FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
November 05, 2018
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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

For the transition period from__________ to___________

Commission file number 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(717) 264-6116

(Registrant's telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 4,399,135 outstanding shares of the Registrant's common stock as of October 31, 2018.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets

| (Dollars in thousands, except share and per share data)(unaudited) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $ 16,281 | $ 21,433 |
| Interest-bearing deposits in other banks | 28,496 | 37,170 |
| Total cash and cash equivalents | 44,777 | 58,603 |
| Debt securities available for sale, at fair value | 125,403 | 126,971 |
| Equity securities | 383 | 365 |
| Restricted stock | 452 | 456 |
| Loans held for sale | 1,072 | 442 |
| Loans | 970,983 | 943,700 |
| Allowance for loan losses | (12,526) | (11,792) |
| Net Loans | 958,457 | 931,908 |
| Premises and equipment, net | 13,267 | 13,741 |
| Bank owned life insurance | 23,366 | 22,980 |
| Goodwill | 9,016 | 9,016 |
| Other real estate owned | 2,665 | 2,598 |
| Deferred tax asset, net | 4,170 | 5,803 |
| Other assets | 11,596 | 6,930 |
| Total assets | $ 1,194,624 | $ 1,179,813 |
| | | |
| Liabilities | | |
| Deposits | | |
| Non-interest bearing checking | $ 196,478 | $ 196,853 |
| Money management, savings and interest checking | 807,643 | 774,857 |
| Time | 67,736 | 75,471 |
| Total deposits | 1,071,857 | 1,047,181 |
| Other liabilities | 8,739 | 17,488 |
| Total liabilities | 1,080,596 | 1,064,669 |
| | | |
| Shareholders' equity | | |
| Common stock, $1 par value per share,15,000,000 shares authorized with 4,701,367 shares issued and 4,398,361 shares outstanding at September 30, 2018 and 4,689,099 shares issued and 4,354,788 shares outstanding at December 31, 2017 | 4,701 | 4,689 |
| Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding | — | — |
| Additional paid-in capital | 41,380 | 40,396 |
| Retained earnings | 81,330 | 82,218 |
| Accumulated other comprehensive loss | (7,790) | (6,028) |

| | | |
|---|---|---|
| Treasury stock, 303,006 shares at September 30, 2018 and 334,311 shares at December 31, 2017, at cost | (5,593) | (6,131) |
| Total shareholders' equity | 114,028 | 115,144 |
| Total liabilities and shareholders' equity | $ 1,194,624 | $ 1,179,813 |

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

Consolidated Statements of Income

| (Dollars in thousands, except per share data) (unaudited) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Interest income | | | | |
| Loans, including fees | $ 10,565 | $ 9,130 | $ 30,268 | $ 26,808 |
| Interest and dividends on investments: | | | | |
| Taxable interest | 507 | 509 | 1,548 | 1,558 |
| Tax exempt interest | 293 | 275 | 862 | 861 |
| Dividend income | 4 | 2 | 15 | 23 |
| Deposits and obligations of other banks | 108 | 147 | 326 | 297 |
| Total interest income | 11,477 | 10,063 | 33,019 | 29,547 |
| Interest expense | | | | |
| Deposits | 1,101 | 629 | 2,847 | 1,785 |
| Short-term borrowings | 21 | — | 24 | 15 |
| Total interest expense | 1,122 | 629 | 2,871 | 1,800 |
| Net interest income | 10,355 | 9,434 | 30,148 | 27,747 |
| Provision for loan losses | 250 | 250 | 9,579 | 420 |
| Net interest income after provision for loan losses | 10,105 | 9,184 | 20,569 | 27,327 |
| Noninterest income | | | | |
| Investment and trust services fees | 1,424 | 1,353 | 4,285 | 3,991 |
| Loan service charges | 191 | 201 | 640 | 657 |
| Deposit service charges and fees | 578 | 611 | 1,726 | 1,789 |
| Other service charges and fees | 357 | 340 | 1,043 | 996 |
| Debit card income | 422 | 325 | 1,224 | 1,062 |
| Increase in cash surrender value of life insurance | 129 | 130 | 386 | 391 |
| Net loss on sale of other real estate owned | — | (23) | — | (23) |
| Debt securities gains, net | 5 | 1 | 56 | 3 |
| Change in fair value of equity securities | (20) | — | 18 | — |
| Other | 34 | 33 | 111 | 186 |
| Total noninterest income | 3,120 | 2,971 | 9,489 | 9,052 |
| Noninterest Expense | | | | |
| Salaries and employee benefits | 4,947 | 4,694 | 15,029 | 14,190 |
| Occupancy, furniture and equipment, net | 780 | 809 | 2,383 | 2,386 |
| Advertising | 345 | 332 | 1,113 | 873 |
| Legal and professional | 436 | 502 | 1,207 | 1,173 |
| Data processing | 591 | 567 | 1,791 | 1,643 |
| Pennsylvania bank shares tax | 239 | 243 | 712 | 728 |
| FDIC Insurance | 159 | 82 | 452 | 281 |
| ATM/debit card processing | 258 | 190 | 734 | 630 |
| Foreclosed real estate | (8) | 24 | 46 | 95 |
| Telecommunications | 95 | 106 | 327 | 308 |
| Provision for credit losses on off-balance sheet exposures | — | — | 2,361 | — |
| Other | 729 | 756 | 2,253 | 2,116 |
| Total noninterest expense | 8,571 | 8,305 | 28,408 | 24,423 |
| Income before federal income taxes | 4,654 | 3,850 | 1,650 | 11,956 |

| | | | | |
|---|---|---|---|---|
| Federal income tax expense (benefit) | 654 | 774 | (671) | 2,517 |
| Net income | $ 4,000 | $ 3,076 | $ 2,321 | $ 9,439 |
| Per share | | | | |
| Basic earnings per share | $ 0.91 | $ 0.71 | $ 0.53 | $ 2.18 |
| Diluted earnings per share | $ 0.91 | $ 0.70 | $ 0.53 | $ 2.17 |
| Cash dividends declared | $ 0.27 | $ 0.24 | $ 0.78 | $ 0.69 |

