ACNB CORP
Form 10-Q
May 02, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

Commission file number 0-11783

ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

Pennsylvania	**23-2233457**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
16 Lincoln Square, Gettysburg, Pennsylvania	**17325**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(717) 334-3161**

Title of each class	Name of each exchange on which registered
Common Stock, $2.50 par value per share	The NASDAQ Stock Market, LLC

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 x 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 x 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 definitions of large accelerated filer,   accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller 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 x

The number of shares of the Registrant s Common Stock outstanding on April 25, 2014, was 5,996,549.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands, except per share data		March 31, 2014		March 31, 2013		December 31, 2013
ASSETS						
Cash and due from banks	$	**15,083**	$	11,967	$	13,963
Interest bearing deposits with banks		**4,132**		34,322		4,153
Total Cash and Cash Equivalents		**19,215**		46,289		18,116
Securities available for sale		**124,758**		152,518		129,983
Securities held to maturity, fair value $89,947; $61,743; $92,082		**91,503**		61,262		94,373
Loans held for sale				2,842		496
Loans, net of allowance for loan losses $16,159; $17,486; $16,091		**716,401**		688,330		712,557
Premises and equipment		**16,100**		15,018		15,991
Restricted investment in bank stocks		**5,989**		4,766		6,861
Investment in bank-owned life insurance		**36,937**		31,503		32,237
Investments in low-income housing partnerships		**4,528**		5,314		4,687
Goodwill		**6,308**		6,308		6,308
Intangible assets		**1,683**		2,249		1,845
Foreclosed assets held for resale		**2,012**		4,017		1,762
Other assets		**20,491**		15,623		20,831
Total Assets	$	**1,045,925**	$	1,036,039	$	1,046,047
LIABILITIES AND STOCKHOLDERS EQUITY						
LIABILITIES						
Deposits:						
Non-interest bearing	$	**134,253**	$	128,580	$	128,011
Interest bearing		**681,966**		703,006		672,632
Total Deposits		**816,219**		831,586		800,643
Short-term borrowings		**39,682**		42,269		49,052
Long-term borrowings		**74,637**		52,892		82,703
Other liabilities		**7,031**		6,988		6,847
Total Liabilities		**937,569**		933,735		939,245
STOCKHOLDERS EQUITY						
Preferred stock, $2.50 par value; 20,000,000 shares authorized; no shares outstanding						
		15,148		15,082		15,135

Common stock, $2.50 par value; 20,000,000 shares authorized; 6,059,149, 6,032,730 and 6,053,911 shares issued; 5,996,549, 5,970,130 and 5,991,311 shares outstanding						
Treasury stock, at cost (62,600 shares)		**(728)**		(728)		(728)
Additional paid-in capital		**9,710**		9,324		9,628
Retained earnings		**83,995**		79,173		82,661
Accumulated other comprehensive income (loss)		**231**		(547)		106
Total Stockholders Equity		**108,356**		102,304		106,802
Total Liabilities and Stockholders Equity	**$**	**1,045,925**	$	1,036,039	$	1,046,047

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Loans, including fees	**$**	**7,990**	$	8,254
Securities:				
Taxable		**1,011**		1,040
Tax-exempt		**273**		348
Dividends		**29**		4
Other		**16**		20
Total Interest Income		**9,319**		9,666
INTEREST EXPENSE				
Deposits		**425**		661
Short-term borrowings		**20**		12
Long-term borrowings		**457**		459
Total Interest Expense		**902**		1,132
Net Interest Income		**8,417**		8,534
PROVISION FOR LOAN LOSSES		**150**		650
Net Interest Income after Provision for Loan Losses		**8,267**		7,884
OTHER INCOME				
Service charges on deposit accounts		**465**		538
Income from fiduciary activities		**326**		331
Earnings on investment in bank-owned life insurance		**255**		241
Service charges on ATM and debit card transactions		**359**		319
Commissions from insurance sales		**1,065**		1,131
Other		**132**		385
Total Other Income		**2,602**		2,945
OTHER EXPENSES				
Salaries and employee benefits		**4,755**		4,748
Net occupancy		**584**		515
Equipment		**643**		658
Other tax		**189**		238
Professional services		**304**		244
Supplies and postage		**153**		131
Marketing and corporate relations		**97**		99
FDIC and regulatory		**198**		209
Intangible assets amortization		**162**		160
Foreclosed real estate expenses (income)		**43**		(21)
Other operating		**554**		775
Total Other Expenses		**7,682**		7,756

Income before Income Taxes		**3,187**		3,073
PROVISION FOR INCOME TAXES		**715**		655
Net Income	**$**	**2,472**	$	2,418
PER SHARE DATA				
Basic earnings	**$**	**0.41**	$	0.41
Cash dividends declared	**$**	**0.19**	$	0.19

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

NET INCOME	**$**	**2,472**	$	2,418
OTHER COMPREHENSIVE INCOME (LOSS)				
SECURITIES				
Unrealized gains (losses) arising during the period, net of income taxes of $65 and $(231), respectively		**125**		(449)
PENSION				
Amortization of pension net loss, transition liability, and prior service cost, net of income taxes of $0 and $59, respectively (A) (B)				114
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)		**125**		(335)
TOTAL COMPREHENSIVE INCOME	**$**	**2,597**	$	2,083

The accompanying notes are an integral part of the consolidated financial statements.

(A) Gross amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income in total other expenses.

