PENNS WOODS BANCORP INC
Form 10-Q
November 12, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

ý Quarterly Report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

for the Quarterly Period Ended September 30, 2013.

o Transition report pursuant to Section 13 or 15 (d) of the Exchange Act

For the Transition Period from to .

No. 0-17077
(Commission File Number)

PENNS WOODS BANCORP, INC.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| PENNSYLVANIA<br>(State or other jurisdiction of incorporation or organization) | 23-2226454<br>(I.R.S. Employer Identification No.) |
| 300 Market Street, P.O. Box 967 Williamsport, Pennsylvania<br>(Address of principal executive offices) | 17703-0967<br>(Zip Code) |

(570) 322-1111
Registrant's telephone number, including area code

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 ý NO o

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 ý NO o

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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o | Small reporting company o |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  YES o NO ý

On November 2, 2013 there were 4,819,054 shares of the Registrant's common stock outstanding.

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INDEX TO QUARTERLY REPORT ON FORM 10-Q

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements
PENNS WOODS BANCORP, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

| (In Thousands, Except Share Data) | September 30, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS: | | |
| Noninterest-bearing balances | $23,073 | $12,695 |
| Interest-bearing deposits in other financial institutions | 9,776 | 2,447 |
| Federal funds sold | 195 | — |
| Total cash and cash equivalents | 33,044 | 15,142 |
| Investment securities available for sale, at fair value | 285,383 | 289,316 |
| Loans held for sale | 1,588 | 3,774 |
| Loans | 806,163 | 512,232 |
| Allowance for loan losses | (9,630) | (7,617) |
| Loans, net | 796,533 | 504,615 |
| Premises and equipment, net | 18,352 | 8,348 |
| Accrued interest receivable | 4,639 | 4,099 |
| Bank-owned life insurance | 25,216 | 16,362 |
| Investment in limited partnerships | 2,387 | 2,883 |
| Goodwill | 17,104 | 3,032 |
| Intangibles | 1,892 | — |
| Deferred tax asset | 10,389 | 4,731 |
| Other assets | 7,563 | 4,233 |
| TOTAL ASSETS | $1,204,090 | $856,535 |
| | | |
| LIABILITIES: | | |
| Interest-bearing deposits | $760,147 | $527,073 |
| Noninterest-bearing deposits | 215,374 | 114,953 |
| Total deposits | 975,521 | 642,026 |
| Short-term borrowings | 15,060 | 33,204 |
| Long-term borrowings, Federal Home Loan Bank (FHLB) | 70,750 | 76,278 |
| Accrued interest payable | 435 | 366 |
| Other liabilities | 16,472 | 10,935 |
| TOTAL LIABILITIES | 1,078,238 | 762,809 |
| | | |
| SHAREHOLDERS’ EQUITY: | | |
| Preferred stock, no par value, 3,000,000 shares authorized; no shares issued | — | — |
| Common stock, par value $8.33, 15,000,000 shares authorized; 4,999,483 and 4,019,112 shares issued | 41,662 | 33,492 |
| Additional paid-in capital | 49,782 | 18,157 |
| Retained earnings | 46,324 | 43,030 |
| Accumulated other comprehensive (loss) income: | | |
| Net unrealized (loss) gain on available for sale securities | (799) | 10,164 |
| Defined benefit plan | (4,807) | (4,807) |
| Treasury stock at cost, 180,596 shares | (6,310) | (6,310) |

| | | |
|---|---|---|
| TOTAL SHAREHOLDERS’ EQUITY | 125,852 | 93,726 |
| TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY | $1,204,090 | $856,535 |

See accompanying notes to the unaudited consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands, Except Per Share Data) | 2013 | 2012 | 2013 | 2012 |
| INTEREST AND DIVIDEND INCOME: | | | | |
| Loans, including fees | $9,211 | $6,346 | $23,256 | $18,954 |
| Investment securities: | | | | |
| Taxable | 1,570 | 1,486 | 4,520 | 4,477 |
| Tax-exempt | 1,124 | 1,339 | 3,553 | 4,127 |
| Dividend and other interest income | 74 | 96 | 208 | 274 |
| TOTAL INTEREST AND DIVIDEND INCOME | 11,979 | 9,267 | 31,537 | 27,832 |
| INTEREST EXPENSE: | | | | |
| Deposits | 855 | 902 | 2,406 | 2,797 |
| Short-term borrowings | 16 | 38 | 63 | 100 |
| Long-term borrowings, FHLB | 479 | 637 | 1,480 | 1,877 |
| TOTAL INTEREST EXPENSE | 1,350 | 1,577 | 3,949 | 4,774 |
| NET INTEREST INCOME | 10,629 | 7,690 | 27,588 | 23,058 |
| PROVISION FOR LOAN LOSSES | 600 | 600 | 1,675 | 1,800 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 10,029 | 7,090 | 25,913 | 21,258 |
| NON-INTEREST INCOME: | | | | |
| Service charges | 671 | 489 | 1,651 | 1,394 |
| Securities (losses) gains, net | (3) | 447 | 2,257 | 1,206 |
| Bank-owned life insurance | 199 | 138 | 481 | 539 |
| Gain on sale of loans | 551 | 527 | 1,204 | 1,053 |
| Insurance commissions | 286 | 295 | 797 | 1,053 |
| Brokerage commissions | 250 | 239 | 797 | 698 |
| Other | 888 | 636 | 1,923 | 1,872 |
| TOTAL NON-INTEREST INCOME | 2,842 | 2,771 | 9,110 | 7,815 |
| NON-INTEREST EXPENSE: | | | | |
| Salaries and employee benefits | 4,515 | 2,939 | 11,025 | 8,806 |
| Occupancy | 554 | 317 | 1,302 | 963 |
| Furniture and equipment | 422 | 355 | 1,242 | 1,058 |
| Pennsylvania shares tax | 225 | 169 | 617 | 505 |
| Amortization of investment in limited partnerships | 165 | 165 | 496 | 496 |
| Federal Deposit Insurance Corporation deposit insurance | 173 | 111 | 421 | 349 |
| Marketing | 156 | 132 | 371 | 405 |
| Intangible amortization | 91 | — | 122 | — |
| Other | 2,674 | 1,270 | 6,195 | 3,683 |
| TOTAL NON-INTEREST EXPENSE | 8,975 | 5,458 | 21,791 | 16,265 |
| INCOME BEFORE INCOME TAX PROVISION | 3,896 | 4,403 | 13,232 | 12,808 |
| INCOME TAX PROVISION | 650 | 736 | 2,643 | 2,054 |
| NET INCOME | $3,246 | $3,667 | $10,589 | $10,754 |
| EARNINGS PER SHARE - BASIC | $0.67 | $0.96 | $2.48 | $2.80 |
| EARNINGS PER SHARE - DILUTED | $0.67 | $0.96 | $2.48 | $2.80 |
| WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC | 4,818,494 | 3,837,925 | 4,272,989 | 3,837,570 |

