026	(102)
Derivatives:				
Unrealized gains arising during the period	-	-	-	31
Reclassification adjustment for losses included in net income (2)	-	-	-	160
Net unrealized gains	-	-	-	191
Tax effect	-	-	-	(65)
Net of tax amount	-	-	-	126
Pension:				
Change in plan assets and benefit obligations	-	-	-	-
Reclassification adjustment for losses included in net income (3)	225	-	225	-
Net unrealized losses	225	-	225	-
Tax effect	(76)	-	(76)	-
Net of tax amount	149	-	149	-
Total other comprehensive (loss) income	(191)	724	1,175	24
Total Comprehensive Income	$ 1,884	$ 3,303	$ 7,538	$ 7,961

Reclassification adjustment / Statement line item	Tax expense (benefit)			
(1) Securities / gain on conversion & securities (gains) losses, including OTTI losses, net	$ (3)	$ -	$ (9)	$ 243
(2) Derivatives / interest expense on deposits	-	-	-	(54)
(3) Pension / Salary & Benefits	(77)	-	(77)	-

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

Consolidated Statements of Changes in Shareholders' Equity

For the Nine Months Ended September 30, 2016 and 2015:

(Dollars in thousands, except per share data) (unaudited)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2014	$ 4,607	$ 37,504	$ 71,452	$ (3,100)	$ (6,942)	$ 103,521
Net income	-	-	7,937	-	-	7,937
Other comprehensive income	-	-	-	24	-	24
Cash dividends declared, $.55 per share	-	-	(2,330)	-	-	(2,330)
Treasury shares issued under stock option plans, 4,794 shares	-	6	-	-	86	92
Common stock issued under dividend reinvestment plan, 36,608 shares	36	833	-	-	-	869
Balance at September 30, 2015	$ 4,643	$ 38,343	$ 77,059	$ (3,076)	$ (6,856)	$ 110,113
Balance at December 31, 2015	$ 4,659	$ 38,778	$ 78,517	$ (3,722)	$ (6,856)	$ 111,376
Net income	-	-	6,363	-	-	6,363
Other comprehensive income	-	-	-	1,175	-	1,175
Cash dividends declared, $.61 per share	-	-	(2,618)	-	-	(2,618)
Acquisition of 30,196 shares of treasury stock	-	-	-	-	(700)	(700)
Treasury shares issued under employer stock purchase plan, 539 shares	-	2	-	-	10	12
Treasury shares issued under dividend reinvestment plan, 24,171 shares	-	134	-	-	438	572
Common stock issued under dividend reinvestment plan, 25,230 shares	25	527	-	-	-	552
Common stock issued under incentive stock option plan, 3,600 shares	4	55	-	-	-	59
Stock option compensation expense	-	88	-	-	-	88
Balance at September 30, 2016	$ 4,688	$ 39,584	$ 82,262	$ (2,547)	$ (7,108)	$ 116,879

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

Consolidated Statements of Cash Flows

	Nine Months Ended September 30	
	2016	2015
(Dollars in thousands) (unaudited)		
Cash flows from operating activities		
Net income	$ 6,363	$ 7,937
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,002	999
Net amortization of loans and investment securities	1,218	1,248
Amortization and net change in mortgage servicing rights valuation	41	20
Amortization of intangibles	-	181
Provision for loan losses	3,325	1,035
Gain on sales of securities	(4)	(8)
Impairment write-down on securities recognized in earnings	30	20
Gain on conversion of investment security	-	(728)
Loans originated for sale	(6,598)	(6,193)
Proceeds from sale of loans	6,692	6,206
Write-down of other real estate owned	46	250
Write-down on premises and equipment	-	60
Net loss (gain) on sale or disposal of other real estate/other repossessed assets	31	(32)
Increase in cash surrender value of life insurance	(399)	(416)
Gain from surrender of life insurance policy	-	(103)
Stock option compensation	88	-
Decrease in other assets	154	1,877
Decrease in other liabilities	(2,247)	(2,497)
Net cash provided by operating activities	9,742	9,856
Cash flows from investing activities		
Proceeds from sales and calls of investment securities available for sale	1,925	1,381
Proceeds from maturities and pay-downs of securities available for sale	18,984	21,607
Purchase of investment securities available for sale	(16,605)	(21,689)
Net increase in restricted stock	(336)	(417)
Net increase in loans	(79,275)	(47,110)
Capital expenditures	(515)	(765)
Proceeds from surrender of life insurance policy	436	-
Proceeds from sale of other real estate	625	129
Net cash used in investing activities	(74,761)	(46,864)
Cash flows from financing activities		
Net increase in demand deposits, interest-bearing checking, and savings accounts	68,454	45,360
Net decrease in time deposits	(8,414)	(9,094)
Net decrease in repurchase agreements	-	(9,079)
Net increase in short-term borrowings	8,530	3,500
Dividends paid	(2,618)	(2,330)
Common stock issued under stock option plans	71	92

