

PEOPLES FINANCIAL SERVICES CORP.

Form 10-Q

August 07, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended June 30, 2015**

or

.. **Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
for the transition period from**

001-36388

(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State of

incorporation)

150 North Washington Avenue, Scranton, PA
(Address of principal executive offices)

(570) 346-7741

23-2391852
(IRS Employer

ID Number)

18503
(Zip code)

(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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company as defined in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of the registrant's common stock, as of the latest practicable date: 7,542,725 at July 31, 2015.

Exhibit index on page 49

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PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended June 30, 2015

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Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED BALANCE SHEETS (UNAUDITED)****(Dollars in thousands, except share data)**

	June 30, 2015	December 31, 2014
Assets:		
Cash and due from banks	\$ 28,847	\$ 24,656
Interest-bearing deposits in other banks	6,710	6,770
Federal funds sold		
Investment securities:		
Available-for-sale	318,790	339,586
Held-to-maturity: Fair value June 30, 2015, \$14,104; December 31, 2014, \$15,215	13,626	14,665
Total investment securities	332,416	354,251
Loans held for sale	2,879	3,486
Loans, net	1,231,541	1,209,894
Less: allowance for loan losses	11,428	10,338
Net loans	1,220,113	1,199,556
Premises and equipment, net	26,552	25,433
Accrued interest receivable	5,507	5,580
Goodwill	63,370	63,370
Intangible assets	4,901	5,501
Other assets	56,460	53,066
Total assets	\$ 1,747,755	\$ 1,741,669
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 296,823	\$ 313,498
Interest-bearing	1,127,944	1,112,060
Total deposits	1,424,767	1,425,558
Short-term borrowings	25,860	19,557
Long-term debt	31,663	33,140
Accrued interest payable	443	574
Other liabilities	14,618	16,061
Total liabilities	1,497,351	1,494,890
Stockholders equity:		
Common stock: par value \$2.00, authorized 25,000,000 shares; June 30, 2015, issued and outstanding 7,542,725 shares; December 31, 2014, issued and	15,086	15,097

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outstanding 7,548,358 shares

Capital surplus	140,045	140,214
Retained earnings	97,093	92,297
Accumulated other comprehensive loss	(1,820)	(829)
Total stockholders' equity	250,404	246,779
Total liabilities and stockholders' equity	\$ 1,747,755	\$ 1,741,669

See notes to consolidated financial statements

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)**

(Dollars in thousands, except per share data)

June 30,	Three Months Ended		Six Months Ended	
	2015	2014	2015	2014
Interest income:				
Interest and fees on loans:				
Taxable	\$ 13,391	\$ 13,159	\$ 26,731	\$ 27,159
Tax-exempt	570	507	1,129	1,142
Interest and dividends on investment securities:				
Taxable	816	942	1,716	1,870
Tax-exempt	835	817	1,640	1,646
Dividends	6	14	15	30
Interest on interest-bearing deposits in other banks	15	9	26	19
Interest on federal funds sold	5	34	9	48
Total interest income	15,638	15,482	31,266	31,914
Interest expense:				
Interest on deposits	1,192	1,414	2,460	2,771
Interest on short-term borrowings	4	24	12	58
Interest on long-term debt	252	289	511	585
Total interest expense	1,448	1,727	2,983	3,414
Net interest income	14,190	13,755	28,283	28,500
Provision for loan losses	750	1,201	1,500	2,058
Net interest income after provision for loan losses	13,440	12,554	26,783	26,442
Noninterest income:				
Service charges, fees and commissions	1,542	1,557	3,154	3,181
Merchant services income	963	888	1,753	1,782
Commission and fees on fiduciary activities	487	548	946	1,115
Wealth management income	198	165	403	352
Mortgage banking income	248	193	470	292
Life insurance investment income	188	267	377	456
Net gain on sale of investment securities available-for-sale		160	832	160
Total noninterest income	3,626	3,778	7,935	7,338
Noninterest expense:				

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Salaries and employee benefits expense	5,613	4,961	10,846	10,129
Net occupancy and equipment expense	2,149	2,327	4,617	4,060
Merchant services expense	650	495	1,183	1,060
Amortization of intangible assets	295	333	600	676
Acquisition related expense		1,008		1,616
Other expenses	2,804	3,115	5,359	5,985
Total noninterest expense	11,511	12,239	22,605	23,526
Income before income taxes	5,555	4,093	12,113	10,254
Income tax expense	1,124	762	2,638	2,225
Net income	4,431	3,331	9,475	8,029