| | | | | |
|---|---|---|---|---|
| WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED | 4,818,494 | 3,837,925 | 4,272,989 | 3,837,570 |
| DIVIDENDS DECLARED PER SHARE | $0.47 | $0.47 | $1.66 | $1.41 |

See accompanying notes to the unaudited consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2013 | 2012 | 2013 | 2012 |
| Net Income | $3,246 | $3,667 | $10,589 | $10,754 |
| Other comprehensive (loss) income: | | | | |
| Change in unrealized (loss) gain on available for sale securities | (1,647) | 6,190 | (14,354) | 13,228 |
| Tax effect | 560 | (2,105) | 4,881 | (4,498) |
| Net realized loss (gain) included in net income | 3 | (447) | (2,257) | (1,206) |
| Tax effect | (1) | 152 | 767 | 410 |
| Total other comprehensive (loss) income | (1,085) | 3,790 | (10,963) | 7,934 |
| Comprehensive income (loss) | $2,161 | $7,457 | $(374) | $18,688 |

See accompanying notes to the unaudited consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

| (In Thousands, Except Per Share Data) | COMMON STOCK SHARES | COMMON STOCK AMOUNT | ADDITIONAL PAID-IN CAPITAL | RETAINED EARNINGS | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | TREASURY STOCK | TOTAL SHAREHOLDERS EQUITY |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2011 | 4,017,677 | $ 33,480 | $ 18,115 | $ 36,394 | $ (1,219 ) | $ (6,310 ) | $ 80,460 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 10,754 | | | 10,754 |
| Other comprehensive income | | | | | 7,934 | | 7,934 |
| Dividends declared, ($1.41 per share) | | | | (5,411 ) | | | (5,411 ) |
| Common shares issued for employee stock purchase plan | 1,100 | 9 | 33 | | | | 42 |
| Balance, September 30, 2012 | 4,018,777 | $ 33,489 | $ 18,148 | $ 41,737 | $ 6,715 | $ (6,310 ) | $ 93,779 |

| (In Thousands, Except Per Share Data) | COMMON STOCK SHARES | COMMON STOCK AMOUNT | ADDITIONAL PAID-IN CAPITAL | RETAINED EARNINGS | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | TREASURY STOCK | TOTAL SHAREHOLDERS' EQUITY |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2012 | 4,019,112 | $ 33,492 | $ 18,157 | $ 43,030 | $ 5,357 | $ (6,310 ) | $ 93,726 |
| Comprehensive loss: | | | | | | | |
| Net income | | | | 10,589 | | | 10,589 |
| Other comprehensive loss | | | | | (10,963 ) | | (10,963 ) |
| Dividends declared, ($1.66 per share) | | | | (7,295 ) | | | (7,295 ) |
| Common shares issued for employee stock purchase plan | 1,394 | 12 | 47 | | | | 59 |
| Common shares issued for acquisition of Luzerne National Bank Corporation | 978,977 | 8,158 | 31,578 | | | | 39,736 |
| Balance, September 30, 2013 | 4,999,483 | $ 41,662 | $ 49,782 | $ 46,324 | $ (5,606 ) | $ (6,310 ) | $ 125,852 |