Common stock issued under dividend reinvestment plan	1,124	869
Purchase of treasury stock	(700)	-
Net cash provided by financing activities	66,447	29,318
Increase (decrease) in cash and cash equivalents	1,428	(7,690)
Cash and cash equivalents as of January 1	39,166	48,593
Cash and cash equivalents as of September 30	$ 40,594	$ 40,903
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest on deposits and other borrowed funds	$ 1,643	$ 1,826
Income taxes	$ 2,100	$ 2,514
Noncash Activities		
Loans transferred to Other Real Estate	$ 123	$ 3,488

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

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

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

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of September 30, 2016, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation's 2015 Annual Report on Form 10-K. The consolidated results of operations for the three and nine month periods ended September 30, 2016 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

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

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

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

(Dollars and shares in thousands, except per share data)	For the Three Months Ended September 30 2016	2015	For the Nine Months Ended September 30 2016	2015
Weighted average shares outstanding (basic)	4,307	4,252	4,295	4,236
Impact of common stock equivalents	7	5	3	7
Weighted average shares outstanding (diluted)	4,314	4,257	4,298	4,243
Anti-dilutive options excluded from calculation	9	26	37	27
Net income	$ 2,075	$ 2,579	$ 6,363	$ 7,937
Basic earnings per share	$ 0.48	$ 0.61	$ 1.48	$ 1.87
Diluted earnings per share	$ 0.48	$ 0.61	$ 1.48	$ 1.87

Note 2. Recent Accounting Pronouncements

Statements of Cash Flow (Topic 320). In August 2016, the FASB issued ASU 2016-15, “Classification of Certain Cash Receipts and Cash Payments (Topic 320).” ASU 2016-15 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 ASU contains additional guidance clarifying when an entity should separate cash receipts and cash payments and classify 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. The amendments are effective fiscal years, and interim periods within those fiscal years, beginning after

December 15, 2017. The Corporation is currently evaluating the impact of the pending adoption of the amended standard on its consolidated financial statements.

Financial Instruments – Credit Losses (Topic 326). In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." ASU 2016-13 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. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal year beginning after December 15, 2018, including interim periods within those fiscal years. The Corporation is currently evaluating the impact of the pending adoption of the new standard on its consolidated 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.

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

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

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

Note 3. Accumulated Other Comprehensive Loss

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

(Dollars in thousands)	September 30 2016	December 31, 2015
Net unrealized gains on securities	$ 2,692	$ 1,138
Tax effect	(915)	(387)
Net of tax amount	1,777	751
Accumulated pension adjustment	(6,552)	(6,777)
Tax effect	2,228	2,304
Net of tax amount	(4,324)	(4,473)
Total accumulated other comprehensive loss	$ (2,547)	$ (3,722)

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Note 4. Investments

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2016 and December 31, 2015 are as follows:

(Dollars in thousands) September 30, 2016	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity securities	$ 164	$ 86	$ -	$ 250
U.S. Government and Agency securities	12,728	292	(21)	12,999
Municipal securities	66,248	1,924	(92)	68,080
Trust preferred securities	5,973	-	(555)	5,418
Agency mortgage-backed securities	66,369	1,089	(79)	67,379
Private-label mortgage-backed securities	1,137	57	(7)	1,187
Asset-backed securities	34	-	(2)	32
	$ 152,653	$ 3,448	$ (756)	$ 155,345