(B) Income tax amounts are included in the provision for income taxes on the Consolidated Statements of Income.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Three Months Ended March 31, 2014 and 2013

[redacted]						
BALANCE JANUARY 1, 2013	$ 15,070	$ (728)	$ 9,246	$ 77,888	$ (212)	$ 101,264
Net income				2,418		2,418
Other comprehensive loss, net of taxes					(335)	(335)
Common stock shares issued (4,762 shares)	12		78			90
Cash dividends declared				(1,133)		(1,133)
BALANCE MARCH 31, 2013	$ 15,082	$ (728)	$ 9,324	$ 79,173	$ (547)	$ 102,304
BALANCE JANUARY 1, 2014	**$ 15,135**	**$ (728)**	**$ 9,628**	**$ 82,661**	**$ 106**	**$ 106,802**
Net income				**2,472**		**2,472**
Other comprehensive income, net of taxes					**125**	**125**
Common stock shares issued (5,238 shares)	**13**		**82**			**95**
Cash dividends declared				**(1,138)**		**(1,138)**
BALANCE MARCH 31, 2014	**$ 15,148**	**$ (728)**	**$ 9,710**	**$ 83,995**	**$ 231**	**$ 108,356**

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Dollars in thousands	Three Months Ended March 31, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 2,472**	$ 2,418
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of loans	**(11)**	(237)
Gain on sales of foreclosed assets held for resale, including writedowns	**(40)**	(30)
Earnings on investment in bank-owned life insurance	**(255)**	(241)
Depreciation and amortization	**496**	506
Provision for loan losses	**150**	650
Net amortization of investment securities premiums	**218**	237
Increase in accrued interest receivable	**(78)**	(56)
Decrease in accrued interest payable	**(68)**	(291)
Mortgage loans originated for sale	**(161)**	(10,690)
Proceeds from sales of loans originated for sale	**668**	14,772
Decrease (increase) in other assets	**512**	(581)
Increase in other liabilities	**252**	154
Net Cash Provided by Operating Activities	**4,155**	6,611
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of investment securities held to maturity	**2,742**	1,028
Proceeds from maturities of investment securities available for sale	**5,325**	13,326
Purchase of investment securities held to maturity		(12,228)
Purchase of investment securities available for sale		(874)
Net (increase) decrease in loans	**(4,338)**	2,119
Redemption of restricted investment in bank stocks	**872**	552
Purchase of bank-owned life insurance	**(4,445)**	(140)
Capital expenditures	**(443)**	(233)
Proceeds from sale of foreclosed real estate	**134**	472
Net Cash (Used in) Provided by Investing Activities	**(153)**	4,022
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	**6,242**	9,283
Net increase (decrease) in time certificates of deposits and interest bearing deposits	**9,334**	(11,873)
Net decrease in short-term borrowings	**(9,370)**	(5,034)
Dividends paid	**(1,138)**	(1,133)
Common stock issued	**95**	90
Proceeds from long-term borrowings	**5,000**	
Repayments on long-term borrowings	**(13,066)**	(7,062)
Net Cash Used in Financing Activities	**(2,903)**	(15,729)
Net Increase (Decrease) in Cash and Cash Equivalents	**1,099**	(5,096)
CASH AND CASH EQUIVALENTS BEGINNING	**18,116**	51,385
CASH AND CASH EQUIVALENTS ENDING	**$ 19,215**	$ 46,289

Interest paid	**$**	**970**	$	1,423
Income taxes paid	**$**		$	725
Loans transferred to foreclosed assets held for resale	**$**	**344**	$	212

The accompanying notes are an integral part of the consolidated financial statements.

ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. **Basis of Presentation**

ACNB Corporation (the Corporation or ACNB), headquartered in Gettysburg, Pennsylvania, provides banking, insurance, and financial services to businesses and consumers through its wholly-owned subsidiaries, ACNB Bank (Bank) and Russell Insurance Group, Inc. (RIG). The Bank engages in full-service commercial and consumer banking and trust services through its nineteen retail banking office locations in Adams, Cumberland and York Counties, Pennsylvania. There is also a loan production office situated in Franklin County, Pennsylvania.

RIG is a full-service insurance agency based in Westminster, Maryland. The agency offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients. In 2008, due to an agency acquisition, a second location of RIG was established in Germantown, Maryland.

The Corporation s primary source of revenue is interest income on loans and investment securities and fee income on its products and services. Expenses consist of interest expense on deposits and borrowed funds, provisions for loan losses, and other operating expenses.

The accompanying unaudited consolidated financial statements 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 Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly ACNB Corporation s financial position and the results of operations, comprehensive income, changes in stockholders equity, and cash flows. All such adjustments are of a normal recurring nature.

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s consolidated financial statements in the 2013 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 7, 2014. It is suggested that the consolidated financial statements contained herein be read in conjunction with the consolidated financial statements and notes included in the Corporation s Annual Report on Form 10-K. The results of operations for the three month period ended March 31, 2014, are not necessarily indicative of the results to be expected for the full year.

The Corporation has evaluated events and transactions occurring subsequent to the statement of condition date of March 31, 2014, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. **Earnings Per Share**

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,992,300 and 5,966,216 weighted average shares of common stock outstanding for the three months ended March 31, 2014 and 2013, respectively. The Corporation does not have dilutive securities outstanding.

