FIDELITY D & D BANCORP INC
Form 10-Q
May 14, 2015
Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2015

OR

[ ] 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: 333-90273

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION: IRS EMPLOYER IDENTIFICATION NO:

PENNSYLVANIA 23-3017653

Address of principal executive offices:

BLAKELY & DRINKER ST.

DUNMORE, PENNSYLVANIA 18512

TELEPHONE:

570-342-8281

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 subjected to such filing requirements for the past 90 days. [X] 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). [X] 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. (Check one):

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]
(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

[ ] YES [X] NO

The number of outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on April 30, 2015, the latest practicable date, was 2,439,905 shares.

Table Of Contents

FIDELITY D & D BANCORP, INC.

Form 10-Q March 31, 2015

Index

2

Table Of Contents

PART I – Financial Information

Item 1: Financial Statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Balance Sheets
(Unaudited)

(dollars in thousands)	March 31, 2015	December 31, 2014
Assets:		
Cash and due from banks	$ 14,157	$ 11,808
Interest-bearing deposits with financial institutions	4,826	14,043
Total cash and cash equivalents	18,983	25,851
Available-for-sale securities	126,481	97,896
Held-to-maturity securities (fair value of $0 in 2015, $0 in 2014)	-	-
Federal Home Loan Bank stock	1,291	1,306
Loans and leases, net (allowance for loan losses of $9,208 in 2015; $9,173 in 2014)	510,488	506,327
Loans held-for-sale (fair value $1,181 in 2015, $1,186 in 2014)	1,159	1,161
Foreclosed assets held-for-sale	1,433	1,972
Bank premises and equipment, net	14,931	14,846
Cash surrender value of bank owned life insurance	10,825	10,741
Accrued interest receivable	2,089	2,086
Other assets	14,827	14,299
Total assets	$ 702,507	$ 676,485
Liabilities:		
Deposits:		
Interest-bearing	$ 467,896	$ 457,574
Non-interest-bearing	133,846	129,370
Total deposits	601,742	586,944
Accrued interest payable and other liabilities	3,470	3,353
Short-term borrowings	13,773	3,969
Long-term debt	10,000	10,000
Total liabilities	628,985	604,266
Shareholders' equity:		
Preferred stock authorized 5,000,000 shares with no par value; none issued	-	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 2,439,905 in 2015; and 2,427,767 in 2014)	26,461	26,272
Retained earnings	44,164	43,204
Accumulated other comprehensive income	2,897	2,743
Total shareholders' equity	73,522	72,219
Total liabilities and shareholders' equity	$ 702,507	$ 676,485

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Income

(Unaudited)	Three months ended	
(dollars in thousands except per share data)	March 31, 2015	March 31, 2014
Interest income:		
Loans and leases:		
Taxable	$ 5,499	$ 5,276
Nontaxable	139	131
Interest-bearing deposits with financial institutions	16	7
Investment securities:		
U.S. government agency and corporations	260	245
States and political subdivisions (nontaxable)	313	321
Other securities	77	22
Total interest income	6,304	6,002
Interest expense:		
Deposits	557	489
Securities sold under repurchase agreements	8	8
Other short-term borrowings and other	1	-
Long-term debt	131	210
Total interest expense	697	707
Net interest income	5,607	5,295
Provision for loan losses	150	300
Net interest income after provision for loan losses	5,457	4,995
Other income:		
Service charges on deposit accounts	415	423
Interchange fees	302	305
Fees from trust fiduciary activities	217	164
Fees from financial services	127	139
Service charges on loans	176	117
Fees and other revenue	196	171
Earnings on bank-owned life insurance	85	83
Gain on sale or disposal of:		
Loans	229	128
Investment securities	2	207
Premises and equipment	1	1
Total other income	1,750	1,738
Other expenses:		
Salaries and employee benefits	2,653	2,476
Premises and equipment	941	917
Advertising and marketing	387	332

Professional services	338	318
FDIC assessment	107	99
Loan collection	30	47
Other real estate owned	99	65
Office supplies and postage	101	107
Automated transaction processing	120	151
Other	311	273
Total other expenses	5,087	4,785
Income before income taxes	2,120	1,948
Provision for income taxes	547	492
Net income	$ 1,573	$ 1,456
Per share data:		
Net income - basic	$ 0.65	$ 0.61
Net income - diluted	$ 0.64	$ 0.61
Dividends	$ 0.25	$ 0.25

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary	Three months ended March 31,	
Consolidated Statements of Comprehensive Income (Unaudited)		
(dollars in thousands)	2015	2014
Net income	$ 1,573	$ 1,456
Other comprehensive income, before tax:		
Unrealized holding gain on available-for-sale securities	235	1,015
Reclassification adjustment for net gains realized in income	(2)	(207)
Net unrealized gain	233	808
Tax effect	(79)	(274)
Unrealized gain, net of tax	154	534
Other comprehensive income, net of tax	154	534
Total comprehensive income, net of tax	$ 1,727	$ 1,990

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
For the three months ended March 31, 2015 and 2014
(Unaudited)

(dollars in thousands)	Capital stock Shares	Amount	Retained earnings	Accumulated other comprehensive income	Total
Balance, December 31, 2013	2,391,617	$ 25,302	$ 39,519	$ 1,239	$ 66,060
Net income			1,456		1,456
Other comprehensive income				534	534
Issuance of common stock through Employee Stock Purchase Plan	4,373	80			80
Issuance of common stock through Dividend Reinvestment Plan	10,427	249			249
Issuance of common stock from vested restricted share grants through stock compensation plans	5,250				
Stock-based compensation expense		72			72
Cash dividends declared			(602)		(602)
Balance, March 31, 2014	2,411,667	$ 25,703	$ 40,373	$ 1,773	$ 67,849
Balance, December 31, 2014	2,427,767	$ 26,272	$ 43,204	$ 2,743	$ 72,219
Net income			1,573		1,573
Other comprehensive income				154	154
Issuance of common stock through Employee Stock Purchase Plan	4,358	102			102
Issuance of common stock from vested restricted share grants through stock compensation plans	7,780				
Stock-based compensation expense		87			87
Cash dividends declared			(613)		(613)
Balance, March 31, 2015	2,439,905	$ 26,461	$ 44,164	$ 2,897	$ 73,522