(Dollars in thousands) December 31, 2015	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity securities	$ 164	$ 69	$ -	$ 233
U.S. Government and Agency securities	13,705	164	(33)	13,836
Municipal securities	67,851	1,555	(218)	69,188
Trust preferred securities	5,958	-	(669)	5,289
Agency mortgage-backed securities	69,284	621	(386)	69,519
Private-label mortgage-backed securities	1,335	39	(2)	1,372
Asset-backed securities	38	-	(2)	36
	$ 158,335	$ 2,448	$ (1,310)	$ 159,473

At September 30, 2016 and December 31, 2015, the fair value of investment securities pledged to secure public funds, trust balances, deposit and other obligations totaled $86.0 million and $79.6 million, respectively.

The amortized cost and estimated fair value of debt securities at September 30, 2016, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities.

(Dollars in thousands)	Amortized cost	Fair value
Due in one year or less	$ 2,073	$ 2,094
Due after one year through five years	11,896	12,218
Due after five years through ten years	28,278	29,158
Due after ten years	42,736	43,059
	84,983	86,529
Mortgage-backed securities	67,506	68,566
	$ 152,489	$ 155,095

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

(Dollars in thousands)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2016	2015	2016	2015
Gross gains realized	$ -	$ -	$ 4	$ 8
Gross losses realized	-	-	-	-
Conversion gain	-	-	-	728
Net gains realized	$ -	$ -	$ 4	$ 736

The following table provides additional detail about trust preferred securities as of September 30, 2016:

Trust Preferred Securities

(Dollars in thousands)

Deal Name	Maturity	Single Issuer or Pooled	Class	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Lowest Credit Rating Assigned
BankAmerica Cap III	1/15/2027	Single	Preferred Stock	$ 966	$ 868	$ (98)	BB+
Wachovia Cap Trust II	1/15/2027	Single	Preferred Stock	279	263	(16)	BBB
Huntington Cap Trust	2/1/2027	Single	Preferred Stock	945	842	(103)	BB
Corestates Captl Tr II	2/15/2027	Single	Preferred Stock	942	883	(59)	BBB+
Huntington Cap Trust II	6/15/2028	Single	Preferred Stock	899	815	(84)	BB
Chase Cap VI JPM	8/1/2028	Single	Preferred Stock	965	877	(88)	BBB-
Fleet Cap Tr V	12/18/2028	Single	Preferred Stock	977	870	(107)	BB+
				$ 5,973	$ 5,418	$ (555)	

The following table provides additional detail about private label mortgage-backed securities as of September 30, 2016:

Private Label Mortgage Backed Securities

(Dollars in thousands) Description	Origination Date	Amortized Cost	Fair Value	Gross Unrealized Gain (Loss)	Collateral Type	Lowest Credit Rating Assigned	Credit Support %	Cumulative OTTI Charges
MALT 2004-6 7A1	6/1/2004	$ 317	$ 310	$ (7)	ALT A	CCC	15.01	$ -
RALI 2005-QS2 A1	2/1/2005	168	181	13	ALT A	CC	4.56	10
RALI 2006-QS4 A2	4/1/2006	400	417	17	ALT A	D	-	323
GSR 2006-5F 2A1	5/1/2006	45	53	8	Prime	D	-	15
RALI 2006-QS8 A1	7/28/2006	207	226	19	ALT A	D	-	237
		$ 1,137	$ 1,187	$ 50				$ 585

Impairment:

The investment portfolio contained fifty securities with $29.0 million of temporarily impaired fair value and $756 thousand in unrealized losses at September 30, 2016. The total unrealized loss position has improved from a $1.3 million unrealized loss at year-end 2015.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. Equity securities are assessed for other-than-temporary impairment based on the length of time of impairment, dollar amount of the impairment and general market and financial conditions relating to specific issues. The impairment identified on debt and equity securities and subject to assessment at September 30, 2016, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the investment portfolio (excluding restricted stock), aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of September 30, 2016 and December 31, 2015:

