

PEOPLES FINANCIAL SERVICES CORP.
Form 10-Q
November 14, 2013

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 September 30, 2013 or

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

0-23863
(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)

82 Franklin Avenue, Hallstead, PA 18822
(Address of principal executive offices) (Zip code)

(570) 879-2175
(Registrant's telephone number, including area code)

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE REGISTRANTS:

Indicate the number of shares outstanding of the registrant's common stock, as of the latest practicable date: 3,087,406 at October 31, 2013.

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PEOPLES FINANCIAL SERVICES CORP.
FORM 10-Q

For the Quarter Ended September 30, 2013

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CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except per share data)

	September 30, 2013	December 31, 2012
Assets:		
Cash and due from banks	\$ 12,724	\$ 9,777
Interest-bearing deposits in other banks	41	1,126
Federal funds sold	11,755	17,180
Investment securities available-for-sale	155,016	147,780
Loans held for sale	3,616	1,917
Loans, net	505,109	465,773
Less: allowance for loan losses	6,835	6,581
Net loans	498,274	459,192
Premises and equipment, net	8,621	8,685
Accrued interest receivable	3,395	3,272
Other assets	20,984	22,594
Total assets	\$ 714,426	\$ 671,523
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 117,170	\$ 102,322
Interest-bearing	504,630	471,989
Total deposits	621,800	574,311
Short-term borrowings	17,854	12,764
Long-term debt	2,507	13,130
Accrued interest payable	219	425
Other liabilities	3,760	4,697
Total liabilities	646,140	605,327
Stockholders' equity:		
Common stock, par value \$2.00; authorized 12,500,000 shares; issued 3,341,251 shares	6,683	6,683
Capital surplus	3,194	3,155
Retained earnings	61,956	57,781
Accumulated other comprehensive income	2,694	4,876
Less: Treasury stock, at cost, September 30, 2013, 253,845 shares; December 31, 2012, 256,995 shares	6,241	6,299
Total stockholders' equity	68,286	66,196
Total liabilities and stockholders' equity	\$ 714,426	\$ 671,523

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

September 30	Three Months Ended		Nine Months Ended	
	2013	2012	2013	2012
Interest income:				
Interest and fees on loans:				
Taxable	\$6,042	\$5,698	\$17,675	\$16,895
Tax-exempt	278	316	867	1,128
Interest and dividends on investment securities available-for-sale:				
Taxable	630	558	1,795	1,797
Tax-exempt	345	325	1,041	1,012
Dividends	5	6	17	21
Interest on interest-bearing deposits in other banks		2	2	7
Interest on federal funds sold	18	11	32	11
Total interest income	7,318	6,916	21,429	20,871
Interest expense:				
Interest on deposits	1,032	1,115	3,004	3,234
Interest on short-term borrowings	36	29	100	140
Interest on long-term debt	32	163	144	506
Total interest expense	1,100	1,307	3,248	3,880
Net interest income	6,218	5,609	18,181	16,991
Provision for loan losses	165	330	495	1,365
Net interest income after provision for loan losses	6,053	5,279	17,686	15,626
Noninterest income:				
Service charges, fees, commissions and other	895	804	2,527	2,344
Wealth management income	195	180	589	461
Mortgage banking income	45	277	458	653
Net gain (loss) on sale of investment securities available-for-sale			(1) 383
Total noninterest income	1,135	1,261	3,573	3,841
Noninterest expense:				
Salaries and employee benefits expense	2,307	1,792	6,265	5,271
Net occupancy and equipment expense	851	747	2,520	2,290
Other expenses	1,902	1,299	4,474	3,496
Total noninterest expense	5,060	3,838	13,259	11,057
Income before income taxes	2,128	2,702	8,000	8,410
Provision for income taxes	385	462	1,695	1,466
Net income	1,743	2,240	6,305	6,944
Other comprehensive income (loss):				
Unrealized gain (loss) on investment securities available-for-sale	(521) 321	(3,307) 2,086
Reclassification adjustment for gain on sales included in net income			1	(383
Income tax expense (benefit) related to other comprehensive income (loss)	(177) 109	(1,124) 580
Other comprehensive income (loss), net of income taxes	(344) 212	(2,182) 1,123
Comprehensive income	\$1,399	\$2,452	\$4,123	\$8,067

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Per share data:

Net income:

Basic	\$0.56	\$0.72	\$2.04	\$2.23
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Diluted	\$0.56	\$0.72	\$2.04	\$2.23
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Average common shares outstanding:

Basic	3,087,249	3,118,356	3,085,901	3,118,298
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Diluted	3,087,408	3,118,356	3,086,110	3,118,705
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Dividends declared	\$0.23	\$0.22	\$0.69	\$0.64
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See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2013	\$ 6,683	\$ 3,155	\$ 57,781	\$ 4,876	\$ (6,299)	\$ 66,196
Net income			6,305			6,305
Other comprehensive loss, net of income taxes				(2,182)		(2,182)
Dividends declared: \$0.69 per share			(2,130)			(2,130)
Reissuance under option plan: 3,150 shares		39			58	97
Balance, September 30, 2013	\$ 6,683	\$ 3,194	\$ 61,956	\$ 2,694	\$ (6,241)	\$ 68,286
Balance, January 1, 2012	\$ 6,683	\$ 3,141	\$ 51,342	\$ 3,645	\$ (5,198)	\$ 59,613
Net income			6,944			6,944
Other comprehensive income, net of income taxes				1,123		1,123
Dividends declared: \$0.64 per share			(1,995)			(1,995)
Reissuance under option plan: 4,500 shares		12			82	94
Purchase of treasury stock 5,000 shares					(143)	(143)
Balance, September 30, 2012	\$ 6,683	\$ 3,153	\$ 56,291	\$ 4,768	\$ (5,259)	\$ 65,636

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Nine Months Ended September 30	2013	2012
Cash flows from operating activities:		
Net income	\$6,305	\$6,944
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	664	631
Amortization of intangibles	81	123
Provision for loan losses	495	1,365
Loss on sale of other real estate owned	109	7
Net amortization of investment securities available-for-sale	1,729	1,468
Amortization of deferred loan costs	211	203
Loss (gain) on sale of investment securities available-for-sale	1	(383)
Net income from investment in life insurance	(274)	(284)
Net change in:		
Loans held for sale	(1,699)	(635)
Accrued interest receivable	(123)	57
Other assets	1,959	481
Accrued interest payable	(206)	(21)
Other liabilities	(937)	(2,335)
Net cash provided by operating activities	8,315	7,621
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	300	5,216
Proceeds from repayments on investment securities available-for-sale	14,593	12,809
Purchases of investment securities available-for-sale	(27,165)	(16,591)
Net increase in loans	(39,878)	(27,421)
Purchases of premises and equipment	(600)	(1,296)
Purchases of investment in life insurance		(450)
Proceeds from sale of other real estate owned	949	62
Net cash used in investing activities	(51,801)	(27,671)
Cash flows from financing activities:		
Net increase in deposits	47,489	60,129
Repayment of long-term debt	(10,623)	(5,594)
Net increase (decrease) in short-term borrowings	5,090	(30,193)
Repurchase of common shares		(143)
Reissuance of common shares	97	94
Cash dividends paid	(2,130)	(1,995)
Net cash provided by financing activities	39,923	22,298
Net increase (decrease) in cash and cash equivalents	(3,563)	2,248
Cash and cash equivalents at beginning of year	28,083	10,559
Cash and cash equivalents at end of period	\$24,520	\$12,807
Supplemental disclosures:		
Cash paid during the period for:		
Interest	\$3,454	\$3,901
Income taxes	\$2,200	\$1,050
Noncash items:		
Transfers from loans to other real estate owned	\$90	\$1,489

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Basis of presentation:

The accompanying unaudited consolidated financial statements of Peoples Financial Services Corp, and subsidiaries (collectively, the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, Regulation S-X and reporting practices applied in the banking industry. 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 with 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 nine months ended and as of September 30, 2013, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, refer to the Notes to Consolidated Financial Statements for the year ended December 31, 2012, included in the Form S-4 filed with the Securities and Exchange Commission on August 13, 2013.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2013, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. Other comprehensive income (loss):

The reclassification adjustment for gain (loss) on investment securities available-for-sale is included in net gain (loss) on sale of investment securities available-for-sale in total noninterest income on the Consolidated Statements of Income and Comprehensive Income. The income tax expense (benefit) on the net gain (loss) on sale of investment securities available-for-sale is included in the provision for income taxes on the Consolidated Statements of Income and Comprehensive Income.

3. Earnings per share:

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Stock options for 2,878 and 5,800 shares of common stock were not considered in computing diluted earnings per share for the three and nine months ended September 30, 2013 and 2012, respectively, because they were antidilutive.