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows

(Unaudited)	Three months ended March 31,	
(dollars in thousands)	2015	2014
Cash flows from operating activities:		
Net income	$ 1,573	$ 1,456
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	806	767
Provision for loan losses	150	300
Deferred income tax expense (benefit)	588	(16)
Stock-based compensation expense	87	72
Proceeds from sale of loans held-for-sale	10,318	7,065
Originations of loans held-for-sale	(10,227)	(6,563)
Earnings from bank-owned life insurance	(85)	(83)
Net gain from sales of loans	(229)	(128)
Net gain from sales of investment securities	(2)	(207)
Net loss (gain) from sale and write-down of foreclosed assets held-for-sale	36	(48)
Change in:		
Accrued interest receivable	(4)	38
Other assets	(954)	(530)
Accrued interest payable and other liabilities	117	(535)
Net cash provided by operating activities	2,174	1,588
Cash flows from investing activities:		
Held-to-maturity securities:		
Proceeds from sales	-	187
Proceeds from maturities, calls and principal pay-downs	-	3
Available-for-sale securities:		
Proceeds from sales	3,573	2,751
Proceeds from maturities, calls and principal pay-downs	6,772	3,580
Purchases	(39,025)	(10,612)
Decrease in FHLB stock	15	464
Net increase in loans and leases	(4,725)	(7,892)
Acquisition of bank premises and equipment	(664)	(433)
Proceeds from sale of foreclosed assets held-for-sale	921	766
Net cash used in investing activities	(33,133)	(11,186)
Cash flows from financing activities:		
Net increase in deposits	14,798	25,067
Net increase in short-term borrowings	9,804	3,685

Proceeds from employee stock purchase plan participants	102	80
Dividends paid, net of dividends reinvested	(613)	(395)
Proceeds from dividend reinvestment plan participants	-	42
Net cash provided by financing activities	24,091	28,479
Net (decrease) increase in cash and cash equivalents	(6,868)	18,881
Cash and cash equivalents, beginning	25,851	13,218
Cash and cash equivalents, ending	$ 18,983	$ 32,099

See notes to unaudited consolidated financial statements

7

Table Of Contents

FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements

(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

Fidelity Deposit and Discount Bank (the Bank) is a commercial bank chartered under the law of the Commonwealth of Pennsylvania and a wholly-owned subsidiary of Fidelity D & D Bancorp, Inc. (collectively, the Company). Having commenced operations in 1903, the Bank is committed to provide superior customer service, while offering a full range of banking products and financial and trust services to both our consumer and commercial customers from our main office located in Dunmore and other branches located throughout Lackawanna and Luzerne Counties.

Principles of consolidation

The accompanying unaudited consolidated financial statements of the Company and the Bank have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to this Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the periods have been included. All significant inter-company balances and transactions have been eliminated in consolidation.

For additional information and disclosures required under GAAP, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Management is responsible for the fairness, integrity and objectivity of the unaudited financial statements included in this report. Management prepared the unaudited financial statements in accordance with GAAP. In meeting its responsibility for the financial statements, management depends on the Company's accounting systems and related internal controls. These systems and controls are designed to provide reasonable but not absolute assurance that the financial records accurately reflect the transactions of the Company, the Company's assets are safeguarded and that the financial statements present fairly the financial condition and results of operations of the Company.

In the opinion of management, the consolidated balance sheets as of March 31, 2015 and December 31, 2014 and the related consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in shareholders' equity and consolidated statements of cash flows for the three months ended March 31, 2015 and 2014 present fairly the financial condition and results of operations of the Company. All material adjustments required for a fair presentation have been made. These adjustments are of a normal recurring nature. Certain reclassifications have been made to the 2014 financial statements to conform to the 2015 presentation.

In preparing these consolidated financial statements, the Company evaluated the events and transactions that occurred after March 31, 2015 through the date these consolidated financial statements were issued.

This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2014, and the notes included therein, included within the Company's Annual Report filed on Form 10-K.

Critical accounting policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at March 31, 2015 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Fair values of investment securities are determined by pricing provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes may be obtained from more than one source. The majority of the Company's investment securities are classified as available-for-sale (AFS). AFS securities are carried at fair value

Table Of Contents

on the consolidated balance sheets, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity as a component of accumulated other comprehensive income (loss) (OCI).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells residential mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. As of March 31, 2015 and December 31, 2014, loans classified as HFS consisted of residential mortgage loans.

Financing of automobiles, provided to customers under lease arrangements of varying terms, are accounted for as direct finance leases. Interest income on automobile direct finance leasing is determined using the interest method. Generally, the interest method is used to arrive at a level effective yield over the life of the lease.

Foreclosed assets held-for-sale includes other real estate acquired through foreclosure (ORE) and may, from time-to-time, include repossessed assets such as automobiles. ORE is carried at the lower of cost (principal balance at date of foreclosure) or fair value less estimated cost to sell. Any write-downs at the date of foreclosure or within a reasonable period of time after foreclosure are charged to the allowance for loan losses. Expenses incurred to maintain ORE properties, subsequent write downs to the asset's fair value, any rental income received and gains or losses on disposal are included as components of other real estate owned expense in the consolidated statements of income.

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and interest-bearing deposits with financial institutions. For each of the three months ended March 31, 2015 and 2014, the Company paid interest of $0.7 million. The Company did not make an income tax payment in the first quarters of 2015 and 2014. Transfers from loans to foreclosed assets held-for-sale amounted to $0.4 million and $1.2 million during the three months ended March 31, 2015 and 2014, respectively. During the same respective periods, transfers from loans to loans HFS amounted to $0 for both periods and from loans to bank premises and equipment amounted to $0 million and $1.0 million. Expenditures for construction in process, a component of other assets in the consolidated balance sheets, are included in acquisition of bank premises and equipment.

2. New accounting pronouncements

In an exposure draft issued in the fourth quarter of 2012, the Financial Accounting Standards Board (FASB) proposed changes to the accounting guidance related to the impairment of financial assets and the recognition of credit losses. The FASB proposal would require financial institutions to reserve for losses for the duration of the credit exposure as opposed to reserving for probable losses. The new methodology would be known as the "current expected credit losses" (CECL) methodology. The FASB is currently in the process of re-deliberating significant issues raised through feedback received from comment letters and outreach activities. Among other things, the guidance in the proposed update regarding an entity's estimate of expected credit losses will be clarified as follows:

- An entity should revert to a historical average loss experience for the future periods beyond which the entity is able to make or obtain reasonable and supportable forecasts;
- An entity should consider all contractual cash flows over the life of the related financial assets;
- When determining the contractual cash flows and the life of the related financial assets:
  - o An entity should consider expected prepayments;

- o An entity should not consider expected extensions, renewals, and modifications unless the entity reasonably expects that it will execute a troubled debt restructuring with a borrower;
- An entity's estimate of expected credit losses should always reflect the risk of loss, even when that risk is remote. However, an entity would not be required to recognize a loss on a financial asset in which the risk of nonpayment is greater than zero yet the amount of loss would be zero;
- In addition to using a discounted cash flow model to estimate expected credit losses, an entity would not be prohibited from developing an estimate of credit losses using loss-rate methods, probability-of-default methods or a provision matrix using loss factors;
- The final guidance on expected credit losses will include implementation guidance describing the factors that an entity should consider to adjust historical loss experience for current conditions and reasonable and supportable forecast.

FASB expects to issue this proposed accounting standard update in late 2015. An effective date has yet to be discussed. Upon adoption, the change in this accounting guidance could result in an increase in the Company's allowance for loan losses and require the Company to record loan losses more rapidly. Upon final issuance of the standard, the Company will be able to better evaluate the potential impact of this new standard on its consolidated financial statements.