	September 30, 2016								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ -	$ -	-	$ 3,486	$ (21)	10	$ 3,486	$ (21)	10
Municipal securities	2,657	(7)	5	2,275	(85)	3	4,932	(92)	8
Trust preferred securities	-	-	-	5,418	(555)	7	5,418	(555)	7
Agency mortgage-backed securities	8,900	(35)	12	5,998	(44)	11	14,898	(79)	23
Private-label mortgage-backed securities	310	(7)	1	-	-	-	310	(7)	1
Asset-backed securities	-	-	-	4	(2)	1	4	(2)	1
Total temporarily impaired securities	$ 11,867	$ (49)	18	$ 17,181	$ (707)	32	$ 29,048	$ (756)	50

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

securities									
Private-label mortgage-backed securities	-	-	-	246	(2)	1	246	(2)	1
Asset-backed securities	-	-	-	5	(2)	1	5	(2)	1
Total temporarily impaired securities	$ 25,262	$ (251)	40	$ 22,083	$ (1,059)	39	$ 47,345	$ (1,310)	79

The unrealized loss in the municipal bond portfolio decreased to $92 thousand from $218 thousand at December 31, 2015 as market prices improved during the quarter. There are three securities in this portfolio with an unrealized loss and the loss in this portfolio is deemed to be non-credit related and no other-than-temporary impairment charges have been recorded.

The trust preferred portfolio contains seven securities with a fair value of $5.4 million and an unrealized loss of $555 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 September 30, 2016, the Bank believes it will be able to collect all interest and principal due on these bonds and no other-than-temporary-impairment charges were recorded.

There is one PLMBS bond showing a small unrealized loss of $7 thousand. However, the PLMBS sector as a whole is showing a net unrealized gain of $50 thousand at quarter end. This is primarily a result of the cumulative OTTI charges recorded on this portfolio. Due to the nature of these bonds, they are evaluated closely. These bonds were all rated AAA at time of purchase, but have since experienced rating declines. Some have experienced increased delinquencies and defaults, while others have seen the credit support increase as the bonds paid-down. The Bank monitors the performance of the PLMBS investments on a regular basis and reviews delinquencies, default rates, credit support levels and various cash flow stress test scenarios. In determining the credit related loss, Management considers all principal past due 60 days or more as a loss. If additional principal moves beyond 60 days past due, it will also be considered a loss. The Bank recorded a $30 thousand impairment charge during the first nine months of 2016 and has recorded $585 thousand of cumulative impairment charges on this portfolio. Management continues to monitor these securities and it is possible that additional write-downs may occur if current loss trends continue.

The following table represents the cumulative credit losses on debt securities recognized in earnings as of September 30:

(Dollars in thousands)	Nine Months Ended	
	2016	2015
Balance of cumulative credit-related OTTI at January 1	$ 555	$ 535
Additions for credit-related OTTI not previously recognized	30	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 September 30	$ 585	$ 555

The Bank held $1.1 million of restricted stock at September 30, 2016. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

Note 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)	September 30, 2016	December 31, 2015
Residential Real Estate 1-4 Family		
Consumer first liens	$ 99,571	$ 103,698
Commercial first lien	63,515	57,780
Total first liens	163,086	161,478
Consumer junior liens and lines of credit	46,688	44,996
Commercial junior liens and lines of credit	5,837	5,917
Total junior liens and lines of credit	52,525	50,913
Total residential real estate 1-4 family	215,611	212,391
Residential real estate - construction		
Consumer	1,589	545
Commercial	7,067	7,343
Total residential real estate construction	8,656	7,888
Commercial real estate	375,316	340,695
Commercial	254,274	215,942
Total commercial	629,590	556,637
Consumer	4,719	5,100
	858,576	782,016
Less: Allowance for loan losses	(10,685)	(10,086)
Net Loans	$ 847,891	$ 771,930
Included in the loan balances are the following:		
Net unamortized deferred loan costs	$ 149	$ 436
Loans pledged as collateral for borrowings and commitments from:		
FHLB	$ 692,043	$ 643,449
Federal Reserve Bank	41,806	45,111
	$ 733,849	$ 688,560