3. **Retirement Benefits**

The components of net periodic benefit (income) cost related to the non-contributory, defined benefit pension plan for the three month periods ended March 31 were as follows:

[redacted]				
Service cost	**$**	**172**	$	194
[redacted]				
Expected return on plan assets		**(578)**		(489)
[redacted]				
Amortization of prior service cost		**10**		10
[redacted]				
Net Periodic Benefit (Income) Cost	**$**	**(132)**	$	101

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2013, that it had not yet determined the amount the Bank planned on contributing to the defined benefit plan in 2014. As of March 31, 2014, this contribution amount had still not been determined. Effective April 1, 2012, no inactive or former participant in the plan is eligible to again participate in the plan, and no employee hired after March 31, 2012, is eligible to participate in the plan. As of the last annual census, ACNB Bank had a combined 368 active, vested, terminated, and retired persons in the plan.

4. **Guarantees**

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $4,524,000 in standby letters of credit as of March 31, 2014. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of March 31, 2014, for guarantees under standby letters of credit issued is not material.

5. **Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss), net of taxes, are as follows:

In thousands		Unrealized Gains on Securities		Pension Liability		Accumulated Other Comprehensive Income (Loss)
BALANCE MARCH 31, 2014	**$**	**2,697**	**$**	**(2,466)**	**$**	**231**
BALANCE DECEMBER 31, 2013	$	2,572	$	(2,466)	$	106
BALANCE MARCH 31, 2013	$	5,165	$	(5,712)	$	(547)

6. **Segment Reporting**

RIG is managed separately from the banking segment, which includes the Bank and related financial services that the Corporation offers through its banking subsidiary. RIG offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients.

Segment information for the three month periods ended March 31, 2014 and 2013, is as follows:

In thousands		Banking		Insurance		Total
2014						
Net interest income and other income from external customers	**$**	**9,949**	**$**	**1,070**	**$**	**11,019**
Income before income taxes		**3,124**		**63**		**3,187**
Total assets		**1,036,411**		**9,514**		**1,045,925**
Capital expenditures		**443**				**443**
2013						
Net interest income and other income from external customers	$	10,359	$	1,120	$	11,479
Income before income taxes		2,975		98		3,073
Total assets		1,026,155		9,884		1,036,039
Capital expenditures		226		7		233

Intangible assets, representing customer lists, are amortized over 10 years on a straight line basis. Goodwill is not amortized, but rather is analyzed annually for impairment. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. Amortization of goodwill and the intangible assets is deductible for tax purposes.

7. **Securities**

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

9

Amortized cost and fair value of securities at March 31, 2014, and December 31, 2013, were as follows:

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
MARCH 31, 2014				
U.S. Government and agencies	**$ 19,063**	**$ 501**	**$**	**$ 19,564**
Mortgage-backed securities, residential	**48,176**	**2,232**	**54**	**50,354**
State and municipal	**40,762**	**1,232**	**152**	**41,842**
Corporate bonds	**11,003**	**158**		**11,161**
CRA mutual fund	**1,044**		**4**	**1,040**
Stock in other banks	**627**	**170**		**797**
	$ 120,675	**$ 4,293**	**$ 210**	**$ 124,758**
DECEMBER 31, 2013				
U.S. Government and agencies	$ 21,094	$ 557	$	$ 21,651
Mortgage-backed securities, residential	51,541	2,322	123	53,740
State and municipal	40,780	1,117	375	41,522
Corporate bonds	11,004	192	31	11,165
CRA mutual fund	1,044		11	1,033
Stock in other banks	627	245		872
	$ 126,090	$ 4,433	$ 540	$ 129,983
SECURITIES HELD TO MATURITY				
MARCH 31, 2014				
U.S. Government and agencies	**$ 36,518**	**$ 68**	**$ 662**	**$ 35,924**
Mortgage-backed securities, residential	**54,985**	**76**	**1,038**	**54,023**
	$ 91,503	**$ 144**	**$ 1,700**	**$ 89,947**
DECEMBER 31, 2013				
U.S. Government and agencies	$ 37,528	$ 142	$ 923	$ 36,747

Mortgage-backed securities, residential	56,845	40	1,550	55,335
	$ 94,373	$ 182	$ 2,473	$ 92,082

The following table shows the Corporation s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2014, and December 31, 2013:

	Less than 12 Months		12 Months or More		Total	
In thousands	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
SECURITIES AVAILABLE FOR SALE						
MARCH 31, 2014						
Mortgage-backed securities, residential	**$ 5,024**	**$ 54**	**$**	**$**	**$ 5,024**	**$ 54**
State and municipal	**6,813**	**109**	**1,567**	**43**	**8,380**	**152**
CRA mutual fund	**1,040**	**4**			**1,040**	**4**
	$ 12,877	**$ 167**	**$ 1,567**	**$ 43**	**$ 14,444**	**$ 210**
DECEMBER 31, 2013						
Mortgage-backed securities, residential	$ 6,944	$ 123	$	$	$ 6,944	$ 123
State and municipal	11,107	340	1,070	35	12,177	375
Corporate bond	4,969	31			4,969	31
CRA mutual fund	1,033	11			1,033	11
	$ 24,053	$ 505	$ 1,070	$ 35	$ 25,123	$ 540
SECURITIES HELD TO MATURITY						
MARCH 31, 2014						
U.S. Government and agencies	**$ 13,981**	**$ 449**	**$ 9,870**	**$ 213**	**$ 23,851**	**$ 662**
Mortgage-backed securities, residential	**29,100**	**610**	**9,724**	**428**	**38,824**	**1,038**
	$ 43,081	**$ 1,059**	**$ 19,594**	**$ 641**	**$ 62,675**	**$ 1,700**
DECEMBER 31, 2013						
U.S. Government and agencies	$ 22,710	$ 812	$ 2,889	$ 111	$ 25,599	$ 923
Mortgage-backed security, residential	45,891	1,446	1,755	104	47,646	1,550
	$ 68,601	$ 2,258	$ 4,644	$ 215	$ 73,245	$ 2,473

All mortgage-backed security investments are government sponsored enterprise (GSE) pass-through instruments issued by the Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA) or Federal Home Loan Mortgage Corporation (FHLMC), which guarantee the timely payment of principal on these investments.