In August 2014, the FASB issued an accounting standard update (ASU 2014-14) related to; Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure. The update requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) The loan has a government guarantee that is not separable from the loan before foreclosure; (2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; (3) At the time of foreclosure, any amount of the claim that is

Table Of Contents

determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in the update are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The Company adopted this accounting standard during the first quarter of 2015 and it did not have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period, an amendment to the stock compensation accounting guidance to clarify that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. This amendment is effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. Entities may apply the amendments in this update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. The Company does not expect this amendment to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP: identify the contract(s) with a customer; identify the performance obligations in the contract; determine the transaction price; allocate the transaction price to the performance obligations in the contract; recognize revenue when (or as) the entity satisfies a performance obligation. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements and has not yet determined the method by which it will adopt the standard effective in the first quarter of 2017.

In January 2014, the FASB issued ASU 2014-04 related to; Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The update applies to all creditors who obtain physical possession of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The amendments in this update clarify when an in-substance repossession or foreclosure occurs and requires disclosure of both (1) the amount of foreclosed residential real estate property held by a creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in the update are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The Company adopted this accounting standard during the first quarter of 2015 and it did not have a material impact on its consolidated financial statements.

3. Accumulated other comprehensive income

The following tables illustrate the changes in accumulated other comprehensive income by component and the details about the components of accumulated other comprehensive income as of and for the periods indicated:

As of and for the three months ended March 31, 2015

(dollars in thousands)	Unrealized gains on available-for-sale securities	Total
Beginning balance	$ 2,743	$ 2,743
Other comprehensive income before reclassifications, net of tax	155	155
Amounts reclassified from accumulated other comprehensive income, net of tax	(1)	(1)
Net current-period other comprehensive income	154	154
Ending balance	$ 2,897	$ 2,897

10

Table Of Contents

As of and for the three months ended March 31, 2014

(dollars in thousands)	Unrealized gains on available-for-sale securities	Total
Beginning balance	$ 1,239	$ 1,239
Other comprehensive income before reclassifications, net of tax	671	671
Amounts reclassified from accumulated other comprehensive income, net of tax	(137)	(137)
Net current-period other comprehensive income	534	534
Ending balance	$ 1,773	$ 1,773

Details about accumulated other comprehensive income components (dollars in thousands)	For the three months ended March 31, 2015	2014	Affected line item in the statement where net income is presented
Unrealized gains on AFS securities	$ 2	$ 207	Gain on sale of investment securities
	(1)	(70)	Provision for income taxes
Total reclassifications for the period	$ 1	$ 137	Net income

4. Investment securities

Agency – Government-sponsored enterprise (GSE) and MBS - GSE residential

Agency – GSE and MBS – GSE residential securities consist of short- to long-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB) and Government National Mortgage Association (GNMA). These securities have interest rates that are fixed and adjustable, have varying short- to long-term maturity dates and have contractual cash flows guaranteed by the U.S. government or agencies of the U.S. government.

Obligations of states and political subdivisions

The municipal securities are bank qualified or bank eligible, general obligation and revenue bonds rated as investment grade by various credit rating agencies and have fixed rates of interest with mid- to long-term maturities. Fair values of these securities are highly driven by interest rates. Management performs ongoing credit quality reviews on these issues.

The amortized cost and fair value of investment securities at March 31, 2015 and December 31, 2014 are summarized as follows:

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
March 31, 2015				
Held-to-maturity securities:				
MBS - GSE residential	$ -	$ -	$ -	$ -
Available-for-sale securities:				
Agency - GSE	$ 18,514	$ 133	$ 10	$ 18,637
Obligations of states and political subdivisions	35,867	2,539	43	38,363
MBS - GSE residential	67,416	1,582	81	68,917
Total debt securities	121,797	4,254	134	125,917
Equity securities - financial services	294	270	-	564
Total available-for-sale securities	$ 122,091	$ 4,524	$ 134	$ 126,481

Table Of Contents

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2014				
Held-to-maturity securities:				
MBS - GSE residential	$ -	$ -	$ -	$ -
Available-for-sale securities:				
Agency - GSE	$ 14,380	$ 29	$ 11	$ 14,398
Obligations of states and political subdivisions	34,609	2,444	20	37,033
MBS - GSE residential	44,455	1,438	23	45,870
Total debt securities	93,444	3,911	54	97,301
Equity securities - financial services	295	300	-	595
Total available-for-sale securities	$ 93,739	$ 4,211	$ 54	$ 97,896

The amortized cost and fair value of debt securities at March 31, 2015 by contractual maturity are summarized below:

(dollars in thousands)	Amortized cost	Fair value
Held-to-maturity securities:		
MBS - GSE residential	$ -	$ -
Available-for-sale securities:		
Debt securities:		
Due in one year or less	$ 201	$ 203
Due after one year through five years	17,446	17,564
Due after five years through ten years	3,216	3,446
Due after ten years	33,518	35,787
Total debt securities	54,381	57,000
MBS - GSE residential	67,416	68,917
Total available-for-sale debt securities	$ 121,797	$ 125,917

Actual maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without call or prepayment penalty. Agency – GSE and municipal securities are included based on their original stated maturity. MBS – GSE residential, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total. Most of the securities have fixed rates or have predetermined scheduled rate changes, and many have call features that allow the issuer to call the security at par before its stated maturity, without penalty.

Table Of Contents

The following table presents the fair value and gross unrealized losses of investment securities aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of March 31, 2015 and December 31, 2014:

	Less than 12 months		More than 12 months		Total	
(dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
March 31, 2015						
Agency - GSE	$ 2,040	$ 10	$ -	$ -	$ 2,040	$ 10
Obligations of states and political subdivisions	3,519	43	-	-	3,519	43
MBS - GSE residential	19,776	81	-	-	19,776	81
Total	$ 25,335	$ 134	$ -	$ -	$ 25,335	$ 134
Number of securities	17		-		17	
December 31, 2014						
Agency - GSE	$ 4,100	$ 11	$ 1,024	$ -	$ 5,124	$ 11
Obligations of states and political subdivisions	1,767	11	670	9	2,437	20
MBS - GSE residential	3,761	23	-	-	3,761	23
Total	$ 9,628	$ 45	$ 1,694	$ 9	$ 11,322	$ 54
Number of securities	9		3		12	

Management believes the cause of the unrealized losses is related to changes in interest rates, instability in the capital markets or the limited trading activity due to illiquid conditions in the debt market and is not directly related to credit quality. Quarterly, management conducts a formal review of investment securities for the presence of other-than-temporary impairment (OTTI). The accounting guidance related to OTTI requires the Company to assess whether OTTI is present when the fair value of a debt security is less than its amortized cost as of the balance sheet date. Under those circumstances, OTTI is considered to have occurred if: (1) the entity has intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost.   The accounting guidance requires that credit-related OTTI be recognized in earnings while non-credit-related OTTI on securities not expected to be sold be recognized in other comprehensive income (loss) (OCI). Non-credit-related OTTI is based on other factors affecting market value, including illiquidity.