Note 6. Loan Quality

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

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
ALL at June 30, 2016	$ 1,023	$ 319	$ 205	$ 5,940	$ 1,596	$ 97	$ 1,138	$ 10,318
Charge-offs	-	-	-	(776)	-	(42)	-	(818)
Recoveries	1	-	-	5	7	22	-	35
Provision	(3)	1	8	876	132	21	115	1,150
ALL at September 30, 2016	$ 1,021	$ 320	$ 213	$ 6,045	$ 1,735	$ 98	$ 1,253	$ 10,685
ALL at December 31, 2015	$ 989	$ 308	$ 194	$ 5,649	$ 1,519	$ 102	$ 1,325	$ 10,086
Charge-offs	(49)	-	-	(2,730)	(66)	(126)	-	(2,971)
Recoveries	34	-	-	18	129	64	-	245
Provision	47	12	19	3,108	153	58	(72)	3,325
ALL at September 30, 2016	$ 1,021	$ 320	$ 213	$ 6,045	$ 1,735	$ 98	$ 1,253	$ 10,685
ALL at June 30, 2015	$ 1,014	$ 281	$ 207	$ 5,179	$ 1,442	$ 110	$ 1,217	$ 9,450
Charge-offs	-	-	-	-	(47)	(75)	-	(122)
Recoveries	1	-	18	-	102	24	-	145
Provision	(16)	18	(27)	389	32	45	(41)	400
ALL at September 30, 2015	$ 999	$ 299	$ 198	$ 5,568	$ 1,529	$ 104	$ 1,176	$ 9,873
ALL at December 31, 2014	$ 994	$ 271	$ 214	$ 4,978	$ 1,515	$ 127	$ 1,012	$ 9,111
Charge-offs	(43)	(21)	-	-	(263)	(155)	-	(482)
Recoveries	4	-	18	14	116	57	-	209
Provision	44	49	(34)	576	161	75	164	1,035
ALL at September 30, 2015	$ 999	$ 299	$ 198	$ 5,568	$ 1,529	$ 104	$ 1,176	$ 9,873

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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 September 30, 2016 and December 31, 2015:

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
September 30, 2016								
Loans evaluated for ALL:								
Individually	$ 632	$ 52	$ 545	$ 13,815	$ -	$ -	$ -	$ 15,044
Collectively	162,454	52,473	8,111	361,501	254,274	4,719	-	843,532
Total	$ 163,086	$ 52,525	$ 8,656	$ 375,316	$ 254,274	$ 4,719	$ -	$ 858,576
ALL established for loans evaluated:								
Individually	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively	1,021	320	213	6,045	1,735	98	1,253	10,685
ALL at September 30, 2016	$ 1,021	$ 320	$ 213	$ 6,045	$ 1,735	$ 98	$ 1,253	$ 10,685
December 31, 2015								
Loans evaluated for ALL:								
Individually	$ 930	$ 51	$ 502	$ 14,309	$ 230	$ -	$ -	$ 16,022
Collectively	160,548	50,862	7,386	326,386	215,712	5,100	-	765,994
Total	$ 161,478	$ 50,913	$ 7,888	$ 340,695	$ 215,942	$ 5,100	$ -	$ 782,016
ALL established for loans evaluated:								
Individually	$ -	$ -	$ -	$ -	$ 9	$ -	$ -	$ 9
Collectively	989	308	194	5,649	1,510	102	1,325	10,077
ALL at December 31, 2015	$ 989	$ 308	$ 194	$ 5,649	$ 1,519	$ 102	$ 1,325	$ 10,086

The following table shows additional information about those loans considered to be impaired at September 30, 2016 and December 31, 2015:

	Impaired Loans With No Allowance		With Allowance		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Recorded Investment	Unpaid Principal Balance	Related Allowance
September 30, 2016					
Residential Real Estate 1-4 Family					
First liens	$ 1,189	$ 1,263	$ -	$ -	$ -
Junior liens and lines of credit	96	107	-	-	-
Total	1,285	1,370	-	-	-
Residential real estate - construction	545	597	-	-	-
Commercial real estate	13,815	14,372	-	-	-
Commercial	24	35	-	-	-
Total	$ 15,669	$ 16,374	$ -	$ -	$ -
December 31, 2015					
Residential Real Estate 1-4 Family					
First liens	$ 1,523	$ 1,725	$ -	$ -	$ -
Junior liens and lines of credit	105	133	-	-	-
Total	1,628	1,858	-	-	-
Residential real estate - construction	502	546	-	-	-
Commercial real estate	14,431	15,007		-	-
Commercial	267	330	9	10	9
Total	$ 16,828	$ 17,741	$ 9	$ 10	$ 9

The following table shows the average of impaired loans and related interest income for the three and nine months ended September 30, 2016 and 2015:

(Dollars in thousands)	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Residential Real Estate 1-4 Family				
First liens	$ 1,196	$ 10	$ 1,262	$ 30
Junior liens and lines of credit	96	-	90	-
Total	1,292	10	1,352	30
Residential real estate - construction	548	-	554	-
Commercial real estate	13,889	118	17,871	478
Commercial	25	-	34	-
Total	$ 15,754	$ 128	$ 19,811	$ 508

(Dollars in thousands)	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Residential Real Estate 1-4 Family				
First liens	$ 1,600	$ 9	$ 2,474	$ 26
Junior liens and lines of credit	181	2	157	4
Total	1,781	11	2,631	30
Residential real estate - construction	510	-	651	-
Commercial real estate	14,836	126	21,774	452
Commercial	380	-	1,181	-
Total	$ 17,507	$ 137	$ 26,237	$ 482

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

(Dollars in thousands)		Loans Past Due and Still Accruing					Total
	Current	30-59 Days	60-89 Days	90 Days+	Total	Non-Accrual	Loans
September 30, 2016							
Residential Real Estate 1-4 Family							
First liens	$ 162,334	$ 239	$ 53	$ 38	$ 330	$ 422	$ 163,086
Junior liens and lines of credit	52,304	62	2	61	125	96	52,525
Total	214,638	301	55	99	455	518	215,611
Residential real estate - construction	8,111	-	-	-	-	545	8,656
Commercial real estate	369,833	200	559	568	1,327	4,156	375,316
Commercial	253,919	300	5	26	331	24	254,274
Consumer	4,699	10	10	-	20	-	4,719
Total	$ 851,200	$ 811	$ 629	$ 693	$ 2,133	$ 5,243	$ 858,576
December 31, 2015							
Residential Real Estate 1-4 Family							
First liens	$ 159,998	$ 44	$ 416	$ 214	$ 674	$ 806	$ 161,478
Junior liens and lines of credit	50,541	217	50	-	267	105	50,913
Total	210,539	261	466	214	941	911	212,391
Residential real estate - construction	7,209	177	-	-	177	502	7,888
Commercial real estate	330,953	5,713	196	152	6,061	3,681	340,695
Commercial	215,449	210	5	2	217	276	215,942
Consumer	5,041	55	4	-	59	-	5,100
Total	$ 769,191	$ 6,416	$ 671	$ 368	$ 7,455	$ 5,370	$ 782,016

The following table reports the internal credit rating for the loan portfolio. Consumer purpose loans (mortgage, home equity and installment) are assigned a rating of either pass or substandard. Substandard consumer loans are comprised of loans 90 days or more past due and still accruing, and nonaccrual loans. Commercial purpose loans may be assigned any rating in accordance with the Bank's internal risk rating system.

(Dollars in thousands)	Pass (1-5)	Special Mention (6)	Substandard (7)	Doubtful (8)	Total
September 30, 2016					
Residential Real Estate 1-4 Family					
First liens	$ 159,758	$ 1,942	$ 1,386	$ -	$ 163,086
Junior liens and lines of credit	52,308	28	189	-	52,525
Total	212,066	1,970	1,575	-	215,611
Residential real estate - construction	7,833	-	823	-	8,656
Commercial real estate	360,788	359	14,169	-	375,316
Commercial	250,118	2,058	2,098	-	254,274
Consumer	4,719	-	-	-	4,719
Total	$ 835,524	$ 4,387	$ 18,665	$ -	$ 858,576