At March 31, 2014, five available for sale residential mortgage-backed securities had unrealized losses that individually did not exceed 3% of amortized cost. These securities have not been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At March 31, 2014, eighteen available for sale state and municipal bonds had unrealized losses that individually did not exceed 5% of amortized cost. Four of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At March 31, 2014, sixteen held to maturity U.S. Government and agency securities had unrealized losses that individually did not exceed 5% of amortized cost. Eight of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At March 31, 2014, twenty-six held to maturity residential mortgage-backed securities had unrealized losses that individually did not exceed 6% of amortized cost. Six of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At March 31, 2014, the CRA mutual fund had an unrealized loss that did not exceed 1% of amortized cost. This security has not been in a continuous loss position for 12 months or more. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security.

In analyzing the issuer s financial condition, management considers industry analysts reports, financial performance, and projected target prices of investment analysts within a one-year time frame. Based on the above information, management has determined that none of these investments are other-than-temporarily impaired.

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses independent service providers to provide matrix pricing.

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At March 31, 2014, management had not identified any securities with an unrealized loss that it intends to sell or will be required to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses.

Amortized cost and fair value at March 31, 2014, by contractual maturity, where applicable, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	$ **5,862**	$ **5,957**	$ **10,003**	$ **10,070**
Over 1 year through 5 years	**33,607**	**34,812**	**18,058**	**17,711**
Over 5 years through 10 years	**28,384**	**28,734**	**8,457**	**8,143**
Over 10 years	**2,975**	**3,064**		
	48,176	**50,354**	**54,985**	**54,023**

Mortgage-backed securities, residential								
CRA mutual fund		**1,044**		**1,040**				
Stock in other banks		**627**		**797**				
	$	**120,675**	**$**	**124,758**	**$**	**91,503**	**$**	**89,947**

The Corporation did not have any sales of securities available for sale during the first quarter of 2014 or 2013.

At March 31, 2014, and December 31, 2013, securities with a carrying value of $132,364,000 and $139,966,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

8. **Loans**

The Corporation grants commercial, residential, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout southcentral Pennsylvania and northern Maryland. The ability of the Corporation s debtors to honor their contracts is dependent upon the real estate values and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The loans receivable portfolio is segmented into commercial, residential mortgage, home equity lines of credit, and consumer loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, and commercial real estate construction.

The accrual of interest on residential mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued, but not collected, for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses (the allowance) is established as losses are estimated to occur through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The reserve for unfunded lending commitments represents management s estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statement of condition. The amount of the reserve for unfunded lending commitments is not material to the consolidated financial statements.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, the estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity, and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for the previous twelve quarters for each of these categories of loans, adjusted for qualitative risk factors. These qualitative risk factors include:

- lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;

- national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans;

- the nature and volume of the portfolio and terms of loans;
- the experience, ability and depth of lending management and staff;
- the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management s best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. It covers risks that are inherently difficult to quantify including, but not limited to, collateral risk, information risk, and historical charge-off risk.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal and/or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and/or interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and commercial construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

A specific allocation within the allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of the Corporation s impaired loans are measured based on the estimated fair value of the loan s collateral or the discounted cash flows method.

It is the policy of the Corporation to order an updated valuation on all real estate secured loans when the loan becomes 90 days past due and there has not been an updated valuation completed within the previous 12 months. In addition, the Corporation orders third-party valuations on all impaired real estate collateralized loans within 30 days of the loan being classified as impaired. Until the valuations are completed, the Corporation utilizes the most recent independent third-party real estate valuation to estimate the need for a specific allocation to be assigned to the loan. These existing valuations are discounted downward to account for such things as the age of the existing collateral valuation, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral. Once the updated valuation is completed, the collateral value is updated accordingly.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower s financial statements, inventory reports, accounts receivable aging reports, equipment appraisals, or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The Corporation actively monitors the values of collateral as well as the age of the valuation of impaired loans. Management believes that the Corporation s market area is not as volatile as other areas throughout the United States, therefore valuations are ordered at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined.

For impaired loans secured by collateral other than real estate, the Corporation considers the net book value of the collateral, as recorded in the most recent financial statements of the borrower, and determines fair value based on estimates made by management.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a troubled debt restructure.

Loans whose terms are modified are classified as troubled debt restructured loans if the Corporation grants such borrowers concessions that it would not otherwise consider and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate, a below market interest rate given the risk associated with the loan, or an extension of a loan s stated maturity date. Nonaccrual troubled debt restructurings may be restored to accrual status if principal and interest payments, under the modified terms, are current for a sustained period of time and, based on a well-documented credit evaluation of the borrower s financial condition, there is reasonable assurance of repayment. Loans classified as troubled debt restructurings are generally designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into credit quality rating categories. The borrower s overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are generally evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments.

Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful, and loss. Loans classified special mention have potential weaknesses that deserve management s close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, federal and state regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management s comprehensive analysis of the loan portfolio and economic conditions, management believes the current level of the allowance for loan losses is adequate.