Other comprehensive income (loss):

Unrealized gain (loss) on investment securities available-for-sale	(1,459)	1,242	(692)	3,636
Reclassification adjustment for net gain on sales included in net income		(160)	(832)	(160)
Other comprehensive income (loss)	(1,459)	1,082	(1,524)	3,476
Income tax expense (benefit) related to other comprehensive income (loss)	(510)	378	(533)	1,216
Other comprehensive income (loss), net of income taxes	(949)	704	(991)	2,260
Comprehensive income	\$ 3,482	\$ 4,035	\$ 8,484	\$ 10,289

Per share data:

Net income:				
Basic	\$ 0.59	\$ 0.44	\$ 1.26	\$ 1.06
Diluted	\$ 0.59	\$ 0.44	\$ 1.26	\$ 1.06
Average common shares outstanding:				
Basic	7,546,198	7,548,358	7,547,272	7,549,300
Diluted	7,546,198	7,570,883	7,547,272	7,575,655
Dividends declared	\$ 0.31	\$ 0.31	\$ 0.62	\$ 0.62

See notes to consolidated financial statements

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)**

(Dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2015	\$ 15,097	\$ 140,214	\$ 92,297	\$ (829)	\$	\$ 246,779
Stock based compensation		35				35
Net income			9,475			9,475
Other comprehensive loss, net of income taxes				(991)		(991)
Dividends declared: \$0.62 per share			(4,679)			(4,679)
Shares retired: 5,633 shares	(11)	(204)				(215)
Balance, June 30, 2015	\$ 15,086	\$ 140,045	\$ 97,093	\$ (1,820)	\$	\$ 250,404
Balance, January 1, 2014	\$ 15,614	\$ 146,109	\$ 84,008	\$ (698)	\$ (6,241)	\$ 238,792
Net income			8,029			8,029
Other comprehensive income, net of income taxes				2,260		2,260
Dividends declared: \$0.62 per share			(4,681)			(4,681)
Shares retired: 3,386 shares	(7)	(102)				(109)
Reissuance under option plan: 600 shares		28			11	39
Repurchase and held: 1,800 shares					(70)	(70)
Retirement of stock options		(95)				(95)
Retirement of treasury shares	(510)	(5,790)			6,300	
Balance, June 30, 2014	\$ 15,097	\$ 140,150	\$ 87,356	\$ 1,562	\$	\$ 244,165

See notes to consolidated financial statements

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(Dollars in thousands, except per share data)

For the Six Months Ended June 30	2015	2014
Cash flows from operating activities:		
Net income	\$ 9,475	\$ 8,029
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	784	947
Amortization of deferred loan costs	284	78
Amortization of intangibles	600	676
Net accretion of purchase accounting adjustments on tangible assets	(501)	(1,965)
Provision for loan losses	1,500	2,058
Net gain on sale of other real estate owned	(110)	(41)
Net loss on disposal of equipment		63
Net amortization of investment securities	2,054	2,116
Loans originated for sale	(14,079)	(4,866)
Proceeds from sale of loans originated for sale	15,155	3,527
Net (gain) loss on sale of loans originated for sale	(469)	339
Net gain on sale of investment securities	(832)	(160)
Life insurance investment income	(377)	(395)
Deferred income tax expense (benefit)	119	
Stock based compensation	35	11
Net change in:		
Accrued interest receivable	73	290
Other assets	(3,235)	(4,764)
Accrued interest payable	(131)	(143)
Stock appreciation rights		301
Other liabilities	(1,478)	3,841
Net cash provided by operating activities	8,867	9,942
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	50,981	4,984
Proceeds from repayments of investment securities:		
Available-for-sale	28,253	18,245
Held-to-maturity	1,016	1,352
Purchases of investment securities:		
Available-for-sale	(61,162)	(34,289)
Held-to-maturity		
Net redemption of restricted equity securities	330	182
Net increase in lending activities	(22,414)	(3,223)
Purchases of premises and equipment	(1,953)	(636)
Proceeds from the sale of premises and equipment		25