The Company's OTTI evaluation process also follows the guidance set forth in topics related to debt and equity securities. The guidance set forth in the pronouncements require the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value which may be to maturity and other factors when evaluating for the existence of OTTI. The guidance requires that credit-related OTTI be recognized as a realized loss through earnings when there has been an adverse change in the holder's expected cash flows such that the full amount (principal and interest) will probably not be received. This requirement is consistent with the impairment model in the guidance for accounting for debt and equity securities.

For all security types, as of March 31, 2015, the Company applied the criteria provided in the recognition and presentation guidance related to OTTI. That is, management has no intent to sell the securities and no conditions were identified by management that more likely than not would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI in the Company's security portfolio. In addition, management believes the change in fair value is attributable to changes in interest rates.

Table Of Contents

5. Loans and leases

The classifications of loans and leases at March 31, 2015 and December 31, 2014 are summarized as follows:

(dollars in thousands)	March 31, 2015	December 31, 2014
Commercial and industrial	$ 80,819	$ 80,301
Commercial real estate:		
Non-owner occupied	92,417	94,771
Owner occupied	97,132	95,780
Construction	6,572	5,911
Consumer:		
Home equity installment	32,649	32,819
Home equity line of credit	42,900	42,188
Auto loans and leases	28,051	27,972
Other	6,078	6,501
Residential:		
Real estate	124,804	119,154
Construction	8,478	10,298
Total	519,900	515,695
Less:		
Allowance for loan losses	(9,208)	(9,173)
Unearned lease revenue	(204)	(195)
Loans and leases, net	$ 510,488	$ 506,327

Net deferred loan costs of $1.4 million have been added to the carrying values of loans at March 31, 2015 and December 31, 2014, respectively.

Unearned lease revenue represents the difference between the lessor's investment in the property and the gross investment in the lease. Unearned revenue accretes over the life of the lease using the effective income method.

The Company services real estate loans for investors in the secondary mortgage market which are not included in the accompanying consolidated balance sheets. The approximate amount of mortgages serviced amounted to $256.2 million as of March 31, 2015 and $256.8 million as of December 31, 2014. Mortgage servicing rights amounted to $1.0 million as of both March 31, 2015 and December 31, 2014, respectively.

Management is responsible for conducting the Company's credit risk evaluation process, which includes credit risk grading of individual commercial and industrial and commercial real estate loans. Commercial and industrial and commercial real estate loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed as the case may be. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The Company utilizes an external independent loan review firm that reviews and validates the credit risk program on at least an annual basis. Results of these reviews are presented to management and the board of directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Non-accrual loans

The decision to place loans on non-accrual status is made on an individual basis after considering factors pertaining to each specific loan. Commercial and industrial and commercial real estate loans are placed on non-accrual status when management has determined that payment of all contractual principal and interest is in doubt or the loan is past due 90 days or more as to principal and interest, unless well-secured and in the process of collection. Consumer loans secured by real estate and residential mortgage loans are placed on non-accrual status at 120 days past due as to principal and interest and unsecured consumer loans are charged off when the loan is 90 days or more past due as to principal and interest. The Company considers all non-accrual loans to be impaired loans.

Table Of Contents

Non-accrual loans, segregated by class, at March 31, 2015 and December 31, 2014, were as follows:

(dollars in thousands)	March 31, 2015	December 31, 2014
Commercial and industrial	$ 19	$ 27
Commercial real estate:		
Non-owner occupied	520	620
Owner occupied	1,724	2,013
Construction	251	256
Consumer:		
Home equity installment	231	312
Home equity line of credit	483	417
Auto loans and leases	1	1
Other	20	20
Residential:		
Real estate	567	549
Total	$ 3,816	$ 4,215

Troubled Debt Restructuring

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company considers all TDRs to be impaired loans. The Company offers various types of concessions when modifying a loan, however, forgiveness of principal is rarely granted. Commercial and industrial (C&I) loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial real estate (CRE) loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Commercial real estate construction loans modified in a TDR may also involve extending the interest-only payment period. Residential mortgage loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers' financial needs for an extended period of time. After the lowered monthly payment period ends, the borrower would revert back to paying principal and interest pursuant to the original terms with the maturity date adjusted accordingly. Consumer loan modifications are typically not granted and therefore standard modification terms do not exist for loans of this type.

Loans modified in a TDR may or may not be placed on non-accrual status. As of March 31, 2015, total TDRs amounted to $3.2 million (consisting of 5 CRE loans and 3 C&I loans to 5 unrelated borrowers), of which one with a balance of $0.9 million was on non-accrual status, compared to $1.6 million (consisting of 4 CRE loans and 1 C&I loan to 3 unrelated borrowers) and $0.9 million, respectively, as of December 31, 2014. Of the TDRs outstanding as of March 31, 2015 and December 31, 2014, when modified, the concessions granted consisted of temporary interest-only payments or a reduction in the rate of interest to a below-market rate for a contractual period of time. Other than the TDR that was on non-accrual status, the TDRs were performing in accordance with their modified terms.

The following presents by class, information related to loans modified in a TDR:

(dollars in thousands)	Loans modified as TDRs for the: Three months ended March 31, 2015		
	Number of contracts	Recorded investment (as of period end)	Increase in allowance (as of period end)
Commercial and industrial	2	$ 749	$ 251
Commercial real estate - owner occupied	1	858	331
Total	3	$ 1,607	$ 582

In the above table, the period end balances are inclusive of all partial pay downs and charge-offs since the modification date.

Loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. There were no loans modified as a TDR within the previous twelve months that subsequently defaulted during the three months ended March 31, 2015.

The allowance for loan losses (allowance) may be increased, adjustments may be made in the allocation of the allowance or partial charge offs may be taken to further write-down the carrying value of the loan. An allowance for impaired loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate

Table Of Contents

or the loan's observable market price. If the loan is collateral dependent, the estimated fair value of the collateral, less any selling costs, is used to establish the allowance.

Past due loans

Loans are considered past due when the contractual principal and/or interest is not received by the due date. An aging analysis of past due loans, segregated by class of loans, as of the period indicated is as follows (dollars in thousands):

March 31, 2015	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more (1)	Total past due	Current	Total loans (3)		Recorded investment past due ≥ 90 days and accruing
Commercial and industrial	$ 158	$ 17	$ 19	$ 194	$ 80,625	$ 80,819		$ -
Commercial real estate:								
Non-owner occupied	528	-	866	1,394	91,023	92,417		346
Owner occupied	79	363	1,724	2,166	94,966	97,132		-
Construction	-	-	251	251	6,321	6,572		-
Consumer:								
Home equity installment	301	33	231	565	32,084	32,649		-
Home equity line of credit	28	-	483	511	42,389	42,900		-
Auto loans and leases	321	2	31	354	27,493	27,847	(2)	30
Other	1	9	20	30	6,048	6,078		-
Residential:								
Real estate	295	-	696	991	123,813	124,804		129
Construction	-	-	-	-	8,478	8,478		-
Total	$ 1,711	$ 424	$ 4,321	$ 6,456	$ 513,240	$ 519,696		$ 505

(1) Includes $3.8 million of non-accrual loans. (2) Net of unearned revenue of $0.2 million. (3) Includes net deferred loan costs of $1.4 million.