December 31, 2015					
Residential Real Estate 1-4 Family					
First liens	$ 157,514	$ 2,122	$ 1,842	$ -	$ 161,478
Junior liens and lines of credit	50,685	28	200	-	50,913
Total	208,199	2,150	2,042	-	212,391
Residential real estate - construction	7,386	-	502	-	7,888
Commercial real estate	319,985	6,175	14,535	-	340,695
Commercial	213,492	1,978	472	-	215,942
Consumer	5,100	-	-	-	5,100
Total	$ 754,162	$ 10,303	$ 17,551	$ -	$ 782,016

The following table presents information on the Bank’s Troubled Debt Restructuring (TDR) loans:

(Dollars in thousands)	Troubled Debt Restructurings				Troubled Debt Restructurings That Have Defaulted on Modified Terms in the Last Twelve Months	
	Number of Contracts	Recorded Investment	Performing*	Nonperforming*	Number of Contracts	Recorded Investment
September 30, 2016						
Residential real estate - construction	1	$ 486	$ 486	$ -	-	$ -
Residential real estate	5	879	728	151	-	-
Commercial real estate	11	12,211	10,930	1,281	1	1,281
Total	17	$ 13,576	$ 12,144	$ 1,432	1	$ 1,281
December 31, 2015						
Residential real estate - construction	1	$ 502	$ 502	$ -	-	$ -
Residential real estate	4	654	503	151	-	-
Commercial real estate	10	12,125	12,125	-	-	-
Total	15	$ 13,281	$ 13,130	$ 151	-	$ -

*The performing status is determined by the loan’s compliance with the modified terms.

The following table reports new TDR loans during 2016, concession granted and the recorded investment as of September 30, 2016:

	New During Period				
Nine Months Ended September 30, 2016	Number of Contracts	Pre-TDR Modification	After-TDR Modification	Recorded Investment	Concession
Commercial real estate	1	$ 525	$ 525	$ 515	multiple
Residential real estate	1	238	238	238	maturity
Total	2	$ 763	$ 763	$ 753	

There were no new TDR loans made in the first nine months of 2015.

Note 7. OREO

Changes in other real estate owned during the nine months ended September 30, 2016 and 2015 were as follows:

	September 30	
(Dollars in thousands)	2016	2015
Balance at January 1	$ 6,451	$ 3,666
Additions	123	3,488
Proceeds from dispositions	(625)	(129)
(Loss) gain on sales, net	(31)	32
Valuation adjustment	(46)	(250)
Balance at September 30	$ 5,872	$ 6,807

Note 8. Pension

The components of pension expense for the periods presented are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands)	2016	2015	2016	2015
Components of net periodic cost:				
Service cost	$ 83	$ 92	$ 247	$ 284
Interest cost	180	172	540	522
Expected return on plan assets	(290)	(296)	(873)	(888)
Settlement expense	225	-	225	-
Recognized net actuarial loss	120	123	351	377
Net period cost	$ 318	$ 91	$ 490	$ 295

The Bank expects its pension expense to increase to approximately $922 thousand in 2016 compared to $387 thousand in 2015. This increase is due to a pension settlement expense of approximately $564 thousand that will be recorded during the second half of 2016, as a result of lump sum distributions. No pension contributions were made or are expected to be made in 2016.

Note 9. Fair Value Measurements and Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Corporation's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates maybe different than the amounts reported at each year-end.

FASB ASC Topic 820, "Financial Instruments", requires disclosure of the fair value of financial assets and liabilities, including those financial assets and liabilities that are not measured and reported at fair value on a recurring and nonrecurring basis. The Corporation does not report any nonfinancial assets at fair value. FASB ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC Topic 820 are as follows:

Level 1: Valuation is based on unadjusted, quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. There may be substantial differences in the assumptions used for securities within the same level. For example, prices for U.S. Agency securities have fewer assumptions and are closer to level 1 valuations than the private label mortgage backed securities that require more assumptions and are closer to level 3 valuations.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Corporation's assumptions regarding what market participants would assume when pricing a financial instrument.