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Proceeds from sale of other real estate owned	463	321
Net cash used in investing activities	(4,486)	(13,039)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(424)	43,866
Repayment of long-term debt	(1,450)	(1,791)
Net increase (decrease) in short-term borrowings	6,303	(7,964)
Redemption of common stock		(70)
Retirement of stock options		(95)
Purchase of treasury stock		(70)
Cash dividends paid	(4,679)	(4,681)
Net cash provided by (used in) financing activities	(250)	29,195
Net increase (decrease) in cash and cash equivalents	4,131	26,098
Cash and cash equivalents at beginning of year	31,426	51,310
Cash and cash equivalents at end of year	\$ 35,557	\$ 77,408

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(Dollars in thousands, except per share data)

For the Six Months Ended June 30	2015	2014
Supplemental disclosures:		
Cash paid during the period for:		
Interest	\$ 3,114	\$ 3,557
Income taxes	1,800	1,300
Noncash items:		
Transfers of loans to other real estate	\$ 247	\$ 258
Retirement of treasury shares		6,300
Acquisition:		
Fair value of assets acquired:		
Loans, net	\$ 157	\$ 1,417
Premises and equipment	(50)	(50)
Core deposit and other intangible assets	(600)	(676)
	\$ (493)	\$ 691
Fair value of liabilities assumed:		
Deposits	\$ 367	\$ 571
Long-term debt	27	27
	\$ 394	\$ 598

See notes to consolidated financial statements

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Summary of significant accounting policies:

Nature of operations:

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company (Peoples Bank), including its subsidiaries, Peoples Advisors, LLC and Penseco Realty, Inc. (collectively, the Company or Peoples). The Company services its retail and commercial customers through twenty-six full-service community banking offices located within the Lackawanna, Lehigh, Luzerne, Monroe, Susquehanna, Wayne and Wyoming Counties of Pennsylvania and Broome County of New York.

Basis of presentation:

The accompanying unaudited consolidated financial statements of the Company 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 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform to the current year presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three and six months ended and as of June 30, 2015, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, impairment of goodwill and fair value of assets acquired and liabilities assumed in business combinations. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, reference is made to the Company s Annual Report on Form 10-K for the period ended December 31, 2014.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2015, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****Recent accounting standards:**

In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-08, Business Combinations (Topic 805): Pushdown Accounting Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin (SAB) 115. This ASU rescinds certain SEC guidance in order to conform with ASU 2014-17, Pushdown Accounting. ASU 2014-17 was issued in November 2014 and provides a reporting entity that is a business or nonprofit activity (an acquiree) the option to apply pushdown accounting to its separate financial statements when an acquirer obtains control of the acquiree. SAB 115 became effective November 21, 2014. The adoption of ASU 2015-18 did not have a material effect on the operating results or financial position of the Company.

2. Other comprehensive income (loss):

The components of other comprehensive loss and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive income (loss) included in the Consolidated Balance Sheets relates to net unrealized gains and losses on investment securities available-for-sale and benefit plan adjustments.

The components of accumulated other comprehensive loss included in stockholders' equity at June 30, 2015 and December 31, 2014 is as follows:

	June 30, 2015	December 31, 2014
Net unrealized gain on investment securities available-for-sale	\$ 4,768	\$ 6,292
Related income taxes	1,669	2,202
Net of income taxes	3,099	4,090
Benefit plan adjustments	(7,567)	(7,567)
Related income taxes	(2,648)	(2,648)
Net of income taxes	(4,919)	(4,919)
Accumulated other comprehensive loss	\$ (1,820)	\$ (829)

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****2. Other comprehensive income (loss) continued:**

Other comprehensive income (loss) and related tax effects for the three and six months ended June 30, 2015 and 2014 is as follows:

Three months ended June 30	2015	2014
Unrealized gain (loss) on investment securities available-for-sale	\$ (1,459)	\$ 1,242
Net gain on the sale of investment securities available-for-sale (1)		(160)
Other comprehensive income (loss) gain before taxes	(1,459)	1,082
Income tax expense (benefit)	(510)	378
Other comprehensive income (loss)	\$ (949)	\$ 704
Six months ended June 30	2015	2014
Unrealized gain (loss) on investment securities available-for-sale	\$ (692)	\$ 3,636
Net gain on the sale of investment securities available-for-sale (1)	(832)	(160)
Other comprehensive income (loss) gain before taxes	(1,524)	3,476
Income tax expense (benefit)	(533)	1,216
Other comprehensive income (loss)	\$ (991)	\$ 2,260

(1) Represents amounts reclassified out of accumulated comprehensive income and included in gains on sale of investment securities on the consolidated statements of income and comprehensive income.