December 31, 2014	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more (1)	Total past due	Current	Total loans (3)	Recorded investment past due ≥ 90 days and accruing
Commercial and industrial	$ 34	$ 76	$ 55	$ 165	$ 80,136	$ 80,301	$ 28

Commercial real estate:								
Non-owner occupied	624	126	719	1,469	93,302	94,771		99
Owner occupied	366	292	2,113	2,771	93,009	95,780		100
Construction	-	-	256	256	5,655	5,911		-
Consumer:								
Home equity installment	170	142	767	1,079	31,740	32,819		455
Home equity line of credit	13	-	417	430	41,758	42,188		-
Auto loans and leases	545	111	16	672	27,105	27,777	(2)	15
Other	38	147	40	225	6,276	6,501		20
Residential:								
Real estate	700	548	892	2,140	117,014	119,154		343
Construction	-	-	-	-	10,298	10,298		-
Total	$ 2,490	$ 1,442	$ 5,275	$ 9,207	$ 506,293	$ 515,500		$ 1,060

(1) Includes $4.2 million of non-accrual loans. (2) Net of unearned revenue of $0.2 million. (3) Includes net deferred loan costs of $1.4 million.

Impaired loans

A loan is considered impaired when, based on current information and events; it is probable that the Company will be unable to collect the scheduled payments in accordance with the contractual terms of the loan. Factors considered in determining impairment include payment status, collateral value and the probability of collecting payments when due. The significance of payment delays and/or shortfalls is determined on a case-by-case basis. All circumstances surrounding the loan are taken into account. Such factors include the length of the delinquency, the underlying reasons and the borrower's prior payment record. Impairment is measured on these loans on a loan-by-loan basis. Impaired loans include non-accrual loans, TDRs and other loans deemed to be impaired based on the aforementioned factors.

At March 31, 2015, impaired loans consisted of accruing TDRs totaling $2.3 million, $3.8 million of non-accrual loans and a $1.2 million accruing loan. At December 31, 2014, impaired loans consisted of accruing TDRs totaling $0.7 million, $4.2 million of non-accrual loans and a $1.2 million accruing loan. As of March 31, 2015 and December 31, 2014, the non-accrual loans included non-

Table Of Contents

accruing TDRs of $0.9 million for both periods, respectively. Payments received from non-accruing impaired loans are first applied against the outstanding principal balance, then to the recovery of any charged-off amounts. Any excess is treated as a recovery of interest income. Payments received from accruing impaired loans are applied to principal and interest, as contractually agreed upon.

Impaired loans, segregated by class, as of the period indicated are detailed below:

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance	Average recorded investment	Interest income recognized	Cash basis interest income recognized
March 31, 2015								
Commercial and industrial	$ 1,081	$ 500	$ 293	$ 793	$ 331	$ 206	$ 6	$ -
Commercial real estate:								
Non-owner occupied	2,354	1,754	443	2,197	454	1,596	14	-
Owner occupied	2,869	1,092	1,749	2,841	302	2,174	13	-
Construction	352	-	251	251	-	265	-	-
Consumer:								
Home equity installment	332	15	216	231	3	326	-	-
Home equity line of credit	534	180	303	483	19	428	1	-
Auto loans and leases	1	-	1	1	-	1	-	-
Other	20	7	13	20	2	22	-	-
Residential:								
Real estate	558	301	266	567	32	605	-	-
Construction	-	-	-	-	-	-	-	-
Total	$ 8,101	$ 3,849	$ 3,535	$ 7,384	$ 1,143	$ 5,623	$ 34	$ -

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance	Average recorded investment	Interest income recognized	Cash basis interest income recognized
December 31, 2014								
Commercial and industrial	$ 326	$ -	$ 52	$ 52	$ -	$ 67	$ 1	$ -
Commercial real estate:								

Non-owner occupied	2,494	1,949	355	2,304	547	1,557	27	-
Owner occupied	2,375	447	1,825	2,272	87	1,996	15	-
Construction	350	-	256	256	-	342	-	-
Consumer:								
Home equity installment	466	-	312	312	-	358	11	-
Home equity line of credit	469	128	289	417	1	382	20	-
Auto	1	-	1	1	-	2	-	-
Other	33	-	20	20	-	22	-	-
Residential:								
Real estate	612	304	245	549	35	762	7	-
Construction	-	-	-	-	-	-	-	-
Total	$ 7,126	$ 2,828	$ 3,355	$ 6,183	$ 670	$ 5,488	$ 81	$ -

Credit Quality Indicators

Commercial and industrial and commercial real estate

The Company utilizes a loan grading system and assigns a credit risk grade to its loans in the commercial and industrial and commercial real estate portfolios. The grading system provides a means to measure portfolio quality and aids in the monitoring of the credit quality of the overall loan portfolio. The credit risk grades are arrived at using a risk rating matrix to assign a grade to each of the loans in the commercial and industrial and commercial real estate portfolios.

The following is a description of each risk rating category the Company uses to classify each of its commercial and industrial and commercial real estate loans:

Pass

Loans in this category have an acceptable level of risk and are graded in a range of one to five. Secured loans generally have good

Table Of Contents

collateral coverage. Current financial statements reflect acceptable balance sheet ratios, sales and earnings trends. Management is considered to be competent, and a reasonable succession plan is evident. Payment experience on the loans has been good with minor or no delinquency experience. Loans with a grade of one are of the highest quality in the range. Those graded five are of marginally acceptable quality.

Special Mention

Loans in this category are graded a six and may be protected but are potentially weak. They constitute a credit risk to the Company, but have not yet reached the point of adverse classification. Some of the following conditions may exist: little or no collateral coverage; lack of current financial information; delinquency problems; highly leveraged; available financial information reflects poor balance sheet ratios and profit and loss statements reflect uncertain trends; and document exceptions. Cash flow may not be sufficient to support total debt service requirements.

Substandard

Loans in this category are graded a seven and have a well-defined weakness which may jeopardize the ultimate collectability of the debt. The collateral pledged may be lacking in quality or quantity. Financial statements may indicate insufficient cash flow to service the debt; and/or do not reflect a sound net worth. The payment history indicates chronic delinquency problems. Management is considered to be weak. There is a distinct possibility that the Company may sustain a loss. All loans on non-accrual are rated substandard. Other loans that are included in the substandard category can be accruing, as well as loans that are current or past due. Loans 90 days or more past due, unless otherwise fully supported, are classified substandard. Also, borrowers that are bankrupt or have loans categorized as troubled debt restructures can be graded substandard.