See accompanying notes to the unaudited consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|---|---|
| (In Thousands) | 2013 | 2012 |
| OPERATING ACTIVITIES: | | |
| Net Income | $10,589 | $10,754 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 708 | 569 |
| Amortization of intangible assets | 122 | — |
| Provision for loan losses | 1,675 | 1,800 |
| Accretion and amortization of investment security discounts and premiums | (44) | (816) |
| Securities gains, net | (2,257) | (1,206) |
| Originations of loans held for sale | (42,985) | (32,116) |
| Proceeds of loans held for sale | 46,375 | 34,671 |
| Gain on sale of loans | (1,204) | (1,053) |
| Earnings on bank-owned life insurance | (481) | (539) |
| (Increase) decrease in deferred tax asset | (86) | 315 |
| Other, net | (445) | (1,189) |
| Net cash provided by operating activities | 11,967 | 11,190 |
| INVESTING ACTIVITIES: | | |
| Investment securities available for sale: | | |
| Proceeds from sales | 69,898 | 35,847 |
| Proceeds from calls and maturities | 12,775 | 17,259 |
| Purchases | (71,221) | (64,965) |
| Investment securities held to maturity: | | |
| Proceeds from calls and maturities | — | 55 |
| Net increase in loans | (43,401) | (50,513) |
| Acquisition of bank premises and equipment | (2,744) | (1,109) |
| Proceeds from the sale of foreclosed assets | — | 700 |
| Purchase of bank-owned life insurance | (981) | (33) |
| Proceeds from bank-owned life insurance death benefit | — | 383 |
| Proceeds from redemption of regulatory stock | 2,237 | 1,034 |
| Purchases of regulatory stock | (980) | — |
| Acquisition, net of cash acquired | 17,487 | — |
| Net cash used for investing activities | (16,930) | (61,342) |
| FINANCING ACTIVITIES: | | |
| Net increase in interest-bearing deposits | 38,636 | 55,515 |
| Net increase in noninterest-bearing deposits | 17,903 | 3,931 |
| Proceeds from long-term borrowing, FHLB | — | 15,000 |
| Repayment of long-term borrowings, FHLB | (5,528) | — |
| Net decrease in short-term borrowings | (20,910) | (11,666) |
| Dividends paid | (7,295) | (5,411) |
| Issuance of common stock | 59 | 42 |
| Net cash provided by financing activities | 22,865 | 57,411 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 17,902 | 7,259 |
| CASH AND CASH EQUIVALENTS, BEGINNING | 15,142 | 13,885 |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS, ENDING | $33,044 | $21,144 |

See accompanying notes to the unaudited consolidated financial statements.

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| (In Thousands) | Nine Months Ended September 30, 2013 | 2012 |
|---|---|---|
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Interest paid | $3,880 | $4,809 |
| Income taxes paid | 2,770 | 2,350 |
| Transfer of loans to foreclosed real estate | 185 | — |
| Acquisition of Luzerne National Bank Corporation | | |
| Noncash assets acquired: | | |
| Securities available for sale | 21,783 | |
| Loans | 250,377 | |
| Premises and equipment, net | 8,014 | |
| Accrued interest receivable | 726 | |
| Bank-owned life insurance | 7,419 | |
| Intangibles | 2,015 | |
| Other assets | 2,636 | |
| Goodwill | 14,072 | |
| | 307,042 | |
| Liabilities assumed: | | |
| Deferred tax liability | 76 | |
| Interest-bearing deposits | 194,438 | |
| Noninterest-bearing deposits | 82,518 | |
| Short-term borrowings | 2,766 | |
| Accrued interest payable | 103 | |
| Other liabilities | 4,892 | |
| | 284,793 | |
| Net noncash assets acquired | 22,249 | |
| Cash and cash equivalents acquired | $20,363 | |

See accompanying notes to the unaudited consolidated financial statements.

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PENNS WOODS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The consolidated financial statements include the accounts of Penns Woods Bancorp, Inc. (the "Company") and its wholly-owned subsidiaries: Woods Investment Company, Inc., Woods Real Estate Development Company, Inc., Luzerne Bank ("Luzerne") and Jersey Shore State Bank (referred to together as the "Bank") and Jersey Shore State Bank's wholly-owned subsidiary, The M Group, Inc. D/B/A The Comprehensive Financial Group ("The M Group"). All significant inter-company balances and transactions have been eliminated in the consolidation.

The interim financial statements are unaudited, but in the opinion of management reflect all adjustments necessary for the fair presentation of results for such periods. The results of operations for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The accounting policies followed in the presentation of interim financial results are the same as those followed on an annual basis. These policies are presented on pages 35 through 39 of the Annual Report on Form 10-K for the year ended December 31, 2012.

In reference to the attached financial statements, all adjustments are of a normal recurring nature pursuant to Rule 10-01(b) (8) of Regulation S-X.

Note 2. Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income by component as of September 30, 2013 were as follows:

| | Three Months Ended September 30, 2013 | | | Three Months Ended September 30, 2012 | | |
|---|---|---|---|---|---|---|
| (In Thousands) | Net Unrealized Gain (Loss) on Available for Sale Securities | Defined Benefit Plan | Total | Net Unrealized Gain on Available for Sale Securities | Defined Benefit Plan | Total |
| Balance, June 30 | $286 | $(4,807) | $(4,521) | $7,058 | $(4,133) | $2,925 |
| Other comprehensive (loss) income before reclassifications | (1,087) | — | (1,087) | 4,085 | — | 4,085 |
| Amounts reclassified from accumulated other comprehensive (loss) income | 2 | — | 2 | (295) | — | (295) |
| Net current-period other comprehensive (loss) income | (1,085) | — | (1,085) | 3,790 | — | 3,790 |
| Balance, September 30 | $(799) | $(4,807) | $(5,606) | $10,848 | $(4,133) | $6,715 |

| | Nine Months Ended September 30, 2013 | | | Nine Months Ended September 30, 2012 | | |
|---|---|---|---|---|---|---|
| (In Thousands) | | Defined | Total | Net Unrealized | Defined | Total |

| | Net Unrealized Gain (Loss) on Available for Sale Securities | Benefit Plan | | Gain on Available for Sale Securities | Benefit Plan | |
|---|---|---|---|---|---|---|
| Balance, December 31 | $10,164 | $(4,807) | $5,357 | $2,914 | $(4,133) | $(1,219) |
| Other comprehensive (loss) income before reclassifications | (9,473) | — | (9,473) | 8,730 | — | 8,730 |
| Amounts reclassified from accumulated other comprehensive (loss) income | (1,490) | — | (1,490) | (796) | — | (796) |
| Net current-period other comprehensive (loss) income | (10,963) | — | (10,963) | 7,934 | — | 7,934 |
| Balance, September 30 | $(799) | $(4,807) | $(5,606) | $10,848 | $(4,133) | $6,715 |