3. Earnings per share:

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company

relate solely to outstanding stock options, and are determined using the treasury stock method.

There were no shares considered anti-dilutive for the three and six month periods ended June 30, 2015 and 2014.

For the three months ended June 30	2015		2014	
	Basic	Diluted	Basic	Diluted
Net Income (Numerator)	\$ 4,431	\$ 4,431	\$ 3,331	\$ 3,331
Average common shares outstanding (Denominator)	7,546,198	7,546,198	7,548,358	7,570,883
Earnings per share	\$ 0.59	\$ 0.59	\$ 0.44	\$ 0.44

For the six months ended June 30	2015		2014	
	Basic	Diluted	Basic	Diluted
Net Income (Numerator)	\$ 9,475	\$ 9,475	\$ 8,029	\$ 8,029
Average common shares outstanding (Denominator)	7,547,272	7,547,272	7,549,300	7,575,655
Earnings per share	\$ 1.26	\$ 1.26	\$ 1.06	\$ 1.06

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****4. Investment securities:**

The amortized cost and fair value of investment securities aggregated by investment category at June 30, 2015 and December 31, 2014 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30 2015				
Available-for-sale:				
U.S. Treasury securities	\$ 30,631	\$ 84	\$ 30	\$ 30,685
U.S. Government-sponsored enterprises	85,377	490	5	85,862
State and municipals:				
Taxable	15,930	804	22	16,712
Tax-exempt	109,241	3,886	613	112,514
Mortgage-backed securities:				
U.S. Government agencies	32,995	156	62	33,089
U.S. Government-sponsored enterprises	39,848	250	170	39,928
Total	\$ 314,022	\$ 5,670	\$ 902	\$ 318,790
Held-to-maturity:				
State and municipals Tax-exempt	\$ 7,369	\$ 103	\$ 53	\$ 7,419
Mortgage-backed securities:				
U.S. Government agencies	93	1		94
U.S. Government-sponsored enterprises	6,164	427		6,591
Total	\$ 13,626	\$ 531	\$ 53	\$ 14,104

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

4. Investment securities (continued):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2014				
Available-for-sale:				
U.S. Treasury securities	\$ 48,393	\$ 157		\$ 48,550
U.S. Government-sponsored enterprises	95,990	337	\$ 82	96,245
State and municipals:				
Taxable	16,490	943	26	17,407
Tax-exempt	87,954	4,971	24	92,901
Mortgage-backed securities:				
U.S. Government agencies	37,511	132	167	37,476
U.S. Government-sponsored enterprises	46,956	277	226	47,007
Total	\$ 333,294	\$ 6,817	\$ 525	\$ 339,586
Held-to-maturity:				
Tax-exempt state and municipals	\$ 7,370	\$ 105	\$ 38	\$ 7,437
Mortgage-backed securities:				
U.S. Government agencies	100	2		102
U.S. Government-sponsored enterprises	7,195	481		7,676
Total	\$ 14,665	\$ 588	\$ 38	\$ 15,215

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at June 30, 2015, is summarized as follows:

	Fair Value
June 30, 2015	
Within one year	\$ 28,289
After one but within five years	108,675
After five but within ten years	54,059
After ten years	54,750
	245,773

Mortgage-backed securities	73,017
Total	\$ 318,790

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The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at June 30, 2015, is summarized as follows:

June 30, 2015	Amortized Cost	Fair Value
Within one year		
After one but within five years	\$ 326	\$ 330
After five but within ten years	176	180
After ten years	6,867	6,909
	7,369	7,419
Mortgage-backed securities	6,257	6,685
Total	\$ 13,626	\$ 14,104

Securities with a carrying value of \$191,687 and \$216,192 at June 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

Securities and short-term investment activities are conducted with a diverse group of government entities, corporations and state and local municipalities. The counterparty's creditworthiness and type of collateral is evaluated on a case-by-case basis. At June 30, 2015 and December 31, 2014, there were no significant concentrations of credit risk from any one issuer, with the exception of U.S. Government agencies and sponsored enterprises that exceeded 10.0 percent of stockholders' equity.