Commercial and Industrial Lending The Corporation originates commercial and industrial loans primarily to businesses located in its primary market area and surrounding areas. These loans are used for various business purposes which include short-term loans and lines of credit to finance machinery and equipment purchases, inventory, and accounts receivable. Generally, the maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Most business lines of credit are written on demand and may be renewed annually.

Commercial and industrial loans are generally secured with short-term assets; however, in many cases, additional collateral such as real estate is provided as additional security for the loan. Loan-to-value maximum values have been established by the Corporation and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, collateral appraisals, etc.

In underwriting commercial and industrial loans, an analysis is performed to evaluate the borrower s character and capacity to repay the loan, the adequacy of the borrower s capital and collateral, as well as the conditions affecting the borrower. Evaluation of the borrower s past, present and future cash flows is also an important aspect of the Corporation s analysis.

Commercial loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions.

Commercial Real Estate Lending The Corporation engages in commercial real estate lending in its primary market area and surrounding areas. The Corporation s commercial loan portfolio is secured primarily by commercial retail space, office buildings, and hotels. Generally, commercial real estate loans have terms that do not exceed 20 years, have loan-to-value ratios of up to 80% of the appraised value of the property, and are typically secured by personal guarantees of the borrowers.

In underwriting these loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower s credit history, and the reliability and predictability of the cash flow generated by the property securing the loan.

Appraisals on properties securing commercial real estate loans originated by the Corporation are performed by independent appraisers.

Commercial real estate loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the complexities involved in valuing the underlying collateral.

Commercial Real Estate Construction Lending The Corporation engages in commercial real estate construction lending in its primary market area and surrounding areas. The Corporation s commercial real estate construction lending consists of commercial and residential site development loans, as well as commercial building construction and residential housing construction loans.

The Corporation s commercial real estate construction loans are generally secured with the subject property. Terms of construction loans depend on the specifics of the project, such as estimated absorption rates, estimated time to complete, etc.

In underwriting commercial real estate construction loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower s credit history, and the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate construction loans originated by the Corporation are performed by independent appraisers.

Commercial real estate construction loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the uncertainties surrounding total construction costs.

Residential Mortgage Lending One-to-four family residential mortgage loan originations, including home equity closed-end loans, are generated by the Corporation s marketing efforts, its present customers, walk-in customers, and referrals. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

The Corporation offers fixed-rate and adjustable-rate mortgage loans with terms up to a maximum of 30 years for both permanent structures and those under construction. The Corporation s one-to-four family residential mortgage originations are secured primarily by properties located in its primary market area and surrounding areas. The majority of the Corporation s residential mortgage loans originate with a loan-to-value of 80% or less. Loans in excess of 80% are required to have private mortgage insurance.

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower s financial ability to repay the loan as agreed and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney s title opinion or title insurance, as well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged in subprime residential mortgage originations.

Residential mortgage loans present a moderate level of risk due primarily to general economic conditions, as well as a continued weak housing market.

Home Equity Lines of Credit Lending The Corporation originates home equity lines of credit primarily within the Corporation s market area or with customers primarily from the market area. Home equity lines of credit are generated by the Corporation s marketing efforts, its present customers, walk-in customers, and referrals.

Home equity lines of credit are secured by the borrower s primary residence with a maximum loan-to-value of 90% and a maximum term of 20 years. In underwriting home equity lines of credit, the Corporation evaluates both the value of the property securing the loan and the borrower s financial ability to repay the loan as agreed. The ability to repay is determined by the borrower s employment history, current financial condition, and credit background.

Home equity lines of credit generally present a moderate level of risk due primarily to general economic conditions, as well as a continued weak housing market.

Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values deteriorate.

Consumer Lending The Corporation offers a variety of secured and unsecured consumer loans, including those for vehicles and mobile homes and those secured by savings deposits. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

Consumer loan terms vary according to the type and value of collateral and the creditworthiness of the borrower. In underwriting consumer loans, a thorough analysis of the borrower s financial ability to repay the loan as agreed is performed. The ability to repay is determined by the borrower s employment history, current financial condition, and credit background.

Consumer loans may entail greater credit risk than residential mortgage loans or home equity lines of credit, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within the Corporation s internal risk rating system as of March 31, 2014, and December 31, 2013:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
MARCH 31, 2014					
Commercial and industrial	**$ 51,827**	**$ 2,753**	**$ 3,476**	**$**	**$ 58,056**
Commercial real estate	**198,150**	**29,299**	**15,151**		**242,600**
Commercial real estate construction	**6,088**	**4,411**	**1,003**		**11,502**
Residential mortgage	**347,063**	**3,174**	**3,020**		**353,257**
Home equity lines of credit	**52,333**	**807**	**55**		**53,195**
Consumer	**13,950**				**13,950**
	$ 669,411	**$ 40,444**	**$ 22,705**	**$**	**$ 732,560**
[redacted]					
Commercial and industrial	$ 53,316	$ 2,364	$ 3,537	$	$ 59,217
[redacted]					
Commercial real estate construction	5,123	5,018	1,055		11,196
[redacted]					

Home equity lines of credit	53,021	608	223		53,852
	$ 663,657	$ 40,196	$ 24,795	$	$ 728,648

17

The following table summarizes information relative to impaired loans by loan portfolio class as of March 31, 2014, and December 31, 2013:

	Impaired Loans with Allowance			Impaired Loans with No Allowance	
In thousands	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal Balance**
MARCH 31, 2014					
Commercial and industrial	$	$	$	$ **1,356**	$ **2,471**
Commercial real estate	**361**	**361**	**111**	**10,126**	**10,326**
Commercial real estate construction				**788**	**1,062**
Residential mortgage	**1,539**	**1,576**	**339**	**445**	**445**
	$ **1,900**	$ **1,937**	$ **450**	$ **12,715**	$ **14,304**
DECEMBER 31, 2013					
Commercial and industrial	$	$	$	$ 1,574	$ 2,688
Commercial real estate				11,197	11,758
Commercial real estate construction				788	1,062
Residential mortgage	1,478	1,478	201	675	712
	$ 1,478	$ 1,478	$ 201	$ 14,234	$ 16,220

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the three months ended March 31, 2014 and 2013:

	Impaired Loans with Allowance		Impaired Loans with No Allowance	
In thousands	**Average Recorded Investment**	**Interest Income**	**Average Recorded Investment**	**Interest Income**
MARCH 31, 2014				

Commercial and industrial	**$**	**$**	**$ 1,465**	**$**
Commercial real estate	**361**		**10,481**	**248**
Commercial real estate construction			**788**	
Residential mortgage	**1,620**		**448**	**4**
	$ 1,981	**$**	**$ 13,182**	**$ 252**
MARCH 31, 2013				
Commercial and industrial	$ 146	$	$ 195	$
Commercial real estate	237		10,269	93
Commercial real estate construction	2,692	60	854	
Residential mortgage	699		935	3
	$ 3,774	$ 60	$ 12,253	$ 96

No additional funds are committed to be advanced in connection with impaired loans.

The following table presents nonaccrual loans by loan portfolio class as of March 31, 2014, and December 31, 2013:

In thousands	March 31, 2014	December 31, 2013
Commercial and industrial	**$ 1,356**	$ 1,574
Commercial real estate	**3,694**	4,363
Commercial real estate construction	**788**	788
Residential mortgage	**1,683**	1,848
	$ 7,521	$ 8,573

The following table summarizes information relative to troubled debt restructurings by loan portfolio class as of March 31, 2014, and December 31, 2013:

In thousands	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment at Period End
MARCH 31, 2014			
Nonaccruing troubled debt restructurings:			
Commercial and industrial	**$ 490**	**$ 485**	**$ 120**
Commercial real estate	**1,021**	**1,021**	**617**
Commercial real estate construction	**1,548**	**1,541**	**694**
Residential mortgage	**566**	**566**	**562**
Total nonaccruing troubled debt restructurings	**3,625**	**3,613**	**1,993**
Accruing troubled debt restructurings:			

Commercial real estate		**7,118**		**7,170**		**6,793**
Residential mortgage		**336**		**336**		**301**
Total accruing troubled debt restructurings		**7,454**		**7,506**		**7,094**
Total Troubled Debt Restructurings	**$**	**11,079**	**$**	**11,119**	**$**	**9,087**
DECEMBER 31, 2013						
Nonaccruing troubled debt restructurings:						
Commercial and industrial	$	490	$	485	$	142
Commercial real estate		1,021		1,021		634
Commercial real estate construction		1,548		1,541		694
Residential mortgage		566		566		566
Total nonaccruing troubled debt restructurings		3,625		3,613		2,036
Accruing troubled debt restructurings:						
Commercial real estate		7,118		7,170		6,834
Residential mortgage		336		336		305
Total accruing troubled debt restructurings		7,454		7,506		7,139
Total Troubled Debt Restructurings	$	11,079	$	11,119	$	9,175

All of the Corporation s troubled debt restructured loans are also impaired loans, of which some have resulted in a specific allocation and, subsequently, a charge-off as appropriate. As of March 31, 2014 and 2013, there were no defaulted troubled debt restructured loans. There were no charge-offs on troubled debt restructured loans for the three months ended March 31, 2014 and 2013. One forbearance agreement was negotiated during 2009 and modified during 2011, two were negotiated during 2010 and modified during 2013, three were negotiated during 2012, and two were negotiated during 2013.

There are forbearance agreements on all loans currently classified as troubled debt restructurings, except for two loans in which the forbearance agreement has expired and one loan in which a modification took place, all of which remain classified as troubled debt restructured loans. All of these troubled debt restructured loans have resulted in additional principal repayment. The terms of these troubled debt restructured loans vary whereby principal payments have been decreased, interest rates have been reduced, and/or the loan will be repaid as collateral is sold.

The following table summarizes loans whose terms have been modified resulting in troubled debt restructurings during the three months ended March 31, 2014 and 2013:

Dollars in thousands	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment at Period End
THREE MONTHS ENDED MARCH 31, 2014				
Troubled debt restructurings		$	$	$
THREE MONTHS ENDED MARCH 31, 2013				
Troubled debt restructurings:				
Commercial real estate	1	$ 2,541	$ 2,593	$ 2,593

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due.