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The reclassifications out of accumulated other comprehensive income as of September 30, 2013 were as follows:
(In Thousands)

| Details about Accumulated Other Comprehensive Income Components | Amount Reclassified from Accumulated Other Comprehensive Income | | Affected Line Item in the Consolidated Statement of Income |
|---|---|---|---|
| | Three Months Ended September 30, 2013 | Three Months Ended September 30, 2012 | |
| Net unrealized loss on available for | $ (3) | $ 447 | Securities (losses) gains, net |
| sale securities | (1) | 152 | Income tax provision |
| Total reclassifications for the period | $ (2) | $ 295 | Net of tax |

(In Thousands)

| Details about Accumulated Other Comprehensive Income Components | Amount Reclassified from Accumulated Other Comprehensive Income | | Affected Line Item in the Consolidated Statement of Income |
|---|---|---|---|
| | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 | |
| Net unrealized gain on available for | $ 2,257 | $ 1,206 | Securities gains, net |
| sale securities | 767 | 410 | Income tax provision |
| Total reclassifications for the period | $ 1,490 | $ 796 | Net of tax |

Note 3. Recent Accounting Pronouncements

In January 2013, the FASB issued ASU 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The amendments clarify that the scope of Update 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. An entity is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The effective date is the same as the effective date of Update 2011-11. This ASU is not expected to have a significant impact on the Company’s financial statements.

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The amendments in this update require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company has provided the necessary disclosures in Note 2 - Accumulated Other Comprehensive Income.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU is not expected to have a significant impact on the Company’s financial statements.

Note 4. Per Share Data

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There are no convertible securities which would affect the denominator in calculating basic and dilutive earnings per share. Net income as presented on the consolidated statement of income will be used as the numerator. The following table sets forth the composition of the weighted average common shares (denominator) used in the basic and dilutive earnings per share computation.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Weighted average common shares issued | 4,999,090 | 4,018,521 | 4,453,585 | 4,018,166 |
| Average treasury stock shares | (180,596) | (180,596) | (180,596) | (180,596) |
| Weighted average common shares and common stock equivalents used to calculate basic and diluted earnings per share | 4,818,494 | 3,837,925 | 4,272,989 | 3,837,570 |

Note 5. Investment Securities

The amortized cost and fair values of investment securities at September 30, 2013 and December 31, 2012 are as follows:

| | September 30, 2013 | | | |
|---|---|---|---|---|
| (In Thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Available for sale (AFS) | | | | |
| U.S. Government and agency securities | $30,263 | $795 | $(289) | $30,769 |
| State and political securities | 148,581 | 3,215 | (4,924) | 146,872 |
| Other debt securities | 97,691 | 858 | (2,424) | 96,125 |
| Total debt securities | 276,535 | 4,868 | (7,637) | 273,766 |
| Financial institution equity securities | 8,384 | 1,616 | (10) | 9,990 |
| Other equity securities | 1,675 | 11 | (59) | 1,627 |
| Total equity securities | 10,059 | 1,627 | (69) | 11,617 |
| Total investment securities AFS | $286,594 | $6,495 | $(7,706) | $285,383 |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| (In Thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Available for sale (AFS) | | | | |
| U.S. Government and agency securities | $24,475 | $1,384 | $(19) | $25,840 |
| State and political securities | 168,843 | 12,805 | (1,424) | 180,224 |
| Other debt securities | 70,108 | 1,750 | (259) | 71,599 |
| Total debt securities | 263,426 | 15,939 | (1,702) | 277,663 |
| Financial institution equity securities | 8,422 | 1,140 | (14) | 9,548 |
| Other equity securities | 2,068 | 74 | (37) | 2,105 |
| Total equity securities | 10,490 | 1,214 | (51) | 11,653 |
| Total investment securities AFS | $273,916 | $17,153 | $(1,753) | $289,316 |

The following tables show the Company’s gross unrealized losses and fair value, aggregated by investment category and length of time, that the individual securities have been in a continuous unrealized loss position, at September 30, 2013 and December 31, 2012.

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| | September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| (In Thousands) | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. Government and agency securities | $16,179 | $(275) | $747 | $(14) | $16,926 | $(289) |
| State and political securities | 41,626 | (3,224) | 3,993 | (1,700) | 45,619 | (4,924) |
| Other debt securities | 60,151 | (2,424) | — | — | 60,151 | (2,424) |
| Total debt securities | 117,956 | (5,923) | 4,740 | (1,714) | 122,696 | (7,637) |
| Financial institution equity securities | 160 | (10) | — | — | 160 | (10) |
| Other equity securities | 1,175 | (59) | — | — | 1,175 | (59) |
| Total equity securities | 1,335 | (69) | — | — | 1,335 | (69) |
| Total | $119,291 | $(5,992) | $4,740 | $(1,714) | $124,031 | $(7,706) |