The fair value and gross unrealized losses of investment securities with unrealized losses for which an other-than-temporary impairment (OTTI) has not been recognized at June 30, 2015 and December 31, 2014, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

June 30, 2015	Less Than 12 Months	12 Months or More	Total
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	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	\$ 10,044	\$ 30			\$ 10,044	\$ 30
U.S. Government-sponsored enterprises	3,003	5			3,003	5
State and municipals:						
Taxable			\$ 545	\$ 22	545	22
Tax-exempt	44,196	636	786	30	44,982	666
Mortgage-backed securities:						
U.S. Government agencies	7,457	26	5,402	36	12,859	62
U.S. Government-sponsored enterprises	13,785	68	3,721	102	17,506	170
Total	\$ 78,485	\$ 765	\$ 10,454	\$ 190	\$ 88,939	\$ 955

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****4. Investment securities (continued):**

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2014						
U.S. Government-sponsored enterprises	\$ 21,228	\$ 33	\$ 7,954	\$ 49	\$ 29,182	\$ 82
State and municipals:						
Taxable			544	26	544	26
Tax-exempt	4,702	23	2,423	39	7,125	62
Mortgage-backed securities:						
U.S. Government agencies	20,148	167			20,148	167
U.S. Government-sponsored enterprises	22,870	226			22,870	226
Total	\$ 68,948	\$ 449	\$ 10,921	\$ 114	\$ 79,869	\$ 563

The Company had 110 investment securities, consisting of 84 tax-exempt state and municipal obligations, two U.S. Treasury Securities, one taxable state and municipal obligation, one U.S. Government-sponsored enterprise securities, and 22 mortgage-backed securities that were in unrealized loss positions at June 30, 2015. Of these securities, one taxable state and municipal obligation, six mortgage-backed securities and three tax-exempt state and municipal securities were in a continuous unrealized loss position for twelve months or more. Management does not consider the unrealized losses on the debt securities, as a result of changes in interest rates, to be OTTI based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuers or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at June 30, 2015. There was no OTTI recognized for the three or six months ended June 30, 2015 and 2014.

The Company had 52 investment securities, consisting of 16 tax-exempt state and municipal obligations, one taxable state and municipal obligation, nine U.S. Government-sponsored enterprise securities and 26 mortgage-backed securities that were in unrealized loss positions at December 31, 2014. Of these securities, two U.S. Government-sponsored enterprise securities, four tax-exempt state and municipal securities, and one taxable state and municipal obligation were in a continuous unrealized loss position for twelve months or more.

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses:

The major classifications of loans outstanding, net of deferred loan origination fees and costs at June 30, 2015 and December 31, 2014 are summarized as follows. Net deferred loan costs were \$700 and \$651 at June 30, 2015 and December 31, 2014.

	June 30, 2015	December 31, 2014
Commercial	\$ 322,418	\$ 319,590
Real estate:		
Commercial	511,835	493,481
Residential	312,567	310,667
Consumer	84,721	86,156
Total	\$ 1,231,541	\$ 1,209,894

The changes in the allowance for loan losses account by major classification of loan for the three and six months ended June 30, 2015 and 2014 are summarized as follows:

June 30, 2015	Real estate				Total
	Commercial	Commercial	Residential	Consumer	
Allowance for loan losses:					
Beginning Balance April 1, 2015	\$ 2,420	\$ 3,087	\$ 3,909	\$ 1,387	\$ 10,803
Charge-offs	(3)	(30)	(35)	(106)	(174)
Recoveries	3	5	3	38	49
Provisions	15	128	150	457	750
Ending balance	\$ 2,435	\$ 3,190	\$ 4,027	\$ 1,776	\$ 11,428

June 30, 2015	Real estate				Total
	Commercial	Commercial	Residential	Consumer	
Allowance for loan losses:					
Beginning Balance January 1, 2015	\$ 2,321	\$ 3,037	\$ 3,690	\$ 1,290	\$ 10,338
Charge-offs	(40)	(79)	(234)	(186)	(539)
Recoveries	64	6	8	51	129

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Provisions	90	226	563	621	1,500
Ending balance	\$ 2,435	\$ 3,190	\$ 4,027	\$ 1,776	\$ 11,428