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

Consolidated Statements of Comprehensive Income

| (Dollars in thousands) (unaudited) | For the Three Months Ended September 30, 2018 | 2017 | For the Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Net Income | $ 4,000 | $ 3,076 | $ 2,321 | $ 9,439 |
| | | | | |
| Debt Securities: | | | | |
| Unrealized (losses) gains arising during the period | (638) | (97) | (1,974) | 924 |
| Reclassification adjustment included in net income (1) | (5) | (1) | (56) | (3) |
| Net unrealized (losses) gains | (643) | (98) | (2,030) | 921 |
| Tax effect | 135 | 33 | 469 | (313) |
| Net of tax amount | (508) | (65) | (1,561) | 608 |
| | | | | |
| Total other comprehensive (loss) income | (508) | (65) | (1,561) | 608 |
| | | | | |
| Total Comprehensive Income | $ 3,492 | $ 3,011 | $ 760 | $ 10,047 |
| | | | | |
| Reclassification adjustment / Statement line item | Tax expense (benefit) | | | |
| (1) Debt securities gains, net | $ 1 | $ — | $ 12 | $ 1 |

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

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Consolidated Statements of Changes in Shareholders' Equity

For the three and nine months ended September 30, 2018 and 2017

| (Dollars in thousands, except per share data) (unaudited) | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock | Total |
|---|---|---|---|---|---|---|
| Balance at June 30, 2018 | $ 4,700 | $ 41,079 | $ 78,514 | $ (7,282) | $ (5,839) | $ 111,172 |
| Net income | — | — | 4,000 | — | — | 4,000 |
| Other comprehensive loss | — | — | — | (508) | — | (508) |
| Cash dividends declared, $.27 per share | — | — | (1,184) | — | — | (1,184) |
| Treasury shares issued under employee stock purchase plan, 381 shares | — | 5 | — | — | 7 | 12 |
| Treasury shares issued under dividend reinvestment plan, 12,957 shares | — | 210 | — | — | 239 | 449 |
| Common stock issued under incentive stock option plan, 1,600 shares | 1 | 24 | — | — | — | 25 |
| Stock option compensation expense | — | 62 | — | — | — | 62 |
| Balance at September 30, 2018 | $ 4,701 | $ 41,380 | $ 81,330 | $ (7,790) | $ (5,593) | $ 114,028 |
| | | | | | | |
| Balance at December 31, 2017 | $ 4,689 | $ 40,396 | $ 82,218 | $ (6,028) | $ (6,131) | $ 115,144 |
| Cumulative adjustment for fair value of equity securities | — | — | 201 | (201) | — | — |
| Net income | — | — | 2,321 | — | — | 2,321 |
| Other comprehensive (loss) | — | — | — | (1,561) | — | (1,561) |
| Cash dividends declared, $.78 per share | — | — | (3,410) | — | — | (3,410) |
| Acquisition of 2,605 shares of treasury stock | — | — | — | — | (88) | (88) |
| Treasury shares issued under employee stock purchase plan, 2,944 shares | — | 34 | — | — | 54 | 88 |
| Treasury shares issued under dividend reinvestment plan, 30,966 shares | — | 513 | — | — | 572 | 1,085 |
| Common stock issued under incentive stock option plan, 12,268 shares | 12 | 252 | — | — | — | 264 |
| Stock option compensation expense | — | 185 | — | — | — | 185 |
| Balance at September 30, 2018 | $ 4,701 | $ 41,380 | $ 81,330 | $ (7,790) | $ (5,593) | $ 114,028 |
| | | | | | | |
| Balance at June 30, 2017 | $ 4,688 | $ 40,096 | $ 87,498 | $ (3,542) | $ (6,380) | $ 122,360 |
| Net income | — | — | 3,076 | — | — | 3,076 |
| Other comprehensive (loss) | — | — | — | (65) | — | (65) |
| Cash dividends declared, $.24 per share | — | — | (1,042) | — | — | (1,042) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Treasury shares issued under employee stock purchase plan, 241 shares | — | 3 | — | — | 4 | 7 |
| Treasury shares issued under dividend reinvestment plan, 5,723 shares | — | 85 | — | — | 105 | 190 |
| Stock option compensation expense | — | 54 | — | — | — | 54 |
| Balance at September 30, 2017 | $ 4,688 | $ 40,238 | $ 89,532 | $ (3,607) | $ (6,271) | $ 124,580 |
| | | | | | | |
| Balance at December 31, 2016 | $ 4,688 | $ 39,752 | $ 83,081 | $ (4,215) | $ (6,813) | $ 116,493 |
| Net income | — | — | 9,439 | — | — | 9,439 |
| Other comprehensive income | — | — | — | 608 | — | 608 |
| Cash dividends declared, $.69 per share | — | — | (2,988) | — | — | (2,988) |
| Treasury shares issued under employee stock purchase plan, 6,568 shares | — | 29 | — | — | 120 | 149 |
| Treasury shares issued under dividend reinvestment plan, 22,990 shares | — | 296 | — | — | 422 | 718 |
| Stock option compensation expense | — | 161 | — | — | — | 161 |
| Balance at September 30, 2017 | $ 4,688 | $ 40,238 | $ 89,532 | $ (3,607) | $ (6,271) | $ 124,580 |