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| (In Thousands) | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. Government and agency securities | $910 | $(19) | $— | $— | $910 | $(19) |
| State and political securities | 8,882 | (316) | 5,647 | (1,108) | 14,529 | (1,424) |
| Other debt securities | 11,250 | (189) | 3,727 | (70) | 14,977 | (259) |
| Total debt securities | 21,042 | (524) | 9,374 | (1,178) | 30,416 | (1,702) |
| Financial institution equity securities | 66 | (1) | 205 | (13) | 271 | (14) |
| Other equity securities | 701 | (28) | 63 | (9) | 764 | (37) |
| Total equity securities | 767 | (29) | 268 | (22) | 1,035 | (51) |
| Total | $21,809 | $(553) | $9,642 | $(1,200) | $31,451 | $(1,753) |

At September 30, 2013 there were a total of 190 and 11 individual securities that were in a continuous unrealized loss position for less than twelve months and twelve months or greater, respectively.

The Company reviews its position quarterly and has determined that, at September 30, 2013, the declines outlined in the above table represent temporary declines and the Company does not intend to sell and does not believe it will be required to sell these securities before recovery of their cost basis, which may be at maturity.  The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes, sector credit ratings changes, or company-specific ratings changes that are not expected to result in the non-collection of principal and interest during the period.

The amortized cost and fair value of debt securities at September 30, 2013, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities since borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (In Thousands) | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $5,783 | $5,803 |
| Due after one year to five years | 30,823 | 31,301 |

| | | |
|---|---|---|
| Due after five years to ten years | 94,538 | 92,686 |
| Due after ten years | 145,391 | 143,976 |
| Total | $276,535 | $273,766 |

Total gross proceeds from sales of securities available for sale were $69,898 and $35,847, for the nine months ended September 30, 2013 and 2012, respectively. The following table represents gross realized gains and losses on those transactions:

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| (In Thousands) | Three Months Ended September 30, 2013 | 2012 | Nine Months Ended September 30, 2013 | 2012 |
|---|---|---|---|---|
| Gross realized gains: | | | | |
| U.S. Government and agency securities | $— | $— | $— | $138 |
| State and political securities | 276 | 52 | 1,917 | 103 |
| Other debt securities | 163 | 142 | 462 | 219 |
| Financial institution equity securities | — | 144 | 130 | 605 |
| Other equity securities | — | 397 | 250 | 523 |
| Total gross realized gains | $439 | $735 | $2,759 | $1,588 |
| | | | | |
| Gross realized losses: | | | | |
| U.S. Government and agency securities | $— | $— | $— | $— |
| State and political securities | 415 | 144 | 475 | 146 |
| Other debt securities | 27 | 53 | 27 | 53 |
| Financial institution equity securities | — | — | — | 67 |
| Other equity securities | — | 91 | — | 116 |
| Total gross realized losses | $442 | $288 | $502 | $382 |

There were no impairment charges included in gross realized losses for the three and nine months ended September 30, 2013 and 2012, respectively.

Note 6. Federal Home Loan Bank Stock

Jersey Shore State Bank and Luzerne are both members of the Federal Home Loan Bank ("FHLB") of Pittsburgh and as such, are required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for impairment as necessary. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB.

Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. More consideration was given to the long-term prospects for the FHLB as opposed to the recent stress caused by the extreme economic conditions the world is facing. Management also considered that the FHLB maintains regulatory capital ratios in excess of all regulatory capital requirements, liquidity appears adequate, new shares of FHLB stock continue to change hands at the $100 par value, and the resumption of dividends.

Note 7. Credit Quality and Related Allowance for Loan Losses

Management segments the Bank's loan portfolio to a level that enables risk and performance monitoring according to similar risk characteristics. Loans are segmented based on the underlying collateral characteristics. Categories include commercial and agricultural, real estate, and installment loans to individuals. Real estate loans are further segmented into three categories: residential, commercial and construction.

The following table presents the related aging categories of loans, by segment, as of September 30, 2013 and December 31, 2012:

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| | September 30, 2013 | | | | |
|---|---|---|---|---|---|
| (In Thousands) | Current | Past Due 30 To 89 Days | Past Due 90 Days Or More & Still Accruing | Non-Accrual | Total |
| Commercial and agricultural | $105,001 | $66 | $4 | $108 | $105,179 |
| Real estate mortgage: | | | | | |
| Residential | 378,441 | 2,117 | 228 | 894 | 381,680 |
| Commercial | 280,793 | 2,840 | — | 3,782 | 287,415 |
| Construction | 17,044 | — | — | 1,049 | 18,093 |
| Installment loans to individuals | 14,346 | 335 | — | — | 14,681 |
| | 795,625 | $5,358 | $232 | $5,833 | 807,048 |
| Net deferred loan fees and discounts | (885) | | | | (885) |
| Allowance for loan losses | (9,630) | | | | (9,630) |
| Loans, net | $785,110 | | | | $796,533 |

| | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| (In Thousands) | Current | Past Due 30 To 89 Days | Past Due 90 Days Or More & Still Accruing | Non-Accrual | Total |
| Commercial and agricultural | $48,322 | $133 | $— | $— | $48,455 |
| Real estate mortgage: | | | | | |
| Residential | 245,674 | 4,888 | 351 | 1,229 | 252,142 |
| Commercial | 177,539 | 443 | — | 4,049 | 182,031 |
| Construction | 13,813 | 177 | — | 6,077 | 20,067 |
| Installment loans to individuals | 10,550 | 109 | — | — | 10,659 |
| | 495,898 | $5,750 | $351 | $11,355 | 513,354 |
| Net deferred loan fees and discounts | (1,122) | | | | (1,122) |
| Allowance for loan losses | (7,617) | | | | (7,617) |
| Loans, net | $487,159 | | | | $504,615 |

Purchased loans acquired are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

Upon acquisition, the Company evaluated whether each acquired loan (regardless of size) was within the scope of ASC 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality. Purchased credit-impaired loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. There were no material increases or decreases in the expected cash flows of these loans between June 1, 2013 (the “acquisition date”) and September 30, 2013. The fair value of purchased credit-impaired loans, on the acquisition date, was determined, primarily based on the fair value of loan collateral. The carrying value of purchased loans acquired with deteriorated credit quality was $909,000 at September 30, 2013.