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

June 30, 2014	Real estate				Total
	Commercial	Commercial	Residential	Consumer	
Allowance for loan losses:					
Beginning Balance April 1, 2014	\$ 1,961	\$ 2,473	\$ 3,248	\$ 1,177	\$ 8,859
Charge-offs	(29)	(404)	(270)	(87)	(790)
Recoveries	1	269	35	47	352
Provisions	268	337	445	151	1,201
Ending balance	\$ 2,201	\$ 2,675	\$ 3,458	\$ 1,288	\$ 9,622

June 30, 2014	Real estate				Total
	Commercial	Commercial	Residential	Consumer	
Allowance for loan losses:					
Beginning Balance January 1, 2014	\$ 2,008	\$ 2,394	\$ 3,135	\$ 1,114	\$ 8,651
Charge-offs	(376)	(432)	(510)	(155)	(1,473)
Recoveries	1	269	38	78	386
Provisions	568	444	795	251	2,058
Ending balance	\$ 2,201	\$ 2,675	\$ 3,458	\$ 1,288	\$ 9,622

The allocation of the allowance for loan losses and the related loans by major classifications of loans at June 30, 2015 and December 31, 2014 is summarized as follows:

June 30, 2015	Real estate				Consumer	Unallocated	Total
	Commercial	Commercial	Residential				
Ending balance	\$ 2,435	\$ 3,190	\$ 4,027	\$ 1,776	\$	\$	11,428
Ending balance: individually evaluated for impairment	1,209	1,338	796	137			3,480
Ending balance: collectively evaluated for impairment	1,226	1,745	3,231	1,639			7,841

Ending balance: loans acquired with deteriorated credit quality	\$	\$ 107	\$	\$	\$ 107
Loans receivable:					
Ending balance	\$	322,418	\$ 511,835	\$ 312,567	\$ 84,721 \$ 1,231,541
Ending balance: individually evaluated for impairment		1,948	6,080	4,385	137 12,550
Ending balance: collectively evaluated for impairment		319,448	504,379	308,127	\$ 84,584 1,216,538
Ending balance: loans acquired with deteriorated credit quality	\$	1,022	\$ 1,376	\$ 55	\$ \$ 2,453

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

December 31, 2014	Real estate				Consumer	Unallocated	Total
	Commercial	Commercial	Residential				
Allowance for loan losses:							
Ending balance	\$ 2,321	\$ 3,037	\$ 3,690	\$ 1,290	\$	\$	10,338
Ending balance: individually evaluated for impairment	1,072	805	767	38			2,682
Ending balance: collectively evaluated for impairment	1,081	2,125	2,921	1,252			7,379
Ending balance: loans acquired with deteriorated credit quality	\$ 168	\$ 107	\$ 2			\$	277
Loans receivable:							
Ending balance	\$ 319,590	\$ 493,481	\$ 310,667	\$ 86,156	\$	\$	1,209,894
Ending balance: individually evaluated for impairment	2,595	5,084	4,001	127			11,807
Ending balance: collectively evaluated for impairment	315,642	487,024	306,608	\$ 86,029			1,195,303
Ending balance: loans acquired with deteriorated credit quality	\$ 1,353	\$ 1,373	\$ 58		\$	\$	2,784

The Company segments loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans are individually analyzed for credit risk by classifying them within the Company's internal risk rating system. The Company's risk rating classifications are defined as follows:

Pass- A loan to borrowers with acceptable credit quality and risk that is not adversely classified as Substandard, Doubtful, Loss nor designated as Special Mention.

Special Mention- A loan that has potential weaknesses that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special Mention loans are not adversely classified since they do not expose the Company to sufficient risk to warrant adverse classification.

Substandard- A loan that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful A loan classified as Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss- A loan classified as Loss is considered uncollectible and of such little value that its continuance as bankable loan is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

The following tables present the major classification of loans summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system at June 30, 2015 and December 31, 2014:

June 30, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 309,696	\$ 6,171	\$ 6,551	\$	\$ 322,418
Real estate:					
Commercial	486,289	13,280	12,266		511,835
Residential	301,962	1,865	8,740		312,567
Consumer	84,583		138		84,721
Total	\$ 1,182,530	\$ 21,316	\$ 27,695	\$	\$ 1,231,541

