

PEOPLES FINANCIAL SERVICES CORP.
Form 10-Q
August 05, 2016
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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, 2016

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)

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(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

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: 7,394,143 at July 29, 2016.

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PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended June 30, 2016

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CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

	June 30, 2016	December 31, 2015
Assets:		
Cash and due from banks	\$ 29,805	\$ 28,218
Interest-bearing deposits in other banks	272	4,699
Investment securities:		
Available-for-sale	251,382	284,935
Held-to-maturity: Fair value June 30, 2016, \$12,065; December 31, 2015, \$12,606	11,262	12,109
Total investment securities	262,644	297,044
Loans, net	1,464,808	1,340,865
Less: allowance for loan losses	14,799	12,975
Net loans	1,450,009	1,327,890
Premises and equipment, net	29,510	28,157
Accrued interest receivable	5,952	5,796
Goodwill	63,370	63,370
Intangible assets	4,795	5,397
Other assets	65,253	58,487
Total assets	\$ 1,911,610	\$ 1,819,058
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 323,785	\$ 320,978
Interest-bearing	1,173,078	1,134,832
Total deposits	1,496,863	1,455,810
Short-term borrowings	86,300	38,325
Long-term debt	59,232	60,354
Accrued interest payable	453	560
Other liabilities	14,437	15,241
Total liabilities	1,657,285	1,570,290
Stockholders' equity:		
Common stock, par value \$2.00, authorized 25,000,000 shares, issued and outstanding 7,394,143 shares at June 30, 2016 and 7,410,606 shares at December 31, 2015	14,788	14,821
Capital surplus	134,835	135,371
Retained earnings	105,852	100,701
Accumulated other comprehensive loss	(1,150)	(2,125)
Total stockholders' equity	254,325	248,768
Total liabilities and stockholders' equity	\$ 1,911,610	\$ 1,819,058

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)

June 30,	Three Months Ended		Six Months Ended	
	2016	2015	2016	2015
Interest income:				
Interest and fees on loans:				
Taxable	\$ 14,760	\$ 13,391	\$ 29,106	\$ 26,731
Tax-exempt	780	570	1,531	1,129
Interest and dividends on investment securities:				
Taxable	617	816	1,304	1,716
Tax-exempt	875	835	1,750	1,640
Dividends	11	6	21	15
Interest on interest-bearing deposits in other banks	15	15	32	26
Interest on federal funds sold		5		9
Total interest income	17,058	15,638	33,744	31,266
Interest expense:				
Interest on deposits	1,322	1,192	2,605	2,460
Interest on short-term borrowings	89	4	166	12
Interest on long-term debt	354	252	714	511
Total interest expense	1,765	1,448	3,485	2,983
Net interest income	15,293	14,190	30,259	28,283
Provision for loan losses	1,200	750	2,400	1,500
Net interest income after provision for loan losses	14,093	13,440	27,859	26,783
Noninterest income:				
Service charges, fees and commissions	1,527	1,542	2,971	3,154
Merchant services income	1,038	963	1,952	1,753
Commission and fees on fiduciary activities	474	487	956	946
Wealth management income	296	198	708	403
Mortgage banking income	195	248	399	470
Life insurance investment income	202	188	395	377
Net gain on sale of investment securities available-for-sale	381		623	832
Total noninterest income	4,113	3,626	8,004	7,935
Noninterest expense:				
Salaries and employee benefits expense	5,904	5,613	11,236	10,846
Net occupancy and equipment expense	2,245	2,149	4,682	4,617
Merchant services expense	748	650	1,380	1,183
Amortization of intangible assets	297	295	602	600
Other expenses	2,919	2,804	5,831	5,359