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

Consolidated Statements of Cash Flows

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| (Dollars in thousands) (unaudited) | | |
| Cash flows from operating activities | | |
| Net income | $ 2,321 | $ 9,439 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 989 | 973 |
| Net amortization of loans and investment securities | 1,307 | 1,269 |
| Amortization and net change in mortgage servicing rights valuation | — | 41 |
| Provision for loan losses | 9,579 | 420 |
| Change in fair value of equity securities | (18) | — |
| Debt securities gains, net | (56) | (3) |
| Pay-out of legal settlement | (10,000) | — |
| Provision for credit losses on off-balance sheet exposures | 2,361 | — |
| Loans originated for sale | (16,137) | (6,773) |
| Proceeds from sale of loans | 15,507 | 6,861 |
| Write-down of other real estate owned | 6 | 60 |
| Acquisition of other real estate owned | 105 | — |
| Write-down on premises and equipment available for sale | — | 45 |
| Loss on sale of premises | 17 | 23 |
| Increase in cash surrender value of life insurance | (386) | (391) |
| Stock option compensation | 185 | 161 |
| Contribution to pension plan | (1,000) | — |
| Increase in other assets | (4,441) | (1,242) |
| Increase in other liabilities | 1,638 | 2,753 |
| Net cash provided by operating activities | 1,977 | 13,636 |
| Cash flows from investing activities | | |
| Proceeds from sales and calls of investment securities available for sale | 4,115 | 875 |
| Proceeds from maturities and pay-downs of securities available for sale | 14,289 | 16,875 |
| Purchase of investment securities available for sale | (20,276) | (6,533) |
| Net decrease in restricted stock | 4 | 1,311 |
| Net increase in loans | (36,188) | (17,643) |
| Capital expenditures | (599) | (871) |
| Proceeds from sale of other assets | 117 | 154 |
| Net proceeds from the sale of other real estate | 32 | 2,255 |
| Net cash used in investing activities | (38,506) | (3,577) |
| Cash flows from financing activities | | |
| Net increase in demand deposits, interest-bearing checking, and savings accounts | 32,411 | 50,325 |
| Net (decrease) increase in time deposits | (7,735) | 703 |
| Net decrease in short-term borrowings | — | (24,270) |
| Dividends paid | (3,410) | (2,988) |
| Treasury shares issued under employee stock purchase plan | 88 | 149 |
| Treasury shares issued under dividend reinvestment plan | 1,085 | 718 |
| Common stock issued under stock option plans | 264 | — |

| | | |
|---|---|---|
| Net cash provided by financing activities | 22,703 | 24,637 |
| (Decrease) increase in cash and cash equivalents | (13,826) | 34,696 |
| Cash and cash equivalents as of January 1 | 58,603 | 36,665 |
| Cash and cash equivalents as of September 30 | $ 44,777 | $ 71,361 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid during the year for: | | |
| Interest on deposits and other borrowed funds | $ 2,818 | $ 1,786 |
| Income taxes | $ 250 | $ 3,405 |

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

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

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

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of September 30, 2018, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted.  It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation’s 2017 Annual Report on Form 10-K.  The consolidated results of operations for the nine month period ended September 30, 2018 are not necessarily indicative of the operating results for the full year.  Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

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

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

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars and shares in thousands, except per share data) | 2018 | 2017 | 2018 | 2017 |
| Weighted average shares outstanding (basic) | 4,391 | 4,343 | 4,375 | 4,332 |
| Impact of common stock equivalents | 21 | 21 | 24 | 21 |
| Weighted average shares outstanding (diluted) | 4,412 | 4,364 | 4,399 | 4,353 |

| | | | | |
|---|---|---|---|---|
| Anti-dilutive options excluded from calculation | — | — | — | — |
| Net income | $ 4,000 | $ 3,076 | $ 2,321 | $ 9,439 |
| Basic earnings per share | $ 0.91 | $ 0.71 | $ 0.53 | $ 2.18 |
| Diluted earnings per share | $ 0.91 | $ 0.70 | $ 0.53 | $ 2.17 |

Note 2. Recent Accounting Pronouncements

| Standard | Description | Effective Date | Effect on the financial statements or other significant matters |
|---|---|---|---|
| ASU 2018-02, Income Statement (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income | Under ASU 2018-02, entities are allowed, but not required, to reclassify from Accumulated Other Comprehensive Income (AOCI) to retained earnings stranded tax effects resulting from the new federal corporate income tax rate of the Tax Cuts and Jobs Act (the Act). The reclassification could include other stranded tax effects that related to the Act but do not directly related to the change in the federal rate. Tax effects that are stranded in AOCI for other reasons may not be reclassified. Entities also will have an option to adopt the standard retrospectively or in the period of adoption. | January 1, 2018 | The Corporation adopted the provisions of the ASU in the fourth quarter of 2017. The Company reclassified the disproportionate tax effect resulting from the Act by increasing retained earnings by $992 thousand and reducing AOCI by $992 thousand. |
| ASU 2016-15, Statements of Cash Flow (Topic 320): Classification of Certain Cash Receipts and Cash Payments | The standard clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are intended to reduce diversity in practice. The standard contains additional guidance clarifying when an entity should separate cash receipts and cash payments and classifies them into more than one class of cash flows (including when reasonable judgement is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance. | January 1, 2018 | The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. |
| ASU 2017-07, Employee Benefits Plan (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost | This standard requires an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The amendments in this update also allow only the service cost component to be eligible for capitalization when applicable. | January 1, 2018 | The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. The service cost is reported in Salaries and Benefits expense and the nonservice cost is included in Other Expense on the Consolidated Statement of Income, which totaled $107 thousand and was reclassified for the first nine months of 2017. |

| | | | |
|---|---|---|---|
| ASU 2014-09, Revenue from Contracts with Customers (Topic 606) | The amendments in this Update (ASU 2014-09) establish a comprehensive revenue recognition standard. The revenue standard’s core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Three basic transition methods are available – full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. | January 1, 2018 | The Corporation adopted this ASU on January 1, 2018, on a modified retrospective approach, and it did not have a material effect on the Corporation's consolidated financial statements.  See Note 11. Revenue Recognition for more information. |