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used to estimate the fair values of the Corporation's financial instruments at September 30, 2016 and December 31, 2015.

Cash and Cash Equivalents: For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment securities: The fair value of investment securities is determined in accordance with the methods described under FASB ASC Topic 820 as discussed below.

Restricted stock: The carrying value of restricted stock approximates its fair value based on redemption provisions for the restricted stock.

Loans held for sale: The fair value of loans held for sale is determined by the price set between the Bank and the purchaser prior to origination. These loans are usually sold at par.

Net loans (including impaired loans): The fair value of fixed-rate loans is estimated for each major type of loan (e.g. real estate, commercial, industrial and agricultural and consumer) by discounting the future cash flows associated with such loans using rates currently offered for loans with similar terms to borrowers of comparable credit quality. The model considers scheduled principal maturities, repricing characteristics, prepayment assumptions and interest cash flows. The discount rates used are estimated based upon consideration of a number of factors including the treasury yield curve, expense and service charge factors. For variable rate loans that reprice frequently and have no significant change in credit quality, carrying values approximate the fair value.

Accrued Interest Receivable: The carrying amount is a reasonable estimate of fair value.

Deposits and Short-term borrowings: The fair value of demand deposits, savings accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-rate certificates of deposit is estimated by discounting the future cash flows using rates approximating those currently offered for certificates of deposit with similar remaining maturities. For short-term borrowings, the carrying value approximates a reasonable estimate of the fair value.

Accrued interest payable: The carrying amount is a reasonable estimate of fair value.

The following information regarding the fair value of the Corporation's financial instruments should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation's disclosures and those of other companies may not be meaningful.

The fair value of the Corporation's financial instruments are as follows:

(Dollars in thousands)	September 30, 2016 Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	$ 40,594	$ 40,594	$ 40,594	$ -	$ -
Investment securities available for sale	155,345	155,345	250	155,095	-
Restricted stock	1,118	1,118	-	1,118	-
Loans held for sale	367	367	-	367	-
Net loans	847,891	858,095	-	-	858,095
Accrued interest receivable	3,105	3,105	-	3,105	-
Financial liabilities:					
Deposits	$ 978,552	$ 978,487	$ -	$ 978,487	$ -
Accrued interest payable	137	137	-	137	-

(Dollars in thousands)	December 31, 2015 Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	$ 39,166	$ 39,166	$ 39,166	$ -	$ -
Investment securities available for sale	159,473	159,473	233	159,240	-
Restricted stock	782	782	-	782	-
Loans held for sale	461	461	-	461	-
Net loans	771,930	779,742	-	-	779,742
Accrued interest receivable	3,164	3,164	-	3,164	-
Financial liabilities:					
Deposits	$ 918,512	$ 918,401	$ -	$ 918,401	$ -
Accrued interest payable	124	124	-	124	-

Recurring Fair Value Measurements

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2016 and December 31, 2015 are as follows:

(Dollars in Thousands	Fair Value at September 30, 2016			
Asset Description	Level 1	Level 2	Level 3	Total
Equity securities	$ 250	$ -	$ -	$ 250
U.S. Government and Agency securities	-	12,999	-	12,999
Municipal securities	-	68,080	-	68,080
Trust Preferred Securities	-	5,418	-	5,418
Agency mortgage-backed securities	-	67,379	-	67,379
Private-label mortgage-backed securities	-	1,187	-	1,187
Asset-backed securities	-	32	-	32
Total assets	$ 250	$ 155,095	$ -	$ 155,345

(Dollars in Thousands)	Fair Value at December 31, 2015			
Asset Description	Level 1	Level 2	Level 3	Total
Equity securities	$ 233	$ -	$ -	$ 233
U.S. Government and Agency securities	-	13,836	-	13,836
Municipal securities	-	69,188	-	69,188
Trust Preferred Securities	-	5,289	-	5,289
Agency mortgage-backed securities	-	69,519	-	69,519
Private-label mortgage-backed securities	-	1,372	-	1,372
Asset-backed securities	-	36	-	36
Total assets	$ 233	$ 159,240	$ -	$ 159,473

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