On the acquisition date, the preliminary estimate of the unpaid principal balance for all loans evidencing credit impairment acquired in the Luzerne acquisition was $1,211,000 and the estimated fair value of the loans was $878,000. Total contractually required payments on these loans, including interest, at the acquisition date was $1,783,000. However, the Company’s preliminary estimate of expected cash flows was $941,000. At such date, the Company established a credit risk related non-accretable discount (a discount representing amounts which are not expected to be collected from the customer nor liquidation of collateral) of $842,000 relating to these impaired loans, reflected in the recorded net fair value. Such amount is reflected as a non-accretable fair value adjustment to loans.

The Company further estimated the timing and amount of expected cash flows in excess of the estimated fair value and established an accretable discount of $63,000 on the acquisition date relating to these impaired loans.

The carrying value of the loans acquired and accounted for in accordance with ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, was determined by projecting discounted contractual cash flows. The table below

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presents the components of the purchase accounting adjustments related to the purchased impaired loans acquired in the Luzerne acquisition as of June 1, 2013:

| (In Thousands) | June 1, 2013 |
|---|---|
| Unpaid principal balance | $1,211 |
| Interest | 572 |
| Contractual cash flows | 1,783 |
| Non-accretable discount | (842) |
| Expected cash flows | 941 |
| Accretable discount | (63) |
| Estimated fair value | $878 |

Changes in the amortizable yield for purchased credit-impaired loans were as follows for the four months ended September 30, 2013:

| (In Thousands) | September 30, 2013 |
|---|---|
| Balance at beginning of period | $63 |
| Accretion | (17) |
| Balance at end of period | $46 |

The following table presents additional information regarding loans acquired with specific evidence of deterioration in credit quality under ASC 310-30:

| (In Thousands) | June 1, 2013 | September 30, 2013 |
|---|---|---|
| Outstanding balance | $1,211 | $1,225 |
| Carrying amount | 878 | 909 |

The following table presents the interest income if interest had been recorded based on the original loan agreement terms and rate of interest for non-accrual loans and interest income recognized on a cash basis for non-accrual loans for the three and nine ended September 30, 2013 and 2012:

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| (In Thousands) | Interest Income That Would Have Been Recorded Based on Original Term and Rate | Interest Income Recorded on a Cash Basis | Interest Income That Would Have Been Recorded Based on Original Term and Rate | Interest Income Recorded on a Cash Basis |
| Commercial and agricultural | $— | $— | $— | $— |
| Real estate mortgage: | | | | |
| Residential | 13 | 10 | 13 | 4 |
| Commercial | 49 | 5 | 92 | 43 |
| Construction | 16 | 8 | 77 | 11 |
| | $78 | $23 | $182 | $58 |

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| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| (In Thousands) | Interest Income That Would Have Been Recorded Based on Original Term and Rate | Interest Income Recorded on a Cash Basis | Interest Income That Would Have Been Recorded Based on Original Term and Rate | Interest Income Recorded on a Cash Basis |
| Commercial and agricultural | $4 | $— | $— | $— |
| Real estate mortgage: | | | | |
| Residential | 67 | 22 | 25 | 17 |
| Commercial | 165 | 89 | 135 | 51 |
| Construction | 97 | 33 | 298 | 67 |
| | $333 | $144 | $458 | $135 |

Impaired Loans

Impaired loans are loans for which it is probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement.  The Bank evaluates such loans for impairment individually and does not aggregate loans by major risk classifications.  The definition of “impaired loans” is not the same as the definition of “non-accrual loans,” although the two categories overlap.  The Bank may choose to place a loan on non-accrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.  Factors considered by management in determining impairment include payment status and collateral value.  The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loan. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than $100,000 and if the loan is either on non-accrual status or has a risk rating of substandard.  Management may also elect to measure an individual loan for impairment if less than $100,000 on a case by case basis.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired.  Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower’s prior payment record, and the amount of shortfall in relation to the principal and interest owed.  Interest income for impaired loans is recorded consistent with the Bank’s policy on nonaccrual loans.