4. Investment securities available-for-sale:

The amortized cost and fair value of investment securities available-for-sale aggregated by investment category at September 30, 2013 and December 31, 2012 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2013				
U.S. Government-sponsored enterprises	\$ 29,147	\$ 2,169		\$ 31,316
State and municipals:				
Taxable	16,139	967	\$ 3	17,103
Tax-exempt	47,263	880	384	47,759
Corporate debt securities	4,034	265		4,299
Mortgage-backed securities:				
U.S. Government agencies	21,144	156	190	21,110
U.S. Government-sponsored enterprises	32,720	256	98	32,878
Common equity securities	487	85	21	551
Total	\$ 150,934	\$ 4,778	\$ 696	\$ 155,016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2012				
U.S. Government-sponsored enterprises	\$ 29,375	\$ 3,556		\$ 32,931
State and municipals:				
Taxable	16,611	2,083		18,694
Tax-exempt	45,480	2,035	\$ 127	47,388
Corporate debt securities	4,038	139	306	3,871
Mortgage-backed securities:				
U.S. Government agencies	21,532	173	151	21,554
U.S. Government-sponsored enterprises	22,868	129	129	22,868
Common equity securities	488	17	31	474
Total	\$ 140,392	\$ 8,132	\$ 744	\$ 147,780

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities available-for-sale
(continued)

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at September 30, 2013, is summarized as follows:

	Fair Value
September 30, 2013	
Within one year	\$ 1,518
After one but within five years	38,096
After five but within ten years	30,045
After ten years	30,818
	100,477
Mortgage-backed securities	53,988
Total	\$ 154,465

Securities with a carrying value of \$103,457 and \$89,699 at September 30, 2013 and December 31, 2012, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

At September 30, 2013 and December 31, 2012, there were no securities of any individual issuer, except for U.S. Government agencies and sponsored enterprises, which exceeded 10.0 percent of stockholders' equity.

The fair value and gross unrealized losses of investment securities available-for-sale with unrealized losses for which an other-than-temporary impairment ("OTTI") has not been recognized at September 30, 2013 and December 31, 2012, 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	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2013						
U.S. Government-sponsored enterprises						
State and municipals:						
Taxable	\$ 497	\$ 3			\$ 497	\$ 3
Tax-Exempt	13,828	384			13,828	384
Corporate debt securities						
Mortgage-backed securities:						
U.S. Government agencies	9,753	190			9,753	190
U.S. Government-sponsored enterprises	6,579	12	\$ 3,086	\$ 86	9,665	98
Common equity securities			116	21	116	21
Total	\$ 30,657	\$ 589	\$ 3,202	\$ 107	\$ 33,859	\$ 696

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities available-for-sale
(continued)

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2012						
U.S. Government-sponsored enterprises						
State and municipals:						
Taxable						
Tax-exempt	\$12,483	\$ 127			\$12,483	\$ 127
Corporate debt securities			\$2,705	\$ 306	2,705	306
Mortgage-backed securities:						
U.S. Government agencies	11,934	146	838	5	12,772	151
U.S. Government-sponsored enterprises	9,042	83	4,229	46	13,271	129
Common equity securities			106	31	106	31
Total	\$33,459	\$ 356	\$7,878	\$ 388	\$41,337	\$ 744

The Company had 49 investment securities, consisting of 37 tax-exempt and one taxable state and municipal obligation, nine mortgage-backed securities and two common equity securities that were in unrealized loss positions at September 30, 2013. Of these securities, two mortgage-backed securities and two common equity securities were in continuous unrealized loss positions for 12 months or more. In comparison, the Company had 59 investment securities, consisting of 36 tax-exempt state and municipal obligations, two corporate debt securities, 19 mortgage-backed securities and two common equity securities, which were in unrealized loss positions at December 31, 2012. Of these securities, seven mortgage-backed securities, and each of the corporate debt securities and common equity securities were in continuous unrealized loss positions for 12 months or more. The unrealized losses on the common equity securities were a direct reflection of reductions in stock values in the financial industry sector, as a whole, and were not a result of credit or other issues that would cause the Company to recognize an OTTI charge. 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 did not consider the unrealized losses to be OTTI at September 30, 2013 and December 31, 2012. In addition, there was no OTTI recognized for the nine month periods ended September 30, 2013 and 2012.

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PEOPLES FINANCIAL SERVICES CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses:

The major classifications of loans outstanding, net of deferred loan origination fees and costs at September 30, 2013 and December 31, 2012 are summarized as follows. Net deferred loan costs were \$679 at September 30, 2013, and \$589 at December 31, 2012.

	September 30, 2013	December 31, 2012
Commercial	\$ 187,462	\$ 170,379
Real estate:		
Commercial	181,557	158,798
Residential	117,796	117,527
Consumer	18,294	19,069
Total	\$ 505,109	\$ 465,773

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PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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

The changes in the allowance for loan losses account by major classification of loan for the three and nine months ended September 30, 2013 and 2012 are summarized as follows:

September 30, 2013	Real estate				Consumer	Unallocated	Total
	Commercial	Commercial	Residential	Real estate			
Allowance for loan losses:							
Beginning Balance July 1, 2013	\$2,711	\$2,831	\$ 886		\$ 176	\$ 131	\$6,735
Charge-offs	(46)				(24)		(70)
Recoveries	(2)		(2)		9		5
Provisions	18	(1)	65		16	67	165
Ending balance	\$2,681	\$2,830	\$ 949		\$ 177	\$ 198	\$6,835

September 30, 2013	Real estate				Consumer	Unallocated	Total
	Commercial	Commercial	Residential	Real estate			
Allowance for loan losses:							
Beginning Balance January 1, 2013	\$2,024	\$2,101	\$ 1,206		\$ 234	\$ 1,016	\$6,581
Charge-offs	(46)	(58)	(187)		(53)		(344)
Recoveries	2		77		24		103
Provisions	701	787	(147)		(28)	(818)	495
Ending balance	\$2,681	\$2,830	\$ 949		\$ 177	\$ 198	\$6,835

September 30, 2012	Real estate				Consumer	Unallocated	Total
	Commercial	Commercial	Residential	Real estate			
Allowance for loan losses:							
Beginning Balance, July 1, 2012	\$2,117	\$1,970	\$ 819		\$ 197	\$ 813	\$5,916
Charge-offs	(12)				(90)		(102)
Recoveries	1				152		153
Provisions	(10)	21	137		(68)	250	330
Ending balance	\$2,096	\$1,991	\$ 956		\$ 191	\$ 1,063	\$6,297

September 30, 2012	Real estate				Consumer	Unallocated	Total
	Commercial	Commercial	Residential	Real estate			
Allowance for loan losses:							
Beginning Balance, January 1, 2012	\$2,047	\$1,515	\$ 761		\$ 198	\$ 828	\$5,349
Charge-offs	(219)	(100)	(21)		(267)		(607)
Recoveries	2				188		190
Provisions	266	576	216		72	235	1,365
Ending balance	\$2,096	\$1,991	\$ 956		\$ 191	\$ 1,063	\$6,297

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PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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

The allocation of the allowance for loan losses and the related loans by major classifications of loans at September 30, 2013 and December 31, 2012 is summarized as follows:

September 30, 2013	Real estate					Unallocated Total
	Commercial	Commercial	Residential	Consumer		
Allowance for loan losses:						
Ending balance	\$ 2,681	\$ 2,830	\$ 949	\$ 177	\$ 198	\$ 6,835
Ending balance: individually evaluated for impairment	386	424	297			1,107
Ending balance: collectively evaluated for impairment	\$ 2,295	\$ 2,406	\$ 652	\$ 177	\$ 198	\$ 5,728
Loans receivable:						
Ending balance	\$ 187,462	\$ 181,557	\$ 117,796	\$ 18,294		\$ 505,109
Ending balance: individually evaluated for impairment	3,275	13,388	1,891			18,554
Ending balance: collectively evaluated for impairment	\$ 184,187	\$ 168,169	\$ 115,905	\$ 18,294		\$ 486,555
December 31, 2012	Real estate					Unallocated Total
	Commercial	Commercial	Residential	Consumer		
Allowance for loan losses:						
Ending balance	\$ 2,024	\$ 2,101	\$ 1,206	\$ 234	\$ 1,016	\$ 6,581
Ending balance: individually evaluated for impairment	327	239	283	6		855
Ending balance: collectively evaluated for impairment	\$ 1,697	\$ 1,862	\$ 923	\$ 228	\$ 1,016	\$ 5,726
Loans receivable:						
Ending balance	\$ 170,379	\$ 158,798	\$ 117,527	\$ 19,069		\$ 465,773
Ending balance: individually evaluated for impairment	5,169	7,137	1,522	6		13,834
Ending balance: collectively evaluated for impairment	\$ 165,210	\$ 151,661	\$ 116,005	\$ 19,063		\$ 451,939

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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

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

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

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

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

Doubtful- A loan classified as Doubtful has all the weakness 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 their continuance as bankable loans 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 effected in the future.

The following tables present the major classifications of the loan portfolio 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 September 30, 2013 and December 31, 2012:

September 30, 2013	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$179,054	\$ 5,186	\$ 815	\$ 2,407	\$187,462
Real estate:					
Commercial	165,829	3,960	8,029	3,739	181,557
Residential	115,557	348	227	1,664	117,796
Consumer	18,278	16			18,294
Total	\$478,718	\$ 9,510	\$ 9,071	\$ 7,810	\$505,109

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

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2012					
Commercial	\$ 161,236	\$ 5,752	\$ 1,113	\$ 2,278	\$ 170,379
Real estate:					
Commercial	146,205	5,302	3,120	4,171	158,798
Residential	116,042			1,485	117,527
Consumer	19,058	11			19,069
Total	\$ 442,541	\$ 11,065	\$ 4,233	\$ 7,934	\$ 465,773

Information concerning nonaccrual loans by major loan category at September 30, 2013 and December 31, 2012, is as follows:

	September 30, 2013	December 31, 2012
Commercial	\$ 2,407	\$ 2,278
Real estate:		
Commercial	3,739	4,171
Residential	1,664	1,485
Consumer		
Total	\$ 7,810	\$ 7,934

The major categories of the loan portfolio by past due status at September 30, 2013 and December 31, 2012, are summarized as follows:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
September 30, 2013							
Commercial	\$ 272	\$ 3	\$ 2,254	\$ 2,529	\$ 184,933	\$ 187,462	\$ 53
Real estate:							
Commercial	1,041	1,540	429	3,010	178,547	181,557	
Residential	1,138	231	1,177	2,546	115,250	117,796	
Consumer	341	152	444	937	17,357	18,294	444
Total	\$ 2,792	\$ 1,926	\$ 4,304	\$ 9,022	\$ 496,087	\$ 505,109	\$ 497

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
December 31, 2012							
Commercial	\$ 883	\$ 255	\$ 324	\$ 1,462	\$ 168,917	\$ 170,379	\$ 324
Real estate:							
Commercial	2,268	245	22	2,535	156,263	158,798	22
Residential	1,528		21	1,549	115,978	117,527	21
Consumer	411	192	494	1,097	17,972	19,069	494

Total	\$5,090	\$ 692	\$ 861	\$6,643	\$459,130	\$465,773	\$ 861
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5. Loans, net and allowance for loan losses (continued)

The following tables summarize information in regards to impaired loans as of and for the three and nine months ended September 30, 2013 and 2012, and as of and for the year ended December 31, 2012, by loan portfolio class:

September 30, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance	This Quarter		Year to Date	
				Average Recorded Investmen	Interest Recognized	Average Recorded Investmen	Interest Recognized
With no related allowance:							
Commercial	\$ 755	\$ 755		\$1,076	\$ 17	\$1,167	\$ 59
Real estate:							
Commercial	10,133	10,133		11,148	63	7,884	146
Residential	1,096	1,096		1,201	2	983	5
Consumer							
Total	11,984	11,984		13,425	82	10,034	210
With an allowance recorded:							
Commercial	2,520	2,520	\$ 386	2,505	1	2,661	1
Real estate:							
Commercial	3,255	3,255	424	3,300	53	3,312	112
Residential	795	795	297	737	5	933	5
Consumer							
Total	6,570	6,570	1,107	6,542	59	6,906	118
Commercial	3,275	3,275	386	3,581	18	3,828	60
Real estate:							
Commercial	13,388	13,388	424	14,448	116	11,196	258
Residential	1,891	1,891	297	1,938	7	1,916	10
Consumer							
Total	\$ 18,554	\$ 18,554	\$ 1,107	\$19,967	\$ 141	\$16,940	\$ 328

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

December 31, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the Year Ended Average Interest Recorded Income Investment Recognized
With no related allowance:				
Commercial	\$ 3,782	\$ 3,782		\$4,792 \$ 114
Real estate:				
Commercial	3,354			