The following table presents the classes of the loan portfolio summarized by the past due status as of March 31, 2014, and December 31, 2013:

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
MARCH 31, 2014							
Commercial and industrial	**$ 10**	**$ 1,232**	**$ 134**	**$ 1,376**	**$ 56,680**	**$ 58,056**	**$ 10**
Commercial real estate	**790**	**554**	**2,227**	**3,571**	**239,029**	**242,600**	
Commercial real estate construction			**788**	**788**	**10,714**	**11,502**	
Residential mortgage	**4,293**	**582**	**2,271**	**7,146**	**346,111**	**353,257**	**1,180**

Home equity lines of credit	**309**	**98**		**407**	**52,788**	**53,195**	
Consumer	**18**	**3**		**21**	**13,929**	**13,950**	
	$ 5,420	**$ 2,469**	**$ 5,420**	**$ 13,309**	**$ 719,251**	**$ 732,560**	**$ 1,190**
DECEMBER 31, 2013							
Commercial and industrial	$ 55	$ 13	$ 152	$ 220	$ 58,997	$ 59,217	$ 3
Commercial real estate	857	552	1,964	3,373	235,813	239,186	
Commercial real estate construction			788	788	10,408	11,196	
Residential mortgage	4,728	795	3,148	8,671	342,338	351,009	1,900
Home equity lines of credit	260	36	14	310	53,542	53,852	14
Consumer	22	15	9	46	14,142	14,188	9
	$ 5,922	$ 1,411	$ 6,075	$ 13,408	$ 715,240	$ 728,648	$ 1,926

The following tables summarize the allowance for loan losses and recorded investment in loans receivable:

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF AND FOR THE PERIOD ENDED MARCH 31, 2014								
Allowance for Loan Losses								
Beginning balance - January 1, 2014	$ 1,915	$ 5,819	$ 247	$ 4,013	$ 537	$ 947	$ 2,613	$ 16,091
Charge-offs	(34)			(22)		(36)		(92)
Recoveries	8					2		10
Provisions	(91)	12	(40)	(251)	(12)	39	493	150
Ending balance - March 31, 2014	$ 1,798	$ 5,831	$ 207	$ 3,740	$ 525	$ 952	$ 3,106	$ 16,159
Ending balance: individually evaluated for impairment	$	$ 111	$	$ 339	$	$	$	$ 450
Ending balance: collectively evaluated for impairment	$ 1,798	$ 5,720	$ 207	$ 3,401	$ 525	$ 952	$ 3,106	$ 15,709
Loans Receivable								
Ending balance	$ 58,056	$ 242,600	$ 11,502	$ 353,257	$ 53,195	$ 13,950	$	$ 732,560
Ending balance: individually evaluated for impairment	$ 1,356	$ 10,487	$ 788	$ 1,984	$	$	$	$ 14,615
Ending balance: collectively evaluated for impairment	$ 56,700	$ 232,113	$ 10,714	$ 351,273	$ 53,195	$ 13,950	$	$ 717,945

AS OF AND FOR THE PERIOD ENDED MARCH 31, 2013								
Allowance for Loan Losses								
Beginning Balance - January 1, 2013	$ 1,507	$ 6,576	$ 518	$ 3,721	$ 517	$ 633	$ 3,353	$ 16,825
Charge-offs	(36)	(35)		(114)		(23)		(208)
Recoveries	216			1		2		219
Provisions	(125)	(297)	1,583	475	(1)	53	(1,038)	650
Ending balance - March 31, 2013	$ 1,562	$ 6,244	$ 2,101	$ 4,083	$ 516	$ 665	$ 2,315	$ 17,486
Ending balance: individually evaluated for impairment	$ 29	$ 7	$ 1,806	$ 415	$	$	$	$ 2,257
Ending balance: collectively evaluated for impairment	$ 1,533	$ 6,237	$ 295	$ 3,668	$ 516	$ 665	$ 2,315	$ 15,229
Loans Receivable								
Ending balance	$ 51,474	$ 240,940	$ 19,179	$ 326,726	$ 52,847	$ 14,650	$	$ 705,816
Ending balance: individually evaluated for impairment	$ 342	$ 12,002	$ 6,238	$ 2,330	$	$	$	$ 20,912
Ending balance: collectively evaluated for impairment	$ 51,132	$ 228,938	$ 12,941	$ 324,396	$ 52,847	$ 14,650	$	$ 684,904

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF DECEMBER 31, 2013								
Allowance for Loan Losses								
Ending balance	$ 1,915	$ 5,819	$ 247	$ 4,013	$ 537	$ 947	$ 2,613	$ 16,091
Ending balance: individually evaluated for impairment	$	$	$	$ 201	$	$	$	$ 201
Ending balance: collectively evaluated for impairment	$ 1,915	$ 5,819	$ 247	$ 3,812	$ 537	$ 947	$ 2,613	$ 15,890
Loans Receivable								
Ending balance	$ 59,217	$ 239,186	$ 11,196	$ 351,009	$ 53,852	$ 14,188	$	$ 728,648
Ending balance: individually evaluated for impairment	$ 1,574	$ 11,197	$ 788	$ 2,153	$	$	$	$ 15,712
Ending balance: collectively evaluated for impairment	$ 57,643	$ 227,989	$ 10,408	$ 348,856	$ 53,852	$ 14,188	$	$ 712,936

9. Fair Value Measurements

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

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance further clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value measurement and disclosure guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

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

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis of measurement used, at March 31, 2014, and December 31, 2013, are as follows:

		March 31, 2014			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		**$ 19,564**	**$**	**$ 19,564**	**$**
Mortgage-backed securities, residential		**50,354**		**50,354**	
State and municipal		**41,842**		**41,842**	
Corporate bonds		**11,161**		**11,161**	
CRA mutual fund		**1,040**	**1,040**		
Stock in other banks		**797**	**797**		
Total securities available for sale	**Recurring**	**$ 124,758**	**$ 1,837**	**$ 122,921**	**$**
Impaired loans	**Nonrecurring**	**$ 6,782**	**$**	**$**	**$ 6,782**
Foreclosed assets held for resale	**Nonrecurring**	**$ 413**	**$**	**$**	**$ 413**