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Total noninterest expense	12,113	11,511	23,731	22,605
Income before income taxes	6,093	5,555	12,132	12,113
Income tax expense	1,238	1,124	2,395	2,638
Net income	4,855	4,431	9,737	9,475
Other comprehensive income (loss):				
Unrealized gain on investment securities available-for-sale	1,128	(1,459)	2,123	(692)
Reclassification adjustment for net gain on sales included in net income	(381)		(623)	(832)
Other comprehensive income (loss)	747	(1,459)	1,500	(1,524)
Income tax related to other comprehensive income (loss)	261	(510)	525	(533)
Other comprehensive income (loss), net of income taxes	486	(949)	975	(991)
Comprehensive income	\$ 5,341	\$ 3,482	\$ 10,712	\$ 8,484
Per share data:				
Net income:				
Basic	\$ 0.66	\$ 0.59	\$ 1.32	\$ 1.26
Diluted	\$ 0.66	\$ 0.59	\$ 1.32	\$ 1.26
Average common shares outstanding:				
Basic	7,395,127	7,546,198	7,399,318	7,547,272
Diluted	7,395,127	7,546,198	7,399,318	7,547,272
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 Loss	Total
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
Balance, January 1, 2015	15,097	140,214	92,297	(829)	246,779
Stock based compensation		35			35
Net income			9,475		9,475
Other comprehensive loss, net of income taxes				(991)	(991)
Dividends declared: \$0.62 per share			(4,679)		(4,679)
Shares retired: 5,633 shares	(11)	(204)			(215)
Balance, June 30, 2015	\$ 15,086	\$ 140,045	\$ 97,093	\$ (1,820)	\$ 250,404

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,	2016	2015
Cash flows from operating activities:		
Net income	\$ 9,737	\$ 9,475
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	788	784
Amortization of deferred loan costs	362	284
Amortization of intangibles	602	600
Amortization of loss on investment tax credits	244	334
Provision for loan losses	2,400	1,500
Net gain on sale of other real estate owned	(9)	(110)
Loans originated for sale	(10,709)	(14,079)
Proceeds from sale of loans originated for sale	11,108	15,155
Net gain on sale of loans originated for sale	(399)	(469)
Net amortization of investment securities	1,997	2,054
Net gain on sale of investment securities	(623)	(832)
Life insurance investment income	(395)	(377)
Deferred income tax expense (benefit)		119
Stock based compensation	35	35
Net change in:		
Accrued interest receivable	(156)	73
Other assets	(1,654)	(3,569)
Accrued interest payable	(107)	(131)
Other liabilities	(804)	(1,478)
Net cash provided by operating activities	12,417	9,368
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	27,408	50,981
Proceeds from repayments of investment securities:		
Available-for-sale	23,013	28,253
Held-to-maturity	830	1,016
Purchases of investment securities:		
Available-for-sale	(16,725)	(61,162)
Net (purchase) redemption of restricted equity securities	(1,475)	330
Net increase in lending activities	(125,528)	(22,571)
Investment in low income housing investment tax credits	(2,050)	
Purchases of premises and equipment	(2,141)	(1,903)
Purchase of investment in life insurance	(1,500)	
Proceeds from sale of other real estate owned	195	463
Net cash used in investing activities	(97,973)	(4,593)
Cash flows from financing activities:		
Net increase (decrease) in deposits	41,053	(791)

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Repayment of long-term debt	(1,122)	(1,477)
Net increase (decrease) in short-term borrowings	47,975	6,303
Retirement of common stock	(604)	
Cash dividends paid	(4,586)	(4,679)
Net cash provided by (used in) financing activities	82,716	(644)
Net increase (decrease) in cash and cash equivalents	(2,840)	4,131
Cash and cash equivalents at beginning of year	32,917	31,426
Cash and cash equivalents at end of year	\$ 30,077	\$ 35,557

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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,	2016	2015
Supplemental disclosures:		
Cash paid during the period for:		
Interest	\$ 3,592	\$ 3,114
Income taxes	1,800	1,800
Noncash items:		
Transfers of loans to other real estate	\$ 761	\$ 247

See notes to unaudited consolidated financial statements

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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-four full-service community banking offices located within the Bucks, Lackawanna, Lehigh, Luzerne, Monroe, Montgomery, 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, 2016, 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, 2015.

Recent accounting standards:

In May 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-11, "Revenue Recognition and Derivatives and Hedging." ASU 2016-11 codifies the SEC's rescission of certain SEC Staff Observer comments that were codified in Topic 605 and Topic 932. In addition, the ASU codifies SEC's rescission of SEC Staff Announcement, "Determining the Nature of a Host Contract Related to a Hybrid Instrument Issued in the Form of a Share under Topic 815," which was previously codified in paragraph 815-10-S99-3. The effective date and transition requirements for ASU 2016-11 are the same as the effective date and transition requirements of Topic 606 and management is currently assessing the impact, if any, on its financial condition or results of operations.