The following table presents the recorded investment, unpaid principal balance, and related allowance of impaired loans by segment as of September 30, 2013 and December 31, 2012:

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| | September 30, 2013 | | |
|---|---|---|---|
| (In Thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| With no related allowance recorded: | | | |
| Commercial and agricultural | $310 | $446 | $— |
| Real estate mortgage: | | | |
| Residential | 845 | 945 | — |
| Commercial | 1,249 | 1,249 | — |
| Construction | 533 | 533 | — |
| | 2,937 | 3,173 | — |
| With an allowance recorded: | | | |
| Commercial and agricultural | 543 | 543 | 233 |
| Real estate mortgage: | | | |
| Residential | 788 | 1,040 | 143 |
| Commercial | 6,939 | 7,083 | 1,895 |
| Construction | 528 | 1,382 | 128 |
| | 8,798 | 10,048 | 2,399 |
| Total: | | | |
| Commercial and agricultural | 853 | 989 | 233 |
| Real estate mortgage: | | | |
| Residential | 1,633 | 1,985 | 143 |
| Commercial | 8,188 | 8,332 | 1,895 |
| Construction | 1,061 | 1,915 | 128 |
| | $11,735 | $13,221 | $2,399 |

| | December 31, 2012 | | |
|---|---|---|---|
| (In Thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| With no related allowance recorded: | | | |
| Commercial and agricultural | $— | $— | $— |
| Real estate mortgage: | | | |
| Residential | 410 | 487 | — |
| Commercial | 324 | 324 | — |
| Construction | 2,894 | 4,599 | — |
| | 3,628 | 5,410 | — |
| With an allowance recorded: | | | |
| Commercial and agricultural | 485 | 485 | 46 |
| Real estate mortgage: | | | |
| Residential | 1,146 | 1,255 | 237 |
| Commercial | 8,515 | 8,611 | 2,018 |
| Construction | 3,196 | 4,696 | 234 |
| | 13,342 | 15,047 | 2,535 |
| Total: | | | |
| Commercial and agricultural | 485 | 485 | 46 |
| Real estate mortgage: | | | |
| Residential | 1,556 | 1,742 | 237 |
| Commercial | 8,839 | 8,935 | 2,018 |
| Construction | 6,090 | 9,295 | 234 |
| | $16,970 | $20,457 | $2,535 |

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The following table presents the average recorded investment in impaired loans and related interest income recognized for the three and nine months ended for September 30, 2013 and 2012:

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| (In Thousands) | Average Investment in Impaired Loans | Interest Income Recognized on an Accrual Basis on Impaired Loans | Interest Income Recognized on a Cash Basis on Impaired Loans | Average Investment in Impaired Loans | Interest Income Recognized on an Accrual Basis on Impaired Loans | Interest Income Recognized on a Cash Basis on Impaired Loans |
| Commercial and agricultural | $786 | $ 7 | $ — | $— | $ — | $ — |
| Real estate mortgage: | | | | | | |
| Residential | 1,652 | 28 | 10 | 1,253 | 10 | 4 |
| Commercial | 8,277 | 45 | 5 | 6,576 | 63 | 6 |
| Construction | 1,119 | 1 | 8 | 6,822 | 1 | 11 |
| | $11,834 | $ 81 | $ 23 | $14,651 | $ 74 | $ 21 |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| (In Thousands) | Average Investment in Impaired Loans | Interest Income Recognized on an Accrual Basis on Impaired Loans | Interest Income Recognized on a Cash Basis on Impaired Loans | Average Investment in Impaired Loans | Interest Income Recognized on an Accrual Basis on Impaired Loans | Interest Income Recognized on a Cash Basis on Impaired Loans |
| Commercial and agricultural | $869 | $ 20 | $ — | $— | $ — | $ — |
| Real estate mortgage: | | | | | | |
| Residential | 2,110 | 45 | 21 | 1,382 | 35 | 33 |
| Commercial | 11,278 | 138 | 89 | 6,541 | 224 | 14 |
| Construction | 4,071 | 1 | 561 | 8,266 | 1 | 67 |
| | $18,328 | $ 204 | $ 671 | $16,189 | $ 260 | $ 114 |

There is approximately $129,000 committed to be advanced in connection with impaired loans.

Modifications

The loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring ("TDR"), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties.  These concessions typically result from loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions.  Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

Loan modifications that are considered TDRs completed during the three and nine months ended September 30, 2013 and 2012 were as follows:

Three Months Ended September 30,

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| (In Thousands, Except Number of Contracts) | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Real estate mortgage: | | | | | | |
| Residential | — | $ — | $ — | 1 | $ 100 | $ 100 |
| Commercial | 2 | 1,634 | 1,634 | — | — | — |
| Construction | — | — | — | — | — | — |
| | 2 | $ 1,634 | $ 1,634 | 1 | $ 100 | $ 100 |

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| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| (In Thousands, Except Number of Contracts) | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Real estate mortgage: | | | | | | |
| Residential | 2 | $ 61 | $ 61 | 3 | $ 254 | $ 254 |
| Commercial | 4 | 1,898 | 1,898 | 1 | 37 | 37 |
| Construction | — | — | — | 2 | 26 | 26 |
| | 6 | $ 1,959 | $ 1,959 | 6 | $ 317 | $ 317 |

There were three loan modifications considered troubled debt restructurings made during the twelve months previous to September 30, 2013 that defaulted during the nine months ended September 30, 2013. The loans that defaulted are commercial real estate loans that are currently in litigation with a recorded investment of $1,343,000 at September 30, 2013.

Troubled debt restructurings amounted to $12,008,000 and $16,217,000 as of September 30, 2013 and December 31, 2012.

Internal Risk Ratings

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The special mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a substandard classification. Loans in the substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Loans in the doubtful category exhibit the same weaknesses found in the substandard loans, however, the weaknesses are more pronounced. Such loans are static and collection in full is improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Loans classified loss are considered uncollectible and charge-off is imminent.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the pass category unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. An external annual loan review of all commercial relationships $800,000 or greater is performed, as well as a sample of smaller transactions. Confirmation of the appropriate risk category is included in the review. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard, Doubtful, or Loss on a quarterly basis.