December 31, 2014:	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 306,066	\$ 6,135	\$ 7,389	\$	\$ 319,590
Real estate:					
Commercial	472,270	9,858	11,353		493,481
Residential	300,299	2,123	8,245		310,667
Consumer	86,037	13	106		86,156
Total	\$ 1,164,672	\$ 18,129	\$ 27,093	\$	\$ 1,209,894

Information concerning nonaccrual loans by major loan classification at June 30, 2015 and December 31, 2014 is summarized as follows:

	June 30, 2015	December 31, 2014
Commercial	\$ 1,499	\$ 1,322
Real estate:		

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Commercial	3,468	3,732
Residential	3,881	3,523
Consumer	135	122
Total	\$ 8,983	\$ 8,699

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

The major classifications of loans by past due status are summarized as follows:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
June 30, 2015							
Commercial	\$ 426	\$ 61	\$ 1,499	\$ 1,986	\$ 320,432	\$ 322,418	
Real estate:							
Commercial	3,000	205	3,468	6,673	505,162	511,835	
Residential	1,098	1,708	4,611	7,417	305,150	312,567	\$ 730
Consumer	654	232	477	1,363	83,358	84,721	342
Total	\$ 5,178	\$ 2,206	\$ 10,055	\$ 17,439	\$ 1,214,102	\$ 1,231,541	\$ 1,072

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
December 31, 2014							
Commercial	\$ 898	\$ 117	\$ 1,322	\$ 2,337	\$ 317,253	\$ 319,590	
Real estate:							
Commercial	2,100	888	3,868	6,856	486,625	493,481	\$ 136
Residential	3,154	1,239	4,585	8,978	301,689	310,667	1,062
Consumer	848	247	547	1,642	84,514	86,156	425
Total	\$ 7,000	\$ 2,491	\$ 10,322	\$ 19,813	\$ 1,190,081	\$ 1,209,894	\$ 1,623

The following tables summarize information concerning impaired loans as of and for the three and six months ended June 30, 2015 and June 30, 2014, and as of and for the year ended, December 31, 2014 by major loan classification:

This Quarter**Year-to-Date**

June 30, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:							
Commercial	\$ 1,658	\$ 3,184		\$ 1,989	\$ 17	\$ 2,168	\$ 37
Real estate:							
Commercial	2,140	2,852		2,169	28	2,366	47
Residential	2,734	2,917		2,503	1	2,488	2
Consumer				6		26	
Total	6,532	8,953		6,667	46	7,048	86
With an allowance recorded:							
Commercial	1,312	1,312	\$ 1,209	1,469	13	1,533	27
Real estate:							
Commercial	5,316	5,316	1,445	4,628	48	4,182	65
Residential	1,706	1,706	796	1,673	7	1,593	17
Consumer	137	137	137	114		91	
Total	8,471	8,471	3,587	7,884	68	7,399	109
Commercial	2,970	4,496	1,209	3,458	30	3,701	64
Real estate:							
Commercial	7,456	8,168	1,445	6,797	76	6,548	112
Residential	4,440	4,623	796	4,176	8	4,081	19
Consumer	137	137	137	120		117	
Total	\$ 15,003	\$ 17,424	\$ 3,587	\$ 14,551	\$ 114	\$ 14,447	\$ 195

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(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses (continued):

December 31, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the Year Ended Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Commercial	\$ 2,379	\$ 4,084		\$ 2,669	141
Real estate:					
Commercial	2,932	3,690		7,944	120
Residential	2,672	2,857		2,731	4
Consumer	83	83		94	
Total	8,066	10,714		13,438	265
With an allowance recorded:					
Commercial	1,569	1,569	\$ 1,240	1,787	\$ 58
Real estate:					
Commercial	3,525	3,525	912	2,293	28
Residential	1,387	1,387	769	590	10
Consumer	44	44	38	10	1
Total	6,525	6,525	2,959	4,680	97
Commercial	3,948	5,653	1,240	4,456	199
Real estate:					
Commercial	6,457	7,215	912	10,237	148
Residential	4,059	4,244	769	3,321	14
Consumer	127	127	38	104	1
Total	\$ 14,591	\$ 17,239	\$ 2,959	\$ 18,118	\$ 362

June 30, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	This Quarter Average Recorded Investment	Interest Income Recognized	Year-to-Date Average Recorded Investment	Interest Income Recognized

With no related allowance:

Commercial	\$ 2,649	\$ 4,470	\$2,329	\$ 28	\$2,908	\$ 52
Real estate:						