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| | | | |
|---|---|---|---|
| ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities | The standard amends the guidance on the classification and measurement of financial instruments. Some of the amendments include the following: 1) requires equity investments to be measured at fair value with changes in fair value recognized in net income; 2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and 4) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value; among others. | January 1, 2018 | The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. The Corporation reclassified the fair value of equity securities by increasing retained earnings by $201 thousand and decreasing AOCI by $201 thousand. In addition, according to the standard, the Corporation measured the fair value of the loan portfolio beginning March 31, 2018 using an exit price notion. See Note 9. Fair Value Measurements and Fair Values of Financial Instruments for more information. |
| ASU 2016-02, Leases (Topic 842) | From the lessee's perspective, the new standard established a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. | January 1, 2019 | The Corporation currently has real estate and equipment leases that it classifies as operating leases that are not recognized on the balance sheet. Under the new standard, these leases will move onto the balance sheet in the form of a lease liability (the present value of a lessee's obligation to make lease payments) and a right-of-use asset (an asset that represents the lessee's right to use a specified asset for the lease term). The offsetting transactions will gross-up the Consolidated Balance Sheet. The Corporation has identified all of its leases (approximately 63, primarily equipment and property leases), but has not determined the effect on the Consolidated Balance Sheet. The Corporation has acquired a lease accounting model to implement the standard to be used in a test mode during 2018. The Corporation expects to adopt the standard using the modified retrospective approach and elect the transition options of ASU 2018-11. The Corporation currently expects that the new standard will not have a material effect on its consolidated results of operations. |

| | | | |
|---|---|---|---|
| ASU 2018-11, Leases - Targeted Improvements (Topic 842) | This guidance provides entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02 (January 1, 2019 for the Corporation). | | |
| ASU 2018-15, Accounting for Implementation Costs in a Cloud Computing Arrangement (Topic 350) | This ASU required an entity in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. Capitalized implementation costs should be presented in the same line item on the balance sheet as amounts prepaid for the hosted service, if any (generally as an "other asset"). The capitalized costs will be amortized over the term of the hosting arrangement, with the amortization expense being presented in the same income statement line item as the fees paid for the hosted service. | January 1, 2019 | The Corporation is reviewing its internal accounting procedures for this implementation. The Corporation does not expect the standard will have a material effect on its consolidated results of operations. |

| | | | |
|---|---|---|---|
| ASU 2018-13, Disclosure Framework (Topic 820) | This guidance eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reason for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. | January 1, 2019 | The Corporation is reviewing its financial reporting procedures for this implementation. The Corporation does not expect the standard will have a material effect on its consolidated results of operations. |
| ASU 2017-04, Goodwill (Topic 350) | This guidance, among other things, removes step 2 of the goodwill impairment test thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting unit. Upon adoption of this standard, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under the current guidance. Early adoption is permitted for any impairment tests performed after January 1, 2017, applied prospectively. | January 1, 2020 | The Corporation expects to early adopt the ASU in the fourth quarter of 2018 with the completion of the 2018 impairment analysis. We do not expect this guidance to have a material effect on the Corporation's consolidated financial statements based upon the prior goodwill impairment analysis. |
| ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments | This standard requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. The ASU replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination ("PCD assets"), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price ("gross up approach") to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above. | January 1, 2020 | We have formed an implementation team led by the Corporation's Risk Management function. The team is reviewing the requirements of the ASU and evaluating methods and models for implementation. The new standard will result in earlier recognition of additions to the allowance for loan losses and possibly a larger allowance for loan loss balance with a corresponding increase in the provision for loan losses in results of operations; however, the Corporation is continuing to evaluate the impact of the pending adoption of the new standard on its consolidated financial statements. A third-party vendor has been selected to assist with the CECL calculations and the implementation process has started. The Corporation expects to be able to run the CECL model in test mode starting near the end of the first quarter of 2019. |

Note 3. Accumulated Other Comprehensive Loss

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

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| (Dollars in thousands) | | |
| Net unrealized (losses) gains on debt securities | $ (2,077) | $ 154 |
| Tax effect | 436 | (33) |
| Net of tax amount | (1,641) | 121 |
| | | |
| Accumulated pension adjustment | (7,784) | (7,784) |
| Tax effect | 1,635 | 1,635 |
| Net of tax amount | (6,149) | (6,149) |
| | | |
| Total accumulated other comprehensive loss | $ (7,790) | $ (6,028) |

Note 4. Investments

Available for Sale (AFS) Securities

The amortized cost and estimated fair value of AFS securities as of September 30, 2018 and December 31, 2017 are as follows:

| (Dollars in thousands) September 30, 2018 | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| U.S. Government and Agency securities | $ 9,405 | $ 15 | $ (144) | $ 9,276 |
| Municipal securities | 63,221 | 176 | (994) | 62,403 |
| Trust preferred securities | 4,069 | — | (122) | 3,947 |
| Agency mortgage-backed securities | 46,394 | 39 | (1,063) | 45,370 |
| Private-label mortgage-backed securities | 474 | 43 | — | 517 |
| Asset-backed securities | 3,917 | — | (27) | 3,890 |
| | $ 127,480 | $ 273 | $ (2,350) | $ 125,403 |

| (Dollars in thousands) December 31, 2017 | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| Equity securities | $ 164 | $ 201 | $ — | $ 365 |
| U.S. Government and Agency securities | 11,451 | 64 | (43) | 11,472 |
| Municipal securities | 57,374 | 650 | (252) | 57,772 |
| Trust preferred securities | 6,000 | — | (183) | 5,817 |
| Agency mortgage-backed securities | 51,307 | 197 | (567) | 50,937 |
| Private-label mortgage-backed securities | 858 | 88 | — | 946 |
| Asset-backed securities | 28 | — | (1) | 27 |
| | $ 127,182 | $ 1,200 | $ (1,046) | $ 127,336 |

At September 30, 2018 and December 31, 2017, the fair value of AFS securities pledged to secure public funds and trust deposits totaled $86.9 million and  $84.1 million, respectively.

The amortized cost and estimated fair value of debt securities at September 30, 2018, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities.

| (Dollars in thousands) | Amortized cost | Fair value |
|---|---|---|
| Due in one year or less | $ 14,466 | $ 14,508 |
| Due after one year through five years | 33,277 | 33,081 |
| Due after five years through ten years | 31,927 | 31,026 |
| Due after ten years | 942 | 901 |
| | 80,612 | 79,516 |
| Mortgage-backed securities | 46,868 | 45,887 |
| | $ 127,480 | $ 125,403 |

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

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2018 | 2017 |
| Gross gains realized | $ 5 | $ 1 | $ 67 | $ 3 |
| Gross losses realized | — | — | (11) | — |
| Net gains realized | $ 5 | $ 1 | $ 56 | $ 3 |

Impairment:

The AFS investment portfolio contained 192 securities with $100 million of temporarily impaired fair value and $2.4 million in unrealized losses at September 30, 2018. The total unrealized loss position has increased $1.3 million since year-end 2017.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. The impairment identified on debt securities and subject to assessment at September 30, 2018, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the AFS portfolio, aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of September 30, 2018 and December 31, 2017:

| | September 30, 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | 12 months or more | | | Total | | |
| (Dollars in thousands) | Fair Value | Unrealized Losses | Count | Fair Value | Unrealized Losses | Count | Fair Value | Unrealized Losses | Count |
| U.S. Government and Agency securities | $ 4,011 | $ (54) | 5 | $ 4,381 | $ (90) | 12 | $ 8,392 | $ (144) | 17 |
| Municipal securities | 28,938 | (520) | 47 | 13,014 | (474) | 23 | 41,952 | (994) | 70 |
| Trust preferred securities | 2,102 | (62) | 3 | 1,845 | (60) | 2 | 3,947 | (122) | 5 |
| Agency mortgage-backed securities | 18,326 | (311) | 40 | 22,996 | (752) | 53 | 41,322 | (1,063) | 93 |
| Asset-backed securities | 3,886 | (26) | 6 | 4 | (1) | 1 | 3,890 | (27) | 7 |
| Total temporarily impaired securities | $ 57,263 | $ (973) | 101 | $ 42,240 | $ (1,377) | 91 | $ 99,503 | $ (2,350) | 192 |

December 31, 2017

| | Less than 12 months | | | 12 months or more | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Fair Value | Unrealized Losses | Count | Fair Value | Unrealized Losses | Count | Fair Value | Unrealized Losses | Count |
| U.S. Government and Agency securities | $ 2,315 | $ (11) | 5 | $ 3,528 | $ (32) | 10 | $ 5,843 | $ (43) | 15 |
| Municipal securities | 13,767 | (89) | 22 | 7,507 | (163) | 14 | 21,274 | (252) | 36 |
| Trust preferred securities | 1,216 | (12) | 2 | 4,601 | (171) | 5 | 5,817 | (183) | 7 |
| Agency mortgage-backed securities | 16,287 | (129) | 29 | 20,563 | (438) | 39 | 36,850 | (567) | 68 |
| Asset-backed securities | — | — | — | 4 | (1) | 1 | 4 | (1) | 1 |
| Total temporarily impaired securities | $ 33,585 | $ (241) | 58 | $ 36,203 | $ (805) | 69 | $ 69,788 | $ (1,046) | 127 |

The following table represents the cumulative credit losses on AFS securities recognized in earnings for:

| (Dollars in thousands) | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|
| Balance of cumulative credit-related OTTI at January 1 | $ 595 | $ 595 |
| Additions for credit-related OTTI not previously recognized | — | — |
| Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis | — | — |
| Decreases for previously recognized credit-related OTTI because there was an intent to sell | (323) | — |
| Reduction for increases in cash flows expected to be collected | — | — |
| Balance of credit-related OTTI at September 30 | $ 272 | $ 595 |

Equity Securities at fair value

The Corporation owns one equity investment. At September 30, 2018, this investment was reported at fair value ($383 thousand) with changes in value reported through income. At December 31, 2017, this investment was reported at fair value with changes in value recorded through other comprehensive income and was included in the Available for Sale Securities table of this note.

Restricted Stock at Cost

The Bank held $452 thousand of restricted stock at September 30, 2018. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

Note 5. Loans

The Bank reports its loan portfolio based on the primary collateral of the loan. It further classifies these loans by the primary purpose, either consumer or commercial. The Bank’s residential real estate loans include long-term loans to individuals and businesses secured by mortgages on the borrower’s real property and include home equity loans. Construction loans are made to finance the purchase of land and the construction of residential and commercial buildings thereon, and are secured by mortgages on real estate. Commercial real estate loans include construction, owner and non-owner occupied properties and farm real estate. Commercial loans are made to businesses of various sizes for a variety of purposes including property, plant and equipment, working capital and loans to government municipalities. Commercial lending is concentrated in the Bank's primary market, but also includes purchased loan participations. Consumer loans are comprised of installment loans and unsecured personal lines of credit.

A summary of loans outstanding, by class, at the end of the reporting periods is as follows:

| (Dollars in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Residential Real Estate 1-4 Family | | |
| Consumer first liens | $ 90,029 | $ 97,159 |
| Commercial first lien | 60,142 | 61,275 |
| Total first liens | 150,171 | 158,434 |
| | | |
| Consumer junior liens and lines of credit | 43,044 | 45,043 |
| Commercial junior liens and lines of credit | 5,040 | 5,328 |
| Total junior liens and lines of credit | 48,084 | 50,371 |
| Total residential real estate 1-4 family | 198,255 | 208,805 |
| | | |
| Residential real estate - construction | | |
| Consumer | 2,779 | 1,813 |
| Commercial | 9,510 | 8,088 |
| Total residential real estate construction | 12,289 | 9,901 |
| | | |
| Commercial real estate | 475,838 | 428,428 |
| Commercial | 279,835 | 291,519 |
| Total commercial | 755,673 | 719,947 |
| | | |
| Consumer | 4,766 | 5,047 |
| | 970,983 | 943,700 |
| Less: Allowance for loan losses | (12,526) | (11,792) |
| Net Loans | $ 958,457 | $ 931,908 |
| | | |
| Included in the loan balances are the following: | | |
| Net unamortized deferred loan costs | $ 73 | $ 98 |
| | | |
| Loans pledged as collateral for borrowings and commitments from: | | |
| FHLB | $ 762,292 | $ 737,313 |
| Federal Reserve Bank | 34,685 | 35,740 |
| | $ 796,977 | $ 773,053 |

Note 6. Loan Quality and Allowance for Loan Losses

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

| | Residential Real Estate 1-4 Family | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | First | Junior Liens & Lines of | | Commercial | | | | |
| (Dollars in thousands) | Liens | Credit | Construction | Real Estate | Commercial | Consumer | Unallocated | Total |
| ALL at June 30, 2018 | $ 1,022 | $ 318 | $ 282 | $ 7,028 | $ 2,233 | $ 107 | $ 1,492 | $ 12,482 |
| Charge-offs | — | — | — | — | (208) | (23) | — | (231) |
| Recoveries | — | — | — | 1 | 19 | 5 | — | 25 |
| Provision | (16) | (4) | (4) | 242 | 122 | 12 | (102) | 250 |
| ALL at September 30, 2018 | $ 1,006 | $ 314 | $ 278 | $ 7,271 | $ 2,166 | $ 101 | $ 1,390 | $ 12,526 |
| ALL at December 31, 2017 | $ 1,060 | $ 330 | $ 224 | $ 6,526 | $ 2,110 | $ 105 | $ 1,437 | $ 11,792 |
| Charge-offs | — | — | — | — | (8,944) | (78) | — | (9,022) |
| Recoveries | 1 | — | — | 17 | 135 | 24 | — | 177 |
| Provision | (55) | (16) | 54 | 728 | 8,865 | 50 | (47) | 9,579 |
| ALL at September 30, 2018 | $ 1,006 | $ 314 | $ 278 | $ 7,271 | $ 2,166 | $ 101 | $ 1,390 | $ 12,526 |
| ALL at June 30, 2017 | $ 1,075 | $ 322 | $ 281 | $ 6,052 | $ 2,023 | $ 100 | $ 1,454 | $ 11,307 |
| Charge-offs | — | — | — | (9) | (6) | (31) | — | (46) |
| Recoveries | 1 | 5 | — | 17 | 5 | 4 | — | 32 |
| Provision | (15) | (3) | (42) | 198 | (19) | 19 | 112 | 250 |
| ALL at September 30, 2017 | $ 1,061 | $ 324 | $ 239 | $ 6,258 | $ 2,003 | $ 92 | $ 1,566 | $ 11,543 |
| ALL at December 31, 2016 | $ 1,105 | $ 323 | $ 224 | $ 6,109 | $ 1,893 | $ 100 | $ 1,321 | $ 11,075 |
| Charge-offs | (13) | — | — | (14) | (8) | (83) | — | (118) |
| Recoveries | 2 | 6 | — | 17 | 111 | 30 | — | 166 |
| Provision | (33) | (5) | 15 | 146 | 7 | 45 | 245 | 420 |
| ALL at September 30, 2017 | $ 1,061 | $ 324 | $ 239 | $ 6,258 | $ 2,003 | $ 92 | $ 1,566 | $ 11,543 |

The following table presents, by class, loans that were evaluated for the ALL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) and the amount of the ALL established in each class as of September 30, 2018 and December 31, 2017:

| | Residential Real Estate 1-4 Family | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | First Liens | Junior Liens & Lines of Credit | Construction | Commercial Real Estate | Commercial | Consumer | Unallocated | Total |
| **September 30, 2018** | | | | | | | | |
| Loans evaluated for ALL: | | | | | | | | |
| Individually | $ 408 | $ — | $ 460 | $ 10,574 | $ 3,106 | $ — | $ — | $ 14,548 |
| Collectively | 149,763 | 48,084 | 11,829 | 465,264 | 276,729 | 4,766 | — | 956,435 |
| Total | $ 150,171 | $ 48,084 | $ 12,289 | $ 475,838 | $ 279,835 | $ 4,766 | $ — | $ 970,983 |
| ALL established for loans evaluated: | | | | | | | | |
| Individually | $ — | $ — | $ — | $ — | $ 181 | $ — | $ — | $ 181 |
| Collectively | 1,006 | 314 | 278 | 7,271 | 1,985 | 101 | 1,390 | 12,345 |
| ALL at September 30, 2018 | $ 1,006 | $ 314 | $ 278 | $ 7,271 | $ 2,166 | $ 101 | $ 1,390 | $ 12,526 |
| **December 31, 2017** | | | | | | | | |
| Loans evaluated for ALL: | | | | | | | | |
| Individually | $ 459 | $ — | $ 466 | $ 10,981 | $ — | $ — | $ — | $ 11,906 |
| Collectively | 157,975 | 50,371 | 9,435 | 417,447 | 291,519 | 5,047 | — | 931,794 |
| Total | $ 158,434 | $ 50,371 | $ 9,901 | $ 428,428 | $ 291,519 | $ 5,047 | $ — | $ 943,700 |
| ALL established for loans evaluated: | | | | | | | | |
| Individually | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Collectively | 1,060 | 330 | 224 | 6,526 | 2,110 | 105 | 1,437 | 11,792 |
| ALL at December 31, 2017 | $ 1,060 | $ 330 | $ 224 | $ 6,526 | $ 2,110 | $ 105 | $ 1,437 | $ 11,792 |

The following table shows additional information about those loans considered to be impaired at September 30, 2018 and December 31, 2017:

| (Dollars in thousands) | Impaired Loans With No Allowance | | With Allowance | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| September 30, 2018 | | | | | |
| Residential Real Estate 1-4 Family | | | | | |
| First liens | $ 754 | $ 870 | $ — | $ — | $ — |
| Junior liens and lines of credit | 66 | 66 | — | — | — |
| Total | 820 | 936 | — | — | — |
| Residential real estate - construction | 460 | 531 | — | — | — |
| Commercial real estate | 10,715 | 11,248 | — | — | — |
| Commercial | 3,082 | 10,653 | 181 | 181 | 181 |
| Total | $ 15,077 | $ 23,368 | $ 181 | $ 181 | $ 181 |
| December 31, 2017 | | | | | |
| Residential Real Estate 1-4 Family | | | | | |
| First liens | $ 869 | $ 950 | $ — | $ — | $ — |
| Junior liens and lines of credit | — | — | — | — | — |
| Total | 869 | 950 | — | — | — |
| Residential real estate - construction | 466 | 531 | — | — | — |
| Commercial real estate | 11,061 | 11,541 | — | — | — |
| Commercial | 187 | 201 | — | — | — |
| Total | $ 12,583 | $ 13,223 | $ — | $ — | $ — |

The following table shows the average of impaired loans and related interest income for the three and nine months ended September 30, 2018 and 2017:

| (Dollars in thousands) | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2018 | |
|---|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| Residential Real Estate 1-4 Family | | | | |
| First liens | $ 1,091 | $ 10 | $ 899 | $ 31 |
| Junior liens and lines of credit | 268 | 2 | 750 | 2 |

| | | | | |
|---|---|---|---|---|
| Total | 1,359 | 12 | 1,649 | 33 |
| Residential real estate - construction | 461 | — | 463 | — |
| Commercial real estate | 10,789 | 107 | 10,314 | 316 |
| Commercial | 3,465 | — | 5,284 | — |
| Total | $ 16,074 | $ 119 | $ 17,710 | $ 349 |

| (Dollars in thousands) | Three Months Ended September 30, 2017 Average Recorded Investment | Three Months Ended September 30, 2017 Interest Income Recognized | Nine Months Ended September 30, 2017 Average Recorded Investment | Nine Months Ended September 30, 2017 Interest Income Recognized |
|---|---|---|---|---|
| Residential Real Estate 1-4 Family | | | | |
| First liens | $ 1,157 | $ 10 | $ 1,152 | $ 32 |
| Junior liens and lines of credit | 54 | — | 85 | — |
| Total | 1,211 | 10 | 1,237 | 32 |
| Residential real estate - construction | 471 | — | 475 | — |
| Commercial real estate | 11,218 | 109 | 12,216 | 328 |
| Commercial | 292 | — | 263 | — |
| Total | $ 13,192 | $ 119 | $ 14,191 | $ 360 |

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

| (Dollars in thousands) | | Loans Past Due and Still Accruing | | | | | Total |
|---|---|---|---|---|---|---|---|
| | Current | 30-59 Days | 60-89 Days | 90 Days+ | Total | Non-Accrual | Loans |
| September 30, 2018 | | | | | | | |
| Residential Real Estate 1-4 Family | | | | | | | |
| First liens | $ 149,366 | $ 503 | $ 231 | $ — | $ 734 | $ 71 | $ 150,171 |
| Junior liens and lines of credit | 47,907 | 40 | 71 | 43 | 154 | 23 | 48,084 |
| Total | 197,273 | 543 | 302 | 43 | 888 | 94 | 198,255 |
| Residential real estate - construction | 11,359 | 70 | 400 | — | 470 | 460 | 12,289 |
| Commercial real estate | 468,202 | 2,224 | 3,606 | — | 5,830 | 1,806 | 475,838 |
| Commercial | 276,180 | 328 | 64 | — | 392 | 3,263 | 279,835 |
| Consumer | 4,726 | 39 | 1 | — | 40 | — | 4,766 |
| Total | $ 957,740 | $ 3,204 | $ 4,373 | $ 43 | $ 7,620 | $ 5,623 | $ 970,983 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| December 31, 2017 | | | | | | | |
| Residential Real Estate 1-4 Family | | | | | | | |
| First liens | $ 157,247 | $ 485 | $ 534 | $ — | $ 1,019 | $ 168 | $ 158,434 |
| Junior liens and lines of credit | 50,202 | 139 | 30 | — | 169 | — | 50,371 |
| Total | 207,449 | 624 | 564 | — | 1,188 | 168 | 208,805 |
| Residential real estate - construction | 9,435 | — | — | — | — | 466 | 9,901 |
| Commercial real estate | 425,806 | 421 | 347 | — | 768 | 1,854 | 428,428 |
| Commercial | 291,221 | 111 | — | — | 111 | 187 | 291,519 |
| Consumer | 5,017 | 23 | 7 | — | 30 | — | 5,047 |
| Total | $ 938,928 | $ 1,179 | $ 918 | $ — | $ 2,097 | $ 2,675 | $ 943,700 |

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

| (Dollars in thousands) | Pass (1-5) | Special Mention (6) | Substandard (7) | Doubtful (8) | Total |
|---|---|---|---|---|---|

| | | | | | |
|---|---|---|---|---|---|
| September 30, 2018 | | | | | |
| Residential Real Estate 1-4 Family | | | | | |
| First liens | $ 149,741 | $ — | $ 430 | $ — | $ 150,171 |
| Junior liens and lines of credit | 48,018 | — | 66 | — | 48,084 |
| Total | 197,759 | — | 496 | — | 198,255 |
| Residential real estate - construction | 11,556 | — | 733 | — | 12,289 |
| Commercial real estate | 466,800 | 665 | 8,373 | — | 475,838 |
| Commercial | 275,249 | — | 4,586 | — | 279,835 |
| Consumer | 4,766 | — | — | — | 4,766 |
| Total | $ 956,130 | $ 665 | $ 14,188 | $ — | $ 970,983 |

| | | | | | |
|---|---|---|---|---|---|
| December 31, 2017 | | | | | |
| Residential Real Estate 1-4 Family | | | | | |
| First liens | $ 157,395 | $ — | $ 1,039 | $ — | $ 158,434 |
| Junior liens and lines of credit | 50,371 | — | — | — | 50,371 |
| Total | 207,766 | — | 1,039 | — | 208,805 |
| Residential real estate - construction | 8,893 | — | 1,008 | — | 9,901 |
| Commercial real estate | 419,277 | 680 | 8,471 | — | 428,428 |
| Commercial | 289,916 | — | 1,603 | — | 291,519 |
| Consumer | 5,047 | — | — | — | 5,047 |
| Total | $ 930,899 | $ 680 | $ 12,121 | $ — | $ 943,700 |

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

| (Dollars in thousands) | Troubled Debt Restructurings | | | | Troubled Debt Restructurings Within the Last 12 Months That Have Defaulted On Modified Terms | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Recorded Investment | Performing* | Nonperforming* | Number of Contracts | Recorded Investment |
| September 30, 2018 | | | | | | |
| Residential real estate - construction | 1 | $ 460 | $ — | $ 460 | — | $ — |
| Residential real estate | 4 | 683 | 683 | — | — | — |
| Commercial real estate | 11 | 10,574 | 8,909 | 1,665 | — | — |
| Total | 16 | $ 11,717 | $ 9,592 | $ 2,125 | — | $ — |
| | | | | | | |
| December 31, 2017 | | | | | | |
| Residential real estate - construction | 1 | $ 466 | $ 466 | $ — | — | $ — |
| Residential real estate | 5 | 737 | 701 | 36 | — | — |
| Commercial real estate | 11 | 10,983 | 10,388 | 595 | — | — |
| Total | 17 | $ 12,186 | $ 11,555 | $ 631 | — | $ — |

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

There were no new TDR loans during 2018 and 2017.