In May 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-12, "Revenue from Contracts with Customers." The amendments do not alter the core principle of the new revenue standard, but make certain targeted changes.

The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of Topic 606 and management is currently assessing the impact, if any, on its financial condition or results of operations.

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Peoples Financial Services Corp.

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

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-13, “Financial Instruments – Credit Losses and Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 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 also 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. Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. The Update has tiered effective dates with early adoption permitted for all entities as of the fiscal year beginning after December 15, 2018. The Company is still evaluating the impact on its financial condition or results of operations.

2. Other comprehensive income (loss):

The components of other comprehensive loss and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive 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, 2016 and December 31, 2015 is as follows:

	June 30, 2016	December 31, 2015
Net unrealized gain on investment securities available-for-sale	\$ 6,093	\$ 4,593
Income tax	2,132	1,607
Net of income taxes	3,961	2,986
Benefit plan adjustments	(7,863)	(7,863)

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Income tax	(2,752)	(2,752)
Net of income taxes	(5,111)	(5,111)
Accumulated other comprehensive loss	\$ (1,150)	\$ (2,125)

Other comprehensive income (loss) and related tax effects for the three and six months ended June 30, 2016 and 2015 is as follows:

Three Months Ended June 30,	2016	2015
Unrealized gain (loss) on investment securities available-for-sale	\$ 1,128	\$ (1,459)
Net gain on the sale of investment securities available-for-sale(1)	(381)	
Other comprehensive income (loss) gain before taxes	747	(1,459)
Income tax	261	(510)
Other comprehensive income (loss)	\$ 486	\$ (949)

Six Months Ended June 30,	2016	2015
Unrealized gain (loss) on investment securities available-for-sale	\$ 2,123	\$ (692)
Net gain on the sale of investment securities available-for-sale(1)	(623)	(832)
Other comprehensive income (loss) gain before taxes	1,500	(1,524)
Income tax	525	(533)
Other comprehensive income (loss)	\$ 975	\$ (991)

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

(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, 2016 and 2015.

	2016		2015	
For the Three Months Ended June 30,	Basic	Diluted	Basic	Diluted
Net Income	\$ 4,855	\$ 4,855	\$ 4,431	\$ 4,431
Average common shares outstanding	7,395,127	7,395,127	7,546,198	7,546,198
Earnings per share	\$ 0.66	\$ 0.66	\$ 0.59	\$ 0.59
	2016		2015	
For the Six Months Ended June 30	Basic	Diluted	Basic	Diluted
Net Income	\$ 9,737	\$ 9,737	\$ 9,475	\$ 9,475
Average common shares outstanding	7,399,318	7,399,318	7,547,272	7,547,272
Earnings per share	\$ 1.32	\$ 1.32	\$ 1.26	\$ 1.26

4. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at June 30, 2016 and December 31, 2015 are summarized as follows:

June 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government-sponsored enterprises	\$ 58,307	\$ 438		\$ 58,745
State and municipals:				
Taxable	14,767	1,182		15,949
Tax-exempt	119,021	4,136	\$ 2	123,155
Mortgage-backed securities:				
U.S. Government agencies	25,878	189	13	26,054
U.S. Government-sponsored enterprises	27,316	241	78	27,479
Total	\$ 245,289	\$ 6,186	\$ 93	\$ 251,382
Held-to-maturity:				
Tax-exempt state and municipals	\$ 6,864	\$ 488	\$	\$ 7,352
Mortgage-backed securities:				
U.S. Government agencies	76	2		78
U.S. Government-sponsored enterprises	4,322	313		4,635
Total	\$ 11,262	\$ 803	\$	\$ 12,065

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Peoples Financial Services Corp.

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

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	\$ 10,030		\$ 31	\$ 9,999
U.S. Government-sponsored enterprises State and municipals:	68,831	\$ 291	62	69,060
Taxable	15,842	735	32	16,545
Tax-exempt	121,099	3,915	90	124,924
Mortgage-backed securities:				
U.S. Government agencies	31,612	73	117	31,568
U.S. Government-sponsored enterprises	32,928	119	208	32,839
Total	\$ 280,342	\$ 5,133	\$ 540	\$ 284,935
Held-to-maturity:				
Tax-exempt state and municipals	\$ 6,865	\$ 186	\$ 16	\$ 7,035
Mortgage-backed securities:				
U.S. Government agencies	84	1		85
U.S. Government-sponsored enterprises	5,160	326		5,486
Total	12,109	\$ 513	\$ 16	\$ 12,606

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, 2016, is summarized as follows:

June 30, 2016	Fair Value
Within one year	\$ 28,145
After one but within five years	78,332
After five but within ten years	59,725
After ten years	31,647
	197,849
Mortgage-backed securities	53,533
Total	\$ 251,382

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at June 30, 2016, is summarized as follows:

June 30, 2016	Amortized Cost	Fair Value
Within one year		
After one but within five years		
After five but within ten years		
After ten years	\$ 6,864	\$ 7,352
	6,864	7,352
Mortgage-backed securities	4,398	4,713
Total	\$ 11,262	\$ 12,065

Securities with a carrying value of \$154,673 and \$180,478 at June 30, 2016 and December 31, 2015, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

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, 2016 and December 31, 2015, 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, 2016 and December 31, 2015, 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
June 30, 2016						
U.S. Government-sponsored enterprises						
State and municipals:						
Taxable						
Tax-exempt	\$ 2,749	\$ 1	\$ 633	\$ 1	\$ 3,382	\$ 2
Mortgage-backed securities:						
U.S. Government agencies			1,844	13	1,844	13
U.S. Government-sponsored enterprises	1,341	1	2,658	77	3,999	78
Total	\$ 4,090	\$ 2	\$ 5,135	\$ 91	\$ 9,225	\$ 93

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2015						
U.S. Treasury securities	\$ 9,999	\$ 31			\$ 9,999	\$ 31
U.S. Government-sponsored enterprises	34,159	62			34,159	62
State and municipals:						

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Taxable			\$ 532	\$ 32	532	32
Tax-exempt	21,341	87	1,952	19	23,293	106
Mortgage-backed securities:						
U.S. Government agencies	15,114	56	5,477	61	20,591	117
U.S. Government-sponsored enterprises	17,647	104	6,030	104	23,677	208
Total	\$ 98,260	\$ 340	\$ 13,991	\$ 216	\$ 112,251	\$ 556

The Company had 24 investment securities, consisting of 11 tax-exempt state and municipal obligations, and 13 mortgage-backed securities that were in unrealized loss positions at June 30, 2016. Of these securities, one tax-exempt state and municipal obligation and five mortgage-backed securities were in a continuous unrealized loss position for twelve months or more. Management does not consider the unrealized losses on the debt securities, as a result of changes in interest rates, to be OTTI based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuers or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at June 30, 2016. There was no OTTI recognized for the three or six months ended June 30, 2016 and 2015.

The Company had 88 investment securities, consisting of 38 tax-exempt state and municipal obligations, one taxable state and municipal obligation, one U.S. Treasury security, 12 U.S. Government-sponsored enterprise securities and 36 mortgage-backed securities that were in unrealized loss positions at December 31, 2015. Of these securities, seven mortgage-backed securities, four tax-exempt state and municipal securities, and one taxable state and municipal obligation were in a continuous unrealized loss position for twelve months or more.

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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, 2016 and December 31, 2015 are summarized as follows. Net deferred loan costs were \$668 and \$690 at June 30, 2016 and December 31, 2015.

	June 30, 2016	December 31, 2015
Commercial	\$ 394,283	\$ 365,767
Real estate:		
Commercial	647,058	567,277
Residential	299,037	306,218
Consumer	124,430	101,603
Total	\$ 1,464,808	\$ 1,340,865

The changes in the allowance for loan losses account by major classification of loan for the three and six months ended June 30, 2016 and 2015 are summarized as follows:

June 30, 2016	Commercial	Real estate			Unallocated	Total
		Commercial	Residential	Consumer		
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

June 30, 2016	Commercial	Real estate			Unallocated	Total
		Commercial	Residential	Consumer		
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)

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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