		December 31, 2013			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		$ 21,651	$	$ 21,651	$
Mortgage-backed securities, residential		53,740		53,740	

State and municipal		41,522		41,522	
Corporate bonds		11,165		11,165	
CRA mutual fund		1,033	1,033		
Stock in other banks		872	872		
Total securities available for sale	Recurring	$ 129,983	$ 1,905	$ 128,078	$
Impaired loans	Nonrecurring	$ 6,887	$	$	$ 6,887
Foreclosed assets held for resale	Nonrecurring	$ 413	$	$	$ 413

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Corporation has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level 3 Fair Value Measurements

Dollars in thousands	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
March 31, 2014					
Impaired loans	**$ 6,782**	**Appraisal of collateral** (a)	**Appraisal adjustments** (b)	**(10) - (50)%**	**(19)%**
Foreclosed assets held for resale	**$ 413**	**Appraisal of collateral** (a)	**Appraisal adjustments** (b)	**(10) - (50)%**	**(35)%**
December 31, 2013					
Impaired loans	$ 6,887	Appraisal of collateral (a)	Appraisal adjustments (b)	**(10) - (50)%**	(19)%
Foreclosed assets held for resale	$ 413	Appraisal of collateral (a)	Appraisal adjustments (b)	**(10) - (50)%**	(35)%

(a) Fair value is generally determined through independent third-party appraisals of the underlying collateral, which generally includes various Level 3 inputs which are not observable.

(b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percentage of the appraisal. Higher downward adjustments are caused by negative changes to the collateral or conditions in the real estate market, actual offers or sales contracts received, and/or age of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation s financial instruments at March 31, 2014, and December 31, 2013:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the consolidated statement of condition for cash and short-term instruments approximate those assets fair value. U.S. currency is Level 1 and cash equivalents are Level 2.

Securities

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or by matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing, and uses the valuation of another provider to compare for reasonableness.

Loans Held for Sale (Carried at Lower of Cost or Fair Value)

The fair values of mortgage loans held for sale are determined based on amounts to be received at settlement by establishing the respective buyer requirement or market interest rates.

Loans (Carried at Cost)

The fair values of loans are estimated using discounted cash flow analyses, as well as using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments, and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Loans for which the Corporation has measured impairment are generally based on the fair value of the loan s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less the valuation allowance and/or charge-offs.

Foreclosed Assets Held for Resale

The fair value of real estate acquired through foreclosure is based on independent third-party appraisals of the properties. These assets are included as Level 3 fair values, based upon appraisals that consider the sales prices of similar properties in the proximate vicinity.

It is the policy of the Corporation to have the initial market value of a foreclosed asset held for resale determined by an independent third-party valuation. If the Corporation already has a valid appraisal on file for the property and that appraisal has been completed within the previous 12 months, another appraisal shall not be required when the Corporation acquires ownership of that real estate. Further, the Corporation shall update the market value of each foreclosed asset with an independent third-party valuation at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined. These valuations may be adjusted downward to account for specialized use of the property, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral.

Restricted Investment in Bank Stock (Carried at Cost)

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amounts of accrued interest receivable and accrued interest payable approximate their fair value.

Deposits (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (e.g., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings (Carried at Cost)

The carrying amounts of short-term borrowings approximate their fair values.

Long-Term Borrowings (Carried at Cost)

The fair values of Federal Home Loan Bank (FHLB) advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms, and remaining maturity. The prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-Balance Sheet Credit-Related Instruments

The fair values for the Corporation s off-balance sheet financial instruments (specifically, lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing.

25

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of March 31, 2014, and December 31, 2013:

	March 31, 2014				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	**$ 15,083**	**$ 15,083**	**$ 5,596**	**$ 9,487**	**$**
Interest-bearing deposits in banks	**4,132**	**4,132**	**4,132**		
Investment securities available for sale	**124,758**	**124,758**	**1,837**	**122,921**	
Investment securities held to maturity	**91,503**	**89,947**		**89,947**	
Loans, less allowance for loan losses	**716,401**	**729,842**			**729,842**
Accrued interest receivable	**3,105**	**3,105**		**3,105**	
Restricted investment in bank stocks	**5,989**	**5,989**		**5,989**	
Financial liabilities:					
Deposits	**816,219**	**816,956**		**816,956**	
Short-term borrowings	**39,682**	**39,682**		**39,682**	
Long-term borrowings	**74,637**	**76,416**		**76,416**	
Accrued interest payable	**613**	**613**		**613**	
Off-balance sheet financial instruments					

December 31, 2013

In thousands	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 13,963	$ 13,963	$ 7,755	$ 6,208	$
Interest-bearing deposits in banks	4,153	4,153	4,153		
Investment securities available for sale	129,983	129,983	1,905	128,078	
Investment securities held to maturity	94,373	92,082		92,082	
Loans held for sale	496	496		496	
Loans, less allowance for loan losses	712,557	724,937			724,937
Accrued interest receivable	3,027	3,027		3,027	
Restricted investment in bank stocks	6,861	6,861		6,861	
Financial liabilities:					
Deposits	800,643	801,063		801,063	
Short-term borrowings	49,052	49,052		49,052	
Long-term borrowings	82,703	84,558		84,558	
Accrued interest payable	681	681		681	
Off-balance sheet financial instruments					

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