The following table presents the credit quality categories identified above as of September 30, 2013 and December 31, 2012:

| | September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Totals |
| Pass | $98,043 | $379,857 | $268,408 | $13,142 | $ 14,681 | $774,131 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Special Mention | 5,109 | 278 | 6,360 | 1,500 | — | 13,247 |
| Substandard | 2,027 | 1,545 | 12,647 | 3,451 | — | 19,670 |
| | $105,179 | $381,680 | $287,415 | $18,093 | $ 14,681 | $807,048 |

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Totals |
| Pass | $46,805 | $250,161 | $167,463 | $13,944 | $ 10,659 | $489,032 |
| Special Mention | 1,480 | — | 1,630 | — | — | 3,110 |
| Substandard | 170 | 1,981 | 12,938 | 6,123 | — | 21,212 |
| | $48,455 | $252,142 | $182,031 | $20,067 | $ 10,659 | $513,354 |

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Allowance for Loan Losses

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated future loss experience, and the amount of non-performing loans.

The Bank’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (previously discussed) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank’s ALL.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. Allowances are segmented based on collateral characteristics previously disclosed, and consistent with credit quality monitoring. Loans that are collectively evaluated for impairment are grouped into two classes for evaluation. A general allowance is determined for “Pass” rated credits, while a separate pool allowance is provided for “Criticized” rated credits that are not individually evaluated for impairment.

For the general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors. A historical charge-off factor is calculated utilizing a twelve quarter moving average. Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and concentrations of credit from a loan type, industry and/or geographic standpoint.

Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors. Management also monitors industry loss factors by loan segment for applicable adjustments to actual loss experience.

Management reviews the loan portfolio on a quarterly basis in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

There has been no allowance for loan losses recorded for acquired loans with or without specific evidence of deterioration in credit quality as of June 1, 2013 as well as those acquired without specific evidence of deterioration in credit quality as of September 30, 2013.

Activity in the allowance is presented for the three and nine months ended September 30, 2013 and 2012:

| | Three Months Ended September 30, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Unallocated | Totals |
| Beginning Balance | $540 | $3,045 | $3,988 | $843 | $ 141 | $847 | $9,404 |
| Charge-offs | — | (105 ) | (193 ) | (100 ) | (29 ) | — | (427 ) |
| Recoveries | 39 | (2 ) | 1 | 1 | 14 | — | 53 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Provision | (59) | 520 | (31) | 8 | 14 | 148 | 600 |
| Ending Balance | $520 | $3,458 | $3,765 | $752 | $ 140 | $995 | $9,630 |

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| | Three Months Ended September 30, 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Unallocated | Totals |
| Beginning Balance | $355 | $960 | $3,164 | $2,139 | $169 | $651 | $7,438 |
| Charge-offs | — | (49) | (1) | (483) | (22) | — | (555) |
| Recoveries | 1 | 4 | 2 | 19 | 12 | — | 38 |
| Provision | (9) | 418 | 223 | 37 | 13 | (82) | 600 |
| Ending Balance | $347 | $1,333 | $3,388 | $1,712 | $172 | $569 | $7,521 |

| | Nine Months Ended September 30, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Unallocated | Totals |
| Beginning Balance | $361 | $1,954 | $3,831 | $950 | $144 | $377 | $7,617 |
| Charge-offs | — | (239) | (199) | (100) | (79) | — | (617) |
| Recoveries | 52 | 3 | 7 | 851 | 42 | — | 955 |
| Provision | 107 | 1,740 | 126 | (949) | 33 | 618 | 1,675 |
| Ending Balance | $520 | $3,458 | $3,765 | $752 | $140 | $995 | $9,630 |

| | Nine Months Ended September 30, 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Unallocated | Totals |
| Beginning Balance | $418 | $939 | $2,651 | $2,775 | $190 | $181 | $7,154 |
| Charge-offs | — | (60) | (19) | (1,360) | (73) | — | (1,512) |
| Recoveries | 7 | 7 | 4 | 23 | 38 | — | 79 |
| Provision | (78) | 447 | 752 | 274 | 17 | 388 | 1,800 |
| Ending Balance | $347 | $1,333 | $3,388 | $1,712 | $172 | $569 | $7,521 |

The Company grants commercial, industrial, residential, and installment loans to customers throughout north-east and central Pennsylvania. Although the Company has a diversified loan portfolio at September 30, 2013, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within this region.

The Company has a concentration of loans at September 30, 2013 and 2012 as follows:

| | September 30, 2013 | |
|---|---|---|
| | 2013 | 2012 |
| Owners of residential rental properties | 15.73 % | 18.32 % |
| Owners of commercial rental properties | 13.20 % | 14.57 % |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as of September 30, 2013 and December 31, 2012:

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| | September 30, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and | Real Estate Mortgages | | | Installment Loans | | |
| (In Thousands) | Agricultural | Residential | Commercial | Construction | to Individuals | Unallocated | Totals |
| Allowance for Loan Losses: | | | | | | | |
| Ending allowance balance attributable to loans: | | | | | | | |
| Individually evaluated for impairment | $233 | $143 | $1,895 | $128 | $ — | $ — | $2,399 |
| Collectively evaluated for impairment | 287 | 3,315 | 1,870 | 624 | 140 | 995 | 7,231 |
| Total ending allowance balance | $520 | $3,458 | $3,765 | $752 | $ 140 | $ 995 | $9,630 |

Loans: