PEOPLES FINANCIAL SERVICES CORP.
Form 10-Q
August 04, 2017
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.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 June 30, 2017

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	23-2391852

(State of incorporation)	(IRS Employer ID Number)
150 North Washington Avenue, Scranton, PA (Address of principal executive offices)	18503 (Zip code)

(570) 346-7741

(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
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 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: 7,396,163 at July 31, 2017.

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PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended June 30, 2017

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Peoples Financial Services Corp.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share and per share data)

	June 30, 2017	December 31, 2016
Assets:		
Cash and due from banks:		
Cash and due from banks	$ 41,026	$ 39,496
Interest-bearing deposits in other banks	375	445
Total cash and due from banks	41,401	39,941
Investment securities:		
Available-for-sale	256,774	259,410
Held-to-maturity: Fair value June 30, 2017, $10,221; December 31, 2016, $10,714	9,868	10,517
Total investment securities	266,642	269,927
Loans, net	1,597,362	1,532,965
Less: allowance for loan losses	17,802	15,961
Net loans	1,579,560	1,517,004
Loans held for sale		
Premises and equipment, net	35,892	33,260
Accrued interest receivable	6,206	6,228
Goodwill	63,370	63,370
Intangible assets, net	3,685	4,211
Other assets	68,002	65,501
Total assets	$ 2,064,758	$ 1,999,442
Liabilities:		
Deposits:		
Noninterest-bearing	$ 356,435	$ 353,686
Interest-bearing	1,282,998	1,235,071
Total deposits	1,639,433	1,588,757
Short-term borrowings	91,500	82,700
Long-term debt	57,160	58,134
Accrued interest payable	431	462
Other liabilities	12,725	12,771
Total liabilities	1,801,249	1,742,824
Stockholders’ equity:		
Common stock, par value $2.00, authorized 25,000,000 shares, issued and outstanding 7,396,163 shares at June 30, 2017 and 7,394,143 shares at December 31, 2016	14,792	14,788
Capital surplus	134,937	134,871
Retained earnings	116,988	111,114
Accumulated other comprehensive loss	(3,208)	(4,155)

Total stockholders' equity	263,509	256,618
Total liabilities and stockholders' equity	$ 2,064,758	$ 1,999,442

See notes to unaudited consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except share and per share data)

	Three Months Ended		Six Months Ended	
June 30,	2017	2016	2017	2016
Interest income:				
Interest and fees on loans:				
Taxable	$ 15,945	$ 14,760	$ 31,486	$ 29,106
Tax-exempt	795	780	1,521	1,531
Interest and dividends on investment securities:				
Taxable	719	617	1,416	1,304
Tax-exempt	752	875	1,546	1,750
Dividends	12	11	24	21
Interest on interest-bearing deposits in other banks	38	15	67	32
Total interest income	18,261	17,058	36,060	33,744
Interest expense:				
Interest on deposits	1,529	1,322	2,963	2,605
Interest on short-term borrowings	248	89	422	166
Interest on long-term debt	349	354	697	714
Total interest expense	2,126	1,765	4,082	3,485
Net interest income	16,135	15,293	31,978	30,259
Provision for loan losses	1,200	1,200	2,400	2,400
Net interest income after provision for loan losses	14,935	14,093	29,578	27,859
Noninterest income:				
Service charges, fees and commissions	1,682	1,527	3,254	2,971
Merchant services income	1,178	1,038	2,193	1,952
Commission and fees on fiduciary activities	494	474	1,002	956
Wealth management income	348	296	667	708
Mortgage banking income	204	195	383	399
Life insurance investment income	195	202	384	395
Net gain on sale of investment securities available-for-sale		381		623
Net gain on sale of merchant services business	2,278		2,278	
Total noninterest income	6,379	4,113	10,161	8,004
Noninterest expense:				
Salaries and employee benefits expense	7,026	5,904	13,301	11,236
Net occupancy and equipment expense	2,450	2,245	4,844	4,682
Merchant services expense	1,033	748	1,763	1,380
Amortization of intangible assets	258	297	526	602
Other expenses	3,235	2,919	5,924	5,831

Total noninterest expense	14,002	12,113	26,358	23,731
Income before income taxes	7,312	6,093	13,381	12,132
Income tax expense	1,653	1,238	2,922	2,395
Net income	5,659	4,855	10,459	9,737
Other comprehensive income:				
Unrealized gain on investment securities available-for-sale	1,184	1,128	1,457	2,123
Reclassification adjustment for net gain on sales included in net income		(381)		(623)
Other comprehensive income	1,184	747	1,457	1,500
Income tax related to other comprehensive income	415	261	510	525
Other comprehensive income, net of income taxes	769	486	947	975
Comprehensive income	$ 6,428	$ 5,341	$ 11,406	$ 10,712
Per share data:				
Net income:				
Basic	$ 0.76	$ 0.66	$ 1.41	$ 1.32
Diluted	$ 0.76	$ 0.66	$ 1.41	$ 1.32
Average common shares outstanding:				
Basic	7,396,163	7,395,127	7,395,158	7,399,318
Diluted	7,396,163	7,395,127	7,395,158	7,399,318
Dividends declared	$ 0.31	$ 0.31	$ 0.62	$ 0.62

See notes to unaudited consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands, except share and per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2017	$ 14,788	$ 134,871	$ 111,114	$ (4,155)	$ 256,618
Stock based compensation		70			70
Net income			10,459		10,459
Other comprehensive income, net of income taxes				947	947
Dividends declared: $0.62 per share			(4,585)		(4,585)
Common stock grants awarded, net of unearned compensation of $81: 2,020 shares	4	(4)			
Balance, June 30, 2017	$ 14,792	$ 134,937	$ 116,988	$ (3,208)	$ 263,509
Balance, January 1, 2016	$ 14,821	$ 135,371	$ 100,701	$ (2,125)	$ 248,768
Stock based compensation		35			35
Net income			9,737		9,737
Other comprehensive income, net of income taxes				975	975
Dividends declared: $0.62 per share			(4,586)		(4,586)
Shares retired: 16,463 shares	(33)	(571)			(604)
Balance, June 30, 2016	$ 14,788	$ 134,835	$ 105,852	$ (1,150)	$ 254,325

See notes to unaudited consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Six Months Ended June 30,	2017	2016
Cash flows from operating activities:		
Net income	$ 10,459	$ 9,737
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	884	788
Amortization of deferred loan costs	427	362
Amortization of intangibles	526	602
Net accretion of purchase accounting adjustments on tangible assets		
Amortization of loss on investment tax credits	235	244
Provision for loan losses	2,400	2,400
Net gain on sale of other real estate owned	(5)	(9)
Loans originated for sale	(10,411)	(10,709)
Proceeds from sale of loans originated for sale	10,520	11,108
Net gain on sale of loans originated for sale	(109)	(399)
Net amortization of investment securities	1,469	1,997
Net gain on sale of investment securities available-for-sale		(623)
Net gain on sale of merchant services business	(2,278)	
Life insurance investment income	(384)	(395)
Stock based compensation	70	35
Net change in:		
Accrued interest receivable	22	(156)
Other assets	(2,136)	(1,654)
Accrued interest payable	(31)	(107)
Other liabilities	(116)	(804)
Net cash provided by operating activities	11,542	12,417
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale		27,408
Proceeds from repayments of investment securities:		
Available-for-sale	21,594	23,013
Held-to-maturity	637	830
Purchases of investment securities:		
Available-for-sale	(18,958)	(16,725)
Net purchase of restricted equity securities	(703)	(1,475)
Net increase in lending activities	(65,625)	(125,528)
Investment in low income housing investment tax credits		(2,050)
Purchases of premises and equipment	(3,516)	(2,141)
Purchase of investment in life insurance		(1,500)
Proceeds from the sale of merchant services business	2,300	
Proceeds from sale of other real estate owned	272	195
Net cash used in investing activities	(63,999)	(97,973)

Cash flows from financing activities:		
Net increase in deposits	50,676	41,053
Repayment of long-term debt	(974)	(1,122)
Net increase in short-term borrowings	8,800	47,975
Retirement of common stock		(604)
Cash dividends paid	(4,585)	(4,586)
Net cash provided by financing activities	53,917	82,716
Net increase (decrease) in cash and cash equivalents	1,460	(2,840)
Cash and cash equivalents at beginning of period	39,941	32,917
Cash and cash equivalents at end of period	$ 41,401	$ 30,077

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (Continued)

(Dollars in thousands, except per share data)

For the Six Months Ended June 30,	2017	2016
Supplemental disclosures:		
Cash paid during the period for:		
Interest	$ 4,113	$ 3,592
Income taxes	3,100	1,800
Noncash items:		
Transfers of loans to other real estate	$ 279	$ 761

See notes to unaudited consolidated financial statements

Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and 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 subsidiary, Peoples Advisors, LLC (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, Montgomery, Northampton, 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’s 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, 2017, 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 year ended December 31, 2016.

Recent accounting standards:

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” The updated standard is a new comprehensive revenue recognition model that requires revenue to be recognized in a manner that depicts the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year. During 2016, the FASB issued ASU Nos. 2016-10, 2016-12 and 2016-20 that provide additional guidance related to the identification of performance obligations within a contract, assessing collectability, contract costs, and other technical corrections and improvements. ASU 2014-09 will become effective for the Company for the annual period beginning after December 15, 2017 and for interim periods within the annual period. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. The Company has not selected a transition method. The Company has completed an evaluation of its revenue-producing contracts and determined they are primarily agreements that are not within the scope of this standard. As a result, the Company does not expect the adoption of this standard to have a material impact to the Company’s reported revenues and interest income. The Company is continuing to evaluate the impact on other revenue and income sources.

In January 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-01, “Financial Instruments – Overall.” The guidance in this ASU among other things, (1) requires equity investments with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (2) simplifies the impairment assessment of

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (3) eliminates the requirement for public businesses entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (4) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (5) requires an entity to present separately in other comprehensive income the portion of the change in 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 in accordance with the fair value option for financial instruments, (6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (7) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. The guidance in this ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is in the process of evaluating the impact of the adoption of this guidance on the Company’s financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases”. From the lessee's perspective, the new standard establishes 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 a lessee. 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 a financing. If the lessor doesn’t convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company’s initial findings conclude that the new pronouncement will not have a significant impact on its consolidated financial statements as the current projected minimum lease payments under existing lease contracts subject to the new pronouncement are less than one percent of its current assets.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU will have a significant impact on the Company’s calculation and accounting for its Allowance for Loan Losses as well as credit losses related to investment securities available-for-sale. A summary of significant provisions of this ASU is as follows:

- The ASU requires that a financial asset (or a group of financial assets) measured at amortized cost basis be presented, net of a valuation allowance for credit losses, at an amount expected to be collected on the financial asset(s), and that the income statement include the measurement of credit losses for newly recognized financial assets as well as changes in expected losses on previously recognized financial assets. The provisions of this ASU require measurement of expected credit losses based on relevant information including past events, historical experience, current conditions, and reasonable and supportive forecasts that affect the collectability of the asset. The provisions of this ASU differ from current U.S. GAAP in that current U.S. GAAP generally delays recognition of the full amount of credit losses until the loss is probable of occurring.

- The amendments in the Update retain many of the disclosure requirements related to credit quality in current U.S. GAAP, updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. In addition, the Update requires that disclosure of credit quality indicators in relation to the amortized cost of financing receivables, a current requirement, be further disaggregated by year of origination.

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- This ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down, and limits the amount of the allowance for credit losses to the amount by which the fair value is below amortized cost. For purchased investment securities available-for-sale with a more-than-insignificant amount of credit deterioration since origination, the ASU requires an allowance be determined in a manner similar to other investment securities available-for-sale; however, the initial allowance would be added to the purchase price, with only subsequent changes in the allowance recorded in credit loss expense, and interest income recognized at the effective rate excluding the discount embedded in the purchase price related to estimated credit losses at acquisition.

- This ASU will be effective for the Company for interim and annual periods beginning in the first quarter of 2020. Earlier adoption is permitted beginning in the first quarter of 2019. The Company will record the effect of implementing this ASU through a cumulative-effect adjustment through retained earnings as of the beginning of the reporting period in which Topic 326 is effective.

The Company cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations; however, it is anticipated that the allowance will increase upon adoption and that the increased allowance level will decrease regulatory capital and ratios.

In June 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230) –Classification of Certain Cash Receipts and Cash Payments. This Update provides clarification regarding eight specific cash flow issues with the objective of reducing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. For the Company, the amendments in this Update are effective beginning in the first quarter 2018. The amendments in this Update should be applied using a retroactive transition method to each period presented. The Company anticipates there will be no adjustments to the Consolidated Statements of Cash Flows, as previously reported, as a result of the clarifications provided in the Update.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350) to simplify the accounting for goodwill impairment. 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 ASU, 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 current guidance. This Update will become effective for the Company's annual and interim goodwill impairment tests beginning in the first quarter of 2020.

2. Other comprehensive 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 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, 2017 and December 31, 2016 is as follows:

	June 30, 2017	December 31, 2016
Net unrealized gain on investment securities available-for-sale	$ 2,010	$ 553
Income tax	703	193
Net of income taxes	1,307	360
Benefit plan adjustments	(6,946)	(6,946)
Income tax	(2,431)	(2,431)
Net of income taxes	(4,515)	(4,515)
Accumulated other comprehensive loss	$ (3,208)	$ (4,155)

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(Dollars in thousands, except share and per share data)

Other comprehensive income (loss) and related tax effects for the three and six months ended June 30, 2017 and 2016 is as follows:

Three Months Ended June 30,	2017	2016
Unrealized gain on investment securities available-for-sale	$ 1,184	$ 1,128
Net gain on the sale of investment securities available-for-sale(1)		(381)
Other comprehensive income gain before taxes	1,184	747
Income tax expense	415	261
Other comprehensive income	$ 769	$ 486

Six Months Ended June 30,	2017	2016
Unrealized gain on investment securities available-for-sale	$ 1,457	$ 2,123
Net gain on the sale of investment securities available-for-sale(1)		(623)
Other comprehensive income gain before taxes	1,457	1,500
Income tax expense	510	525
Other comprehensive income	$ 947	$ 975

(1)Represents amounts reclassified out of accumulated comprehensive loss 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.

There were no shares considered anti-dilutive for the three and six month periods ended June 30, 2017 and 2016.

	2017	2016

For the Three Months Ended June 30,	Basic	Diluted	Basic	Diluted
Net Income	$ 5,659	$ 5,659	$ 4,855	$ 4,855
Average common shares outstanding	7,396,163	7,396,163	7,395,127	7,395,127
Earnings per share	$ 0.76	$ 0.76	$ 0.66	$ 0.66

	2017		2016	
For the Six Months Ended June 30	Basic	Diluted	Basic	Diluted
Net Income	$ 10,459	$ 10,459	$ 9,737	$ 9,737
Average common shares outstanding	7,395,158	7,395,158	7,399,318	7,399,318
Earnings per share	$ 1.41	$ 1.41	$ 1.32	$ 1.32

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Peoples Financial Services Corp.

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(Dollars in thousands, except share and per share data)

4. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at June 30, 2017 and December 31, 2016 are summarized as follows:

June 30, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	$ 20,047	$ 56	$ 23	$ 20,080
U.S. Government-sponsored enterprises	81,495	96	847	80,744
State and municipals:				
Taxable	14,629	667	1	15,295
Tax-exempt	102,737	2,191	59	104,869
Mortgage-backed securities:				
U.S. Government agencies	17,576	31	29	17,578
U.S. Government-sponsored enterprises	18,280	39	111	18,208
Total	$ 254,764	$ 3,080	$ 1,070	$ 256,774
Held-to-maturity:				
Tax-exempt state and municipals	$ 6,860	$ 163	$ 3	$ 7,020
Mortgage-backed securities:				
U.S. Government agencies	61			61
U.S. Government-sponsored enterprises	2,947	193		3,140
Total	$ 9,868	$ 356	$ 3	$ 10,221

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	$ 7,570		$ 132	$ 7,438
U.S. Government-sponsored enterprises	82,314	$ 79	1,480	80,913
State and municipals:				

Taxable	14,698	566	39	15,225
Tax-exempt	110,931	2,309	640	112,600
Mortgage-backed securities:				
U.S. Government agencies	21,041	48	47	21,042
U.S. Government-sponsored enterprises	22,303	48	159	22,192
Total	$ 258,857	$ 3,050	$ 2,497	$ 259,410
Held-to-maturity:				
Tax-exempt state and municipals	$ 6,862	$ 72	$ 67	$ 6,867
Mortgage-backed securities:				
U.S. Government agencies	68	1		69
U.S. Government-sponsored enterprises	3,587	191		3,778
Total	$ 10,517	$ 264	$ 67	$ 10,714

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

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, 2017, is summarized as follows:

June 30, 2017	Fair Value
Within one year	$ 33,157
After one but within five years	127,433
After five but within ten years	45,799
After ten years	14,599
	220,988
Mortgage-backed securities	35,786
Total	$ 256,774

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at June 30, 2017, is summarized as follows:

June 30, 2017	Amortized Cost	Fair Value
Within one year		
After one but within five years		
After five but within ten years		
After ten years	$ 6,860	$ 7,020
	6,860	7,020
Mortgage-backed securities	3,008	3,201
Total	$ 9,868	$ 10,221

Securities with a carrying value of $138,272 and $144,750 at June 30, 2017 and December 31, 2016, respectively, were pledged to secure public deposits and certain other deposits 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, 2017 and December 31, 2016, 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, 2017 and December 31, 2016, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

	Less Than 12 Months		12 Months or More		Total	
June 30, 2017	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	$ 2,501	$ 23			$ 2,501	$ 23
U.S. Government-sponsored enterprises	65,845	823	$ 1,067	$ 24	66,912	847
State and municipals:						
Taxable	554	1			554	1
Tax-exempt	15,898	62			15,898	62
Mortgage-backed securities:						
U.S. Government agencies	2,848	8	3,503	21	6,351	29
U.S. Government-sponsored enterprises	11,218	50	2,327	61	13,545	111
Total	$ 98,864	$ 967	$ 6,897	$ 106	$ 105,761	$ 1,073

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	Less Than 12 Months		12 Months or More		Total	
December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	$ 7,438	$ 132			$ 7,438	$ 132
U.S. Government-sponsored enterprises	59,460	1,480			59,460	1,480
State and municipals:						
Taxable	1,035	39			1,035	39
Tax-exempt	55,166	707	$ 226		55,392	707
Mortgage-backed securities:						
U.S. Government agencies	5,917	27	1,496	$ 20	7,413	47
U.S. Government-sponsored enterprises	16,412	85	2,712	74	19,124	159
Total	$ 145,428	$ 2,470	$ 4,434	$ 94	$ 149,862	$ 2,564

The Company had 80 investment securities, consisting of 27 tax-exempt state and municipal obligations, one U.S. Treasury security, one taxable municipal obligation, 25 U.S. Government-sponsored enterprise securities, and 26 mortgage-backed securities that were in unrealized loss positions at June 30, 2017. Of these securities, eleven mortgage-backed securities and one U.S. Government-sponsored enterprise security 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, 2017. There was no OTTI recognized for the three or six months ended June 30, 2017 and 2016.

The Company had 163 investment securities, consisting of 107 tax-exempt state and municipal obligations, two taxable state and municipal obligations, two U.S. Treasury securities, 22 U.S. Government-sponsored enterprise securities and 30 mortgage-backed securities that were in unrealized loss positions at December 31, 2016. Of these securities, nine mortgage-backed securities, and two tax-exempt state and municipal securities were in a continuous unrealized loss position for twelve months or more.

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, 2017 and December 31, 2016 are summarized as follows. Net deferred loan costs were $542 and $579 at June 30, 2017 and December 31, 2016.

	June 30, 2017	December 31, 2016
Commercial	$ 452,180	$ 408,814
Real estate:		
Commercial	719,652	700,144
Residential	286,232	289,781
Consumer	139,298	134,226
Total	$ 1,597,362	$ 1,532,965

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The changes in the allowance for loan losses account by major classification of loan for the three and six months ended June 30, 2017 and 2016 are summarized as follows:

June 30, 2017	Commercial	Real estate Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Beginning Balance April 1, 2017	$ 4,129	$ 6,291	$ 4,978	$ 1,571	$	$ 16,969
Charge-offs	(32)	(242)	(8)	(149)		(431)
Recoveries	6	22	4	32		64
Provisions	323	516	222	139		1,200
Ending balance	$ 4,426	$ 6,587	$ 5,196	$ 1,593	$	$ 17,802

June 30, 2016	Commercial	Real estate Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Beginning Balance April 1, 2016	$ 3,322	$ 4,616	$ 4,359	$ 1,646	$ 215	$ 14,158
Charge-offs	(393)	(48)	(126)	(65)		(632)
Recoveries	34	14	10	15		73
Provisions	300	495	222	83	100	1,200
Ending balance	$ 3,263	$ 5,077	$ 4,465	$ 1,679	$ 315	$ 14,799

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		Real estate				
June 30, 2017	Commercial	Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Beginning Balance January 1, 2017	$ 3,799	$ 5,847	$ 4,707	1,608		15,961
Charge-offs	(32)	(367)	(23)	(320)		(742)
Recoveries	13	55	26	89		183
Provisions	646	1,052	486	216		2,400
Ending balance	$ 4,426	$ 6,587	$ 5,196	$ 1,593	$	$ 17,802

		Real estate				
June 30, 2016	Commercial	Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Beginning Balance January 1, 2016	$ 3,042	$ 4,245	$ 4,082	$ 1,583	$ 23	$ 12,975
Charge-offs	(396)	(103)	(126)	(130)		(755)
Recoveries	36	30	35	78		179
Provisions	581	905	474	148	292	2,400
Ending balance	$ 3,263	$ 5,077	$ 4,465	$ 1,679	$ 315	$ 14,799

The allocation of the allowance for loan losses and the related loans by major classifications of loans at June 30, 2017 and December 31, 2016 is summarized as follows:

		Real estate				
June 30, 2017	Commercial	Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending balance	$ 4,426	$ 6,587	$ 5,196	$ 1,593	$	$ 17,802
Ending balance: individually evaluated for impairment	322	509	461	43		1,335
Ending balance: collectively evaluated for impairment	4,104	6,078	4,735	1,550		16,467

Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$
Loans receivable:						
Ending balance	$ 452,180	$ 719,652	$ 286,232	$ 139,298	$	$ 1,597,362
Ending balance: individually evaluated for impairment	1,944	3,951	3,285	232		9,412
Ending balance: collectively evaluated for impairment	449,868	715,056	282,915	139,066		1,586,905
Ending balance: loans acquired with deteriorated credit quality	$ 368	$ 645	$ 32	$	$	$ 1,045

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December 31, 2016	Commercial	Real estate Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending balance	$ 3,799	$ 5,847	$ 4,707	$ 1,608	$	$ 15,961
Ending balance: individually evaluated for impairment	225	1,197	520			1,942
Ending balance: collectively evaluated for impairment	3,574	4,650	4,187	1,608		14,019
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$
Loans receivable:						
Ending balance	$ 408,814	$ 700,144	$ 289,781	$ 134,226	$	$ 1,532,965
Ending balance: individually evaluated for impairment	1,724	5,820	3,543	155		11,242
Ending balance: collectively evaluated for impairment	406,127	692,987	286,201	134,071		1,519,386
Ending balance: loans acquired with deteriorated credit quality	$ 963	$ 1,337	$ 37	$	$	$ 2,337

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:

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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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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, 2017 and December 31, 2016:

June 30, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 444,700	$ 2,976	$ 4,504	$	$ 452,180
Real estate:					
Commercial	698,625	8,590	12,437		719,652
Residential	279,578	143	6,511		286,232
Consumer	139,154		144		139,298
Total	$ 1,562,057	$ 11,709	$ 23,596	$	$ 1,597,362

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 398,867	$ 6,222	$ 3,725	$	$ 408,814
Real estate:					
Commercial	674,914	10,392	14,838		700,144
Residential	282,737	233	6,811		289,781
Consumer	133,983		243		134,226
Total	$ 1,490,501	$ 16,847	$ 25,617	$	$ 1,532,965

Information concerning nonaccrual loans by major loan classification at June 30, 2017 and December 31, 2016 is summarized as follows:

	June 30, 2017	December 31, 2016
Commercial	$ 1,285	$ 934
Real estate:		

Commercial	4,115	7,016
Residential	2,645	3,003
Consumer	232	155
Total	$ 8,277	$ 11,108

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

June 30, 2017	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
Commercial	$ 501	$ 105	$ 1,285	$ 1,891	$ 450,289	$ 452,180	
Real estate:							
Commercial	2,003	71	4,115	6,189	713,463	719,652	
Residential	964	474	3,212	4,650	281,582	286,232	$ 567
Consumer	964	346	500	1,810	137,488	139,298	268
Total	$ 4,432	$ 996	$ 9,112	$ 14,540	$ 1,582,822	$ 1,597,362	$ 835

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December 31, 2016	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
Commercial	$ 249	$ 75	$ 934	$ 1,258	$ 407,556	$ 408,814	
Real estate:							
Commercial	4,782	527	7,016	12,325	687,819	700,144	
Residential	2,100	354	3,561	6,015	283,766	289,781	$ 558
Consumer	962	259	441	1,662	132,564	134,226	286
Total	$ 8,093	$ 1,215	$ 11,952	$ 21,260	$ 1,511,705	$ 1,532,965	$ 844

The following tables summarize information concerning impaired loans as of and for the three and six months ended June 30, 2017 and June 30, 2016, and as of and for the year ended, December 31, 2016 by major loan classification:

				This Quarter		Year-to-Date	
June 30, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:							
Commercial	$ 1,580	$ 2,197		$ 1,173	$ 18	$ 1,583	$ 35
Real estate:							
Commercial	3,058	3,706		3,387	7	3,045	13
Residential	2,083	2,265		2,216	4	2,212	6
Consumer	188	188		186		176	
Total	6,909	8,356		6,962	29	7,016	54
With an allowance recorded:							
Commercial	732	732	$ 321	1,328		979	
Real estate:							
Commercial	1,538	1,538	509	1,505			