Doubtful

Loans in this category are graded an eight and have a better than 50% possibility of the Company sustaining a loss, but the loss cannot be determined because of specific reasonable factors which may strengthen credit in the near-term. Many of the weaknesses present in a substandard loan exist. Liquidation of collateral, if any, is likely. Any loan graded lower than an eight is considered to be uncollectible and charged-off.

Consumer and residential

The consumer and residential loan segments are regarded as homogeneous loan pools and as such are not risk rated. For these portfolios, the Company utilizes payment activity, history and recency of payment in assessing performance. Non-performing loans are considered to be loans past due 90 days or more and accruing and non-accrual loans. All loans not classified as non-performing are considered performing.

The following table presents loans including $1.4 million of deferred costs in both periods, segregated by class, categorized into the appropriate credit quality indicator category as of the period indicated:

Commercial credit exposure

Credit risk profile by creditworthiness category

(dollars in thousands)	Commercial and industrial		Commercial real estate - non-owner occupied		Commercial real estate - owner occupied		Commercial real estate - construction	
	3/31/2015	12/31/2014	3/31/2015	12/31/2014	3/31/2015	12/31/2014	3/31/2015	12/31/2014
Pass	$ 77,319	$ 76,902	$ 80,991	$ 83,387	$ 89,582	$ 88,256	$ 5,521	$ 5,073
Special mention	2,200	2,202	3,046	3,611	3,257	2,933	715	502
Substandard	1,300	1,197	8,380	7,773	4,293	4,591	336	336
Doubtful	-	-	-	-	-	-	-	-
Total	$ 80,819	$ 80,301	$ 92,417	$ 94,771	$ 97,132	$ 95,780	$ 6,572	$ 5,911

Consumer credit exposure

Credit risk profile based on payment activity

(dollars in thousands)	Home equity installment		Home equity line of credit		Auto loans and leases		Other	
	3/31/2015	12/31/2014	3/31/2015	12/31/2014	3/31/2015	12/31/2014	3/31/2015	12/31/2014
Performing	$ 32,418	$ 32,052	$ 42,417	$ 41,771	$ 27,816	$ 27,761	$ 6,058	$ 6,461
Non-performing	231	767	483	417	31	16	20	40
Total	$ 32,649	$ 32,819	$ 42,900	$ 42,188	$ 27,847 (1)	$ 27,777 (1)	$ 6,078	$ 6,501

(1)Net of unearned revenue of $0.2 million.

Table Of Contents

Mortgage lending credit exposure

Credit risk profile based on payment activity

(dollars in thousands)	Residential real estate 3/31/2015	Residential real estate 12/31/2014	Residential construction 3/31/2015	Residential construction 12/31/2014
Performing	$ 124,108	$ 118,262	$ 8,478	$ 10,298
Non-performing	696	892	-	-
Total	$ 124,804	$ 119,154	$ 8,478	$ 10,298

Allowance for loan losses

Management continually evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance for loan losses (the allowance) on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. Management's judgment is based on the evaluation of individual loans, past experience, the assessment of current economic conditions and other relevant factors including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

Management applies two primary components during the loan review process to determine proper allowance levels. The two components are a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated. The methodology to analyze the adequacy of the allowance for loan losses is as follows:

§ identification of specific impaired loans by loan category;
§ identification of specific loans that are not impaired, but have an identified potential for loss;
§ calculation of specific allowances where required for the impaired loans based on collateral and other objective and quantifiable evidence;
§ determination of loans with similar credit characteristics within each class of the loan portfolio segment and eliminating the impaired loans;
§ application of historical loss percentages to pools to determine the allowance allocation;
§ application of qualitative factor adjustment percentages to historical losses for trends or changes in the loan portfolio.
§ Qualitative factor adjustments include:
o levels of and trends in delinquencies and non-accrual loans;
o levels of and trends in charge-offs and recoveries;
o trends in volume and terms of loans;
o changes in risk selection and underwriting standards;
o changes in lending policies, procedures and practices;
o experience, ability and depth of lending management;
o national and local economic trends and conditions; and

o changes in credit concentrations.

Allocation of the allowance for different categories of loans is based on the methodology as explained above. A key element of the methodology to determine the allowance is the Company's credit risk evaluation process, which includes credit risk grading of individual commercial and industrial and commercial real estate loans. Commercial and industrial and commercial real estate loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed as the case may be. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The credit risk grades for the commercial and industrial and commercial real estate loan portfolios are taken into account in the reserve methodology and loss factors are applied based upon the credit risk grades. The loss factors applied are based upon the Company's historical experience and environmental factors. Historical experience reveals there is a direct correlation between the credit risk grades and loan charge-offs. The changes in allocations in the commercial and industrial and commercial real estate loan portfolio from period to period are based upon the credit risk grading system and from periodic reviews of the loan portfolio.

Each quarter, management performs an assessment of the allowance for loan losses. The Company's Special Assets Committee meets monthly and the applicable lenders discuss each relationship under review and reach a consensus on the appropriate estimated loss amount, if applicable, based on current accounting guidance. The Special Assets Committee's focus is on ensuring the pertinent facts are considered regarding not only loans considered for specific reserves, but also the collectability of loans that may be past due in payment. The assessment process also includes the review of all loans on a non-accruing basis as well as a review of certain loans to which the lenders or the Company's Credit Administration function have assigned a criticized or classified risk rating.

Table Of Contents

The Company’s policy is to charge off unsecured consumer loans when they become 90 days or more past due as to principal and interest. In the other portfolio segments, amounts are charged off at the point in time when the Company deems the balance, or a portion thereof, to be uncollectible.

Information related to the change in the allowance for loan losses and the Company’s recorded investment in loans by portfolio segment as of the period indicated is as follows:

As of and for the three months ended March 31, 2015

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	$ 1,052	$ 4,672	$ 1,519	$ 1,316	$ 614	$ 9,173
Charge-offs	24	67	92	-	-	183
Recoveries	9	7	24	28	-	68
Provision	177	(97)	62	(1)	9	150
Ending balance	$ 1,214	$ 4,515	$ 1,513	$ 1,343	$ 623	$ 9,208
Ending balance: individually evaluated for impairment	$ 331	$ 756	$ 24	$ 32	$ -	$ 1,143
Ending balance: collectively evaluated for impairment	$ 883	$ 3,759	$ 1,489	$ 1,311	$ 623	$ 8,065
Loans Receivables:						
Ending balance (2)	$ 80,819	$ 196,121	$ 109,474 (1)	$ 133,282	$ -	$ 519,696
Ending balance: individually evaluated for impairment	$ 793	$ 5,289	$ 735	$ 567	$ -	$ 7,384
Ending balance: collectively evaluated for impairment	$ 80,026	$ 190,832	$ 108,739	$ 132,715	$ -	$ 512,312

(1) Net of unearned revenue of $0.2 million. (2) Includes $1.4 million of net deferred loan costs.