Note 7. Other Real Estate Owned

Changes in other real estate owned during the nine months ended September 30, 2018 and 2017 were as follows:

| | September 30, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Balance at beginning of the period | $ 2,598 | $ 4,915 |
| Additions | 105 | 52 |
| Proceeds from dispositions | (32) | (2,255) |
| Loss on sales, net | — | (23) |

| | | |
|---|---|---|
| Valuation adjustment | (6) | (60) |
| Balance at the end of the period | $ 2,665 | $ 2,629 |

Note 8. Pension

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2018 | 2017 |
| Components of net periodic cost: | | | | |
| Service cost | $ 90 | $ 80 | $ 270 | $ 237 |
| Interest cost | 138 | 167 | 414 | 500 |
| Expected return on plan assets | (279) | (268) | (837) | (804) |
| Recognized net actuarial loss | 176 | 137 | 528 | 411 |
| Net period cost | $ 125 | $ 116 | $ 375 | $ 344 |

The Bank expects its pension expense to increase to approximately $500 thousand in 2018 compared to $459 thousand in 2017, due primarily to increases in interest costs and recognized net actuarial losses.  A pension contribution of $1.0 million was made in first quarter of 2018. The service cost component of pension expense is in the salaries and employee benefits line on the income statement.  All other cost components are in the other expense line on the income statement.

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

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

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

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

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

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

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

On January 1, 2018, the Corporation adopted ASU 2016-01, which requires the use of the exit price notion to measure the fair value of financial instruments.

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

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

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| Financial assets, carried at cost: | | | | | |
| Cash and cash equivalents | $ 44,777 | $ 44,777 | $ 44,777 | $ — | $ — |
| Restricted stock | 452 | 452 | — | 452 | — |
| Loans held for sale | 1,072 | 1,072 | | 1,072 | |
| Net loans | 958,457 | 933,824 | — | — | 933,824 |
| Accrued interest receivable | 3,733 | 3,733 | — | 3,733 | — |
| | | | | | |
| Financial assets, available for sale | | | | | |
| Debt securities | 125,403 | 125,403 | — | 125,403 | — |
| | | | | | |
| Financial assets, fair value | | | | | |
| Equity securities | 383 | 383 | 383 | — | — |
| | | | | | |
| Financial liabilities: | | | | | |
| Deposits | $ 1,071,857 | $ 1,071,744 | $ — | $ 1,071,744 | $ — |
| Accrued interest payable | 202 | 202 | — | 202 | — |
| Off balance sheet financial instruments | — | — | — | — | — |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 58,603 | $ 58,603 | $ 58,603 | $ — | $ — |
| Investment securities available for sale | 127,336 | 127,336 | 365 | 126,971 | — |
| Restricted stock | 456 | 456 | — | 45 | — |
| Loans held for sale | 442 | 442 | — | 442 | — |
| Net loans | 931,908 | 929,891 | — | — | 929,891 |
| Accrued interest receivable | 3,847 | 3,847 | — | 3,847 | — |
| | | | | | |
| Financial liabilities: | | | | | |
| Deposits | $ 1,047,181 | $ 1,046,476 | $ — | $ 1,046,476 | $ — |
| Accrued interest payable | 149 | 149 | — | 149 | — |

Recurring Fair Value Measurements

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2018 and December 31, 2017 are as follows:

| (Dollars in Thousands | Fair Value at September 30, 2018 | | | |
|---|---|---|---|---|
| Asset Description | Level 1 | Level 2 | Level 3 | Total |
| Equity securities, at fair value | $ 383 | $ — | $ — | $ 383 |
| Available for sale: | | | | |
| U.S. Government and Agency securities | — | 9,276 | — | 9,276 |
| Municipal securities | — | 62,403 | — | 62,403 |
| Trust Preferred Securities | — | 3,947 | — | 3,947 |
| Agency mortgage-backed securities | — | 45,370 | — | 45,370 |
| Private-label mortgage-backed securities | — | 517 | — | 517 |
| Asset-backed securities | — | 3,890 | — | 3,890 |
| Total assets | $ 383 | $ 125,403 | $ — | $ 125,786 |

| (Dollars in Thousands) | Fair Value at December 31, 2017 | | | |
|---|---|---|---|---|
| Asset Description | Level 1 | Level 2 | Level 3 | Total |
| Equity securities | $ 365 | $ — | $ — | $ 365 |
| U.S. Government and Agency securities | — | 11,472 | — | 11,472 |
| Municipal securities | — | 57,772 | — | 57,772 |
| Trust Preferred Securities | — | 5,817 | — | 5,817 |
| Agency mortgage-backed securities | — | 50,937 | — | 50,937 |
| Private-label mortgage-backed securities | — | 946 | — | 946 |
| Asset-backed securities | — | 27 | — | 27 |
| Total assets | $ 365 | $ 126,971 | $ — | $ 127,336 |

Investment securities: Level 1 securities represent equity securities that are valued using quoted market prices form nationally recognized markets. Level 2 securities represent debt securities that are valued using a mathematical model based upon the specific characteristics of a security in relationship to quoted prices for similar securities.

Nonrecurring Fair Value Measurements

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2018 and December 31, 2017 are as follows:

(Dollars in Thousands)