As of and for the year ended December 31, 2014

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	$ 944	$ 4,253	$ 1,482	$ 1,613	$ 636	$ 8,928
Charge-offs	309	239	361	93	-	1,002
Recoveries	32	91	30	34	-	187
Provision	385	567	368	(238)	(22)	1,060
Ending balance	$ 1,052	$ 4,672	$ 1,519	$ 1,316	$ 614	$ 9,173

Ending balance: individually evaluated for impairment	$ -	$ 634	$ 1	$ 35	$ -	$ 670
Ending balance: collectively evaluated for impairment	$ 1,052	$ 4,038	$ 1,518	$ 1,281	$ 614	$ 8,503
Loans Receivables:						
Ending balance (2)	$ 80,301	$ 196,462	$ 109,285 (1)	$ 129,452	$ -	$ 515,500
Ending balance: individually evaluated for impairment	$ 52	$ 4,832	$ 750	$ 549	$ -	$ 6,183
Ending balance: collectively evaluated for impairment	$ 80,249	$ 191,630	$ 108,535	$ 128,903	$ -	$ 509,317

(1) Net of unearned revenue of $0.2 million. (2) Includes $1.4 million of net deferred loan costs.

Information related to the change in the allowance for loan losses as of and for the three months ended March 31, 2014 is as follows:

As of and for the three months ended March 31, 2014

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	$ 944	$ 4,253	$ 1,482	$ 1,613	$ 636	$ 8,928
Charge-offs	28	152	118	59	-	357
Recoveries	11	1	16	-	-	28
Provision	35	215	137	(30)	(57)	300
Ending balance	$ 962	$ 4,317	$ 1,517	$ 1,524	$ 579	$ 8,899

20

Table Of Contents

6. Earnings per share

Basic earnings per share (EPS) is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed in the same manner as basic EPS but also reflects the potential dilution that could occur from the grant of stock-based compensation awards. The Company maintains two active share-based compensation plans that may generate additional potentially dilutive common shares. For granted and unexercised stock options, dilution would occur if Company-issued stock options were exercised and converted into common stock. As of the three months ended March 31, 2015 and 2014, there were 2,545 and 15 potentially dilutive shares related to issued and unexercised stock options. For restricted stock, dilution would occur from the Company's previously granted but unvested shares. There were 3,887 and 3,283 potentially dilutive shares related to unvested restricted share grants as of the three months ended March 31, 2015 and 2014, respectively.

In the computation of diluted EPS, the Company uses the treasury stock method to determine the dilutive effect of its granted but unexercised stock options and unvested restricted stock. Under the treasury stock method, the assumed proceeds, as defined, received from shares issued in a hypothetical stock option exercise or restricted stock grant, are assumed to be used to purchase treasury stock. Proceeds include: amounts received from the exercise of outstanding stock options; compensation cost for future service that the Company has not yet recognized in earnings; and any windfall tax benefits that would be credited directly to shareholders' equity when the grant generates a tax deduction (or a reduction in proceeds if there is a charge to equity). The Company does not consider awards from share-based grants in the computation of basic EPS.

The following table illustrates the data used in computing basic and diluted EPS for the periods indicated:

	Three months ended March 31,	
	2015	2014
(dollars in thousands except per share data)		
Basic EPS:		
Net income available to common shareholders	$ 1,573	$ 1,456
Weighted-average common shares outstanding	2,435,884	2,398,731
Basic EPS	$ 0.65	$ 0.61
Diluted EPS:		
Net income available to common shareholders	$ 1,573	$ 1,456
Weighted-average common shares outstanding	2,435,884	2,398,731
Potentially dilutive common shares	6,432	3,298
Weighted-average common and potentially dilutive shares outstanding	2,442,316	2,402,029
Diluted EPS	$ 0.64	$ 0.61

7. Stock plans

The Company has two stock-based compensation plans (the stock compensation plans) from which it can grant stock-based compensation awards, and applies the fair value method of accounting for stock-based compensation provided under current accounting guidance. The guidelines require the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. The Company's stock compensation plans were shareholder-approved and permit the grant of share-based compensation awards to its employees and directors. The Company believes that the stock-based compensation plans will advance the development, growth and financial condition of the Company by providing incentives through participation in the appreciation in the value of the Company's common stock. In return, the Company hopes to secure, retain and motivate the employees and directors who are responsible for the operation and the management of the affairs of the Company by aligning the interest of its employees and directors with the interest of its shareholders. In the stock compensation plans, employees and directors are eligible to be awarded stock-based compensation grants which can consist of stock options (qualified and non-qualified), stock appreciation rights (SARs) and restricted stock.

At the 2012 annual shareholders' meeting, the Company's shareholders approved and the Company adopted the 2012 Omnibus Stock Incentive Plan and the 2012 Director Stock Incentive Plan (collectively, the 2012 stock incentive plans). The 2012 stock incentive plans replaced both the expired 2000 Independent Directors Stock Option Plan and the 2000 Stock Incentive Plan (collectively, the 2000 stock incentive plans). Unless terminated by the Company's board of directors, the 2012 stock incentive plans will expire on, and no stock-based awards shall be granted after the year 2022.

In each of the 2012 stock incentive plans, the Company has reserved 500,000 shares of its no-par common stock for future issuance. The Company recognizes share-based compensation expense over the requisite service or vesting period.

Table Of Contents

The following table summarizes the weighted-average fair value and vesting of restricted stock grants awarded during the three months ended March 31, 2015 and 2014 under the 2012 stock incentive plans:

	2015			2014		
	Shares granted	Weighted-average grant date fair value	Vesting period	Shares granted	Weighted-average grant date fair value	Vesting period
Director plan	3,200	$ 32.25	1 year	2,000	$ 27.00	1 year
Omnibus plan	3,300	32.25	4 yrs - 25% per year	2,120	27.00	4 yrs - 25% per year
Omnibus plan	50	32.50	1 year	-	-	
Total	6,550	$ 32.25		4,120	$ 27.00	

A summary of the status of the Company's restricted stock grants as of and changes during the periods indicated are presented in the following table:

	2012 Stock incentive plans		
	Director	Omnibus	Total
Balance at December 31, 2014	6,000	5,870	11,870
Granted	3,200	3,350	6,550
Vested	(6,000)	(1,780)	(7,780)
Balance at March 31, 2015	3,200	7,440	10,640

For restricted stock, intrinsic value represents the closing price of the underlying stock at the end of the period. As of March 31, 2015, the intrinsic value of the Company's restricted stock under the Director and Omnibus plans was $36.00 per share.

Share-based compensation expense is included as a component of salaries and employee benefits in the consolidated statements of income. The following tables illustrate stock-based compensation expense recognized during the three months ended March 31, 2015 and 2014 and the unrecognized stock-based compensation expense as of March 31, 2015:

Three
months

	ended March 31,	
(dollars in thousands)	2015	2014
Stock-based compensation expense:		
Director plan	$ 28	$ 30
Omnibus plan	15	9
Total stock-based compensation expense	$ 43	$ 39

	As of March 31,
(dollars in thousands)	2015
Unrecognized stock-based compensation expense:	
Director plan	$ 86
Omnibus plan	192
Total unrecognized stock-based compensation expense	$ 278

The unrecognized stock-based compensation expense as of March 31, 2015 will be recognized ratably over the periods ended January 2016 and January 2019 for the Director Plan and the Omnibus Plan, respectively.

In addition to the 2012 stock incentive plans, the Company established the 2002 Employee Stock Purchase Plan (the ESPP) and reserved 110,000 shares of its un-issued capital stock for issuance under the plan. The ESPP was designed to promote broad-based employee ownership of the Company's stock and to motivate employees to improve job performance and enhance the financial results of the Company. Under the ESPP, participation is voluntary whereby employees use automatic payroll withholdings to purchase the Company's capital stock at a discounted price based on the fair market value of the capital stock as measured on either the commencement or termination dates, as defined. As of March 31, 2015, 38,687 shares have been issued under the ESPP. The ESPP is considered a compensatory plan and is required to comply with the provisions of current accounting guidance. The Company recognizes compensation expense on its ESPP on the date the shares are purchased. For the three months ended March 31, 2015 and 2014, compensation expense related to the ESPP approximated $44 thousand and $33 thousand, respectively, and is included as a component of salaries and employee benefits in the consolidated statements of income.

Table Of Contents

8. Fair value measurements

The accounting guidelines establish a framework for measuring and disclosing information about fair value measurements. The guidelines of fair value reporting instituted a valuation hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 - inputs are quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 - inputs are unobservable and are based on the Company's own assumptions to measure assets and liabilities at fair value. Level 3 pricing for securities may also include unobservable inputs based upon broker-traded transactions.

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company uses fair value to measure certain assets and, if necessary, liabilities on a recurring basis when fair value is the primary measure for accounting. Thus, the Company uses fair value for AFS securities. Fair value is used on a non-recurring basis to measure certain assets when adjusting carrying values to market values, such as impaired loans, other real estate owned (ORE) and other repossessed assets.

The following table represents the carrying amount and estimated fair value of the Company's financial instruments as of the periods indicated:

March 31, 2015

(dollars in thousands)	Carrying amount	Estimated fair value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Financial assets:					
Cash and cash equivalents	$ 18,983	$ 18,983	$ 18,983	$ -	$ -
Available-for-sale securities	126,481	126,481	564	125,917	-
Loans and leases, net	510,488	510,676	-	-	510,676
Loans held-for-sale	1,159	1,181	-	1,181	-
Financial liabilities:					
Deposit liabilities	601,742	601,604	-	601,604	-
Short-term borrowings	13,773	13,773	-	13,773	-
Long-term debt	10,000	10,676	-	10,676	-

December 31, 2014

(dollars in thousands)	Carrying amount	Estimated fair value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Financial assets:					
Cash and cash equivalents	$ 25,851	$ 25,851	$ 25,851	$ -	$ -
Available-for-sale securities	97,896	97,896	595	97,301	-
Loans and leases, net	506,327	505,387	-	-	505,387
Loans held-for-sale	1,161	1,186	-	1,186	-
Financial liabilities:					
Deposit liabilities	586,944	586,756	-	586,756	-
Short-term borrowings	3,969	3,969	-	3,969	-
Long-term debt	10,000	10,758	-	10,758	-

Table Of Contents

The carrying value of short-term financial instruments, as listed below, approximates their fair value. These instruments generally have limited credit exposure, no stated or short-term maturities, carry interest rates that approximate market and generally are recorded at amounts that are payable on demand :

- Cash and cash equivalents;
- Non-interest bearing deposit accounts;
- Savings, interest-bearing checking and money market accounts and
- Short-term borrowings.

Securities: Fair values on investment securities are determined by prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions.

Loans: The fair value of loans is estimated by the net present value of the future expected cash flows discounted at current offering rates for similar loans. Current offering rates consider, among other things, credit risk. The carrying value that fair value is compared to is net of the allowance for loan losses and since there is significant judgment included in evaluating credit quality, loans are classified within Level 3 of the fair value hierarchy.

Loans held-for-sale: The fair value of loans held-for-sale is estimated using rates currently offered for similar loans and is typically obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank of Pittsburgh (FHLB).

Certificates of deposit: The fair value of certificates of deposit is based on discounted cash flows using rates which approximate market rates for deposits of similar maturities.

Long-term debt: Fair value is estimated using the rates currently offered for similar borrowings.

The following tables illustrate the financial instruments measured at fair value on a recurring basis segregated by hierarchy fair value levels as of the periods indicated:

(dollars in thousands)	Total carrying value March 31, 2015	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	$ 18,637	$ -	$ 18,637	$ -
Obligations of states and political subdivisions	38,363	-	38,363	-
MBS - GSE residential	68,917	-	68,917	-
Equity securities - financial services	564	564	-	-
Total available-for-sale securities	$ 126,481	$ 564	$ 125,917	$ -

(dollars in thousands)	Total carrying value December 31, 2014	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	$ 14,398	$ -	$ 14,398	$ -
Obligations of states and political subdivisions	37,033	-	37,033	-
MBS - GSE residential	45,870	-	45,870	-
Equity securities - financial services	595	595	-	-
Total available-for-sale securities	$ 97,896	$ 595	$ 97,301	$ -

Equity securities in the AFS portfolio are measured at fair value using quoted market prices for identical assets and are classified within Level 1 of the valuation hierarchy. Debt securities in the AFS portfolio are measured at fair value using market quotations provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Assets classified as Level 2 use valuation techniques that are common to bond valuations. That is, in active markets whereby bonds of similar characteristics frequently trade, quotes for similar assets are obtained. For the three months ended March 31, 2015 and the year ended December 31, 2014, there were no transfers to or from Level 1 and Level 2 fair value measurements for financial assets

Table Of Contents

measured on a recurring basis.

There were no changes in Level 3 financial instruments measured at fair value on a recurring basis as of and for the periods ending March 31, 2015 and December 31, 2014.

The following table illustrates the financial instruments measured at fair value on a non-recurring basis segregated by hierarchy fair value levels as of the periods indicated:

(dollars in thousands)	Total carrying value at March 31, 2015	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Impaired loans	$ 2,706	$ -	$ -	$ 2,706
Other real estate owned	1,241	-	-	1,241
Other repossessed assets	22	-	-	22
Total	$ 3,969	$ -	$ -	$ 3,969

(dollars in thousands)	Total carrying value at December 31, 2014	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Impaired loans	$ 2,158	$ -	$ -	$ 2,158
Other real estate owned				