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

June 30, 2015	Commercial	Real estate		Consumer	Total
		Commercial	Residential		
Allowance for loan losses:					
Beginning Balance January 1, 2015	\$ 2,321	\$ 3,037	\$ 3,690	\$ 1,290	\$ 10,338
Charge-offs	(40)	(79)	(234)	(186)	(539)
Recoveries	64	6	8	51	129
Provisions	90	226	563	621	1,500
Ending balance	\$ 2,435	\$ 3,190	\$ 4,027	\$ 1,776	\$ 11,428

The allocation of the allowance for loan losses and the related loans by major classifications of loans at June 30, 2016 and December 31, 2015 is summarized as follows:

June 30, 2016	Commercial	Real estate		Consumer	Unallocated	Total
		Commercial	Residential			
Allowance for loan losses:						
Ending balance	\$ 3,263	\$ 5,077	\$ 4,465	\$ 1,679	\$ 315	\$ 14,799
Ending balance: individually evaluated for impairment	615	405	723	71		1,814
Ending balance: collectively evaluated for impairment	2,648	4,672	3,742	1,608	315	12,985
Ending balance: loans acquired with	\$	\$	\$	\$	\$	\$ —

deteriorated credit quality						
Loans receivable:						
Ending balance	\$ 394,283	\$ 647,058	\$ 299,037	\$ 124,430	\$	\$ 1,464,808
Ending balance:						
individually evaluated for impairment	870	5,073	3,177	228		9,348
Ending balance:						
collectively evaluated for impairment	392,372	640,642	295,817	124,202		1,453,033
Ending balance: loans acquired with deteriorated credit quality	\$ 1,041	\$ 1,343	\$ 43	\$	\$	\$ 2,427

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December 31, 2015	Commercial	Real estate Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending balance	\$ 3,042	\$ 4,245	\$ 4,082	\$ 1,583	\$ 23	\$ 12,975
Ending balance:						
individually evaluated for impairment	759	126	1,138	117		2,140
Ending balance:						
collectively evaluated for impairment	2,283	4,012	2,944	1,466	23	10,728
Ending balance: loans acquired with deteriorated credit quality	\$	\$ 107	\$	\$	\$	\$ 107
Loans receivable:						
Ending balance	\$ 365,767	\$ 567,277	\$ 306,218	\$ 101,603	\$	\$ 1,340,865
Ending balance:						
individually evaluated for impairment	1,196	4,006	4,917	148		10,267
Ending balance:						
collectively evaluated for impairment	363,620	561,903	301,252	101,455		1,328,230
Ending balance: loans acquired with deteriorated credit quality	\$ 951	\$ 1,368	\$ 49	\$	\$	\$ 2,368

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

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

- Special Mention- A loan that has potential weaknesses that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special Mention loans are not adversely classified since they do not expose the Company to sufficient risk to warrant adverse classification.
- Substandard- A loan that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.
- Doubtful – A loan classified as Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
- Loss- A loan classified as Loss is considered uncollectible and of such little value that its continuance as bankable loan is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

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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, 2016 and December 31, 2015:

June 30, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 386,532	\$ 4,960	\$ 2,791	\$	\$ 394,283
Real estate:					
Commercial	610,356	20,454	16,248		647,058
Residential	292,293	598	6,146		299,037
Consumer	124,218		212		124,430
Total	\$ 1,413,399	\$ 26,012	\$ 25,397	\$	\$ 1,464,808

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 357,894	\$ 3,566	\$ 4,307	\$	\$ 365,767
Real estate:					
Commercial	538,130	10,150	18,997		567,277
Residential	296,587	983	8,648		306,218
Consumer	101,486		117		101,603
Total	\$ 1,294,097	\$ 14,699	\$ 32,069	\$	\$ 1,340,865

Information concerning nonaccrual loans by major loan classification at June 30, 2016 and December 31, 2015 is summarized as follows:

	June 30, 2016	December 31, 2015
Commercial	\$ 1,262	\$ 1,632
Real estate:		

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Commercial	4,929	3,859
Residential	2,826	4,732
Consumer	228	148
Total	\$ 9,245	\$ 10,371

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

June 30, 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	\$ 724	\$ 234	\$ 1,262	\$ 2,220	\$ 392,063	\$ 394,283	
Real estate:							
Commercial	2,172	617	4,929	7,718	639,340	647,058	
Residential	1,673	289	4,545	6,507	292,530	299,037	\$ 1,719
Consumer	955	269	580	1,804	122,626	124,430	352
Total	\$ 5,524	\$ 1,409	\$ 11,316	\$ 18,249	\$ 1,446,559	\$ 1,464,808	\$ 2,071

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December 31, 2015	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	\$ 126	\$	\$ 1,632	\$ 1,758	\$ 364,009	\$ 365,767	
Real estate:							
Commercial	1,364	165	3,859	5,388	561,889	567,277	
Residential	3,891	1,067	5,257	10,215	296,003	306,218	\$ 525
Consumer	705	353	386	1,444	100,159	101,603	238
Total	\$ 6,086	\$ 1,585	\$ 11,134	\$ 18,805	\$ 1,322,060	\$ 1,340,865	\$ 763

The following tables summarize information concerning impaired loans as of and for the three and six months ended June 30, 2016 and June 30, 2015, and as of and for the year ended, December 31, 2015 by major loan classification:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	This Quarter Average Recorded Investment	Interest Income Recognized	Year-to-Date Average Recorded Investment	Interest Income Recognized
June 30, 2016							
With no related allowance:							
Commercial	\$ 1,296	\$ 2,378		\$ 1,235	\$ 14	\$ 1,249	\$ 30
Real estate:							
Commercial	5,517	6,181		4,340	30	3,643	61
Residential	1,941	2,124		2,079	3	2,355	11
Consumer	157	157		123		92	
Total	8,911	10,840	—	7,777	47	7,339	102
With an allowance recorded:							
Commercial	615	615	\$ 615	878		923	
Real estate:							
Commercial	899	899	405	1,964		2,400	
Residential	1,279	1,279	723	1,136	2	1,295	4
Consumer	71	71	71	80		92	
Total	2,864	2,864	1,814	4,058	2	4,710	4
Commercial	1,911	2,993	615	2,113	14	2,172	30
Real estate:							
Commercial	6,416	7,080	405	6,304	30	6,043	61

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Residential	3,220	3,403	723	3,215	5	3,650	15
Consumer	228	228	71	203	—	184	—
Total	\$ 11,775	\$ 13,704	\$ 1,814	\$ 11,835	\$ 49	\$ 12,049	\$ 106

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December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the Year Ended	
				Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Commercial	\$ 1,352	\$ 2,720		\$ 1,848	\$ 87
Real estate:					
Commercial	2,731	3,408		2,394	95
Residential	3,048	3,231		2,664	4
Consumer	31	31		17	
Total	7,162	9,390		6,923	186
With an allowance recorded:					
Commercial	795	795	\$ 759	1,680	40
Real estate:					
Commercial	2,643	2,643	233	4,155	86
Residential	1,918	1,918	1,138	1,776	30
Consumer	117	117	117	126	
Total	5,473	5,473	2,247	7,737	156
Commercial	2,147	3,515	759	3,528	127
Real estate:					
Commercial	5,374	6,051	233	6,549	181
Residential	4,966	5,149	1,138	4,440	34
Consumer	148	148	117	143	
Total	\$ 12,635	\$ 14,863	\$ 2,247	\$ 14,660	\$ 342

June 30, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	This Quarter		Year-to-Date	
				Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:							
Commercial	\$ 1,658	\$ 3,184		\$ 1,989	\$ 17	\$ 2,168	37
Real estate:							
Commercial	2,140	2,852		2,169	28	2,366	47
Residential	2,734	2,917		2,503	1	2,488	2
Consumer				6		26	

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Total	6,532	8,953		6,667	46	7,048	86
With an allowance recorded:							
Commercial	1,312	1,312	\$ 1,209	1,469	\$ 13	1,533	\$ 27
Real estate:							
Commercial	5,316	5,316	1,445	4,628	48	4,182	65
Residential	1,706	1,706	796	1,673	7	1,593	17
Consumer	137	137	137	114		91	
Total	8,471	8,471	3,587	7,884	68	7,399	109
Commercial	2,970	4,496	1,209	3,458	30	3,701	64
Real estate:							
Commercial	7,456	8,168	1,445	6,797	76	6,548	112
Residential	4,440	4,623	796	4,176	8	4,081	19
Consumer	137	137	137	120		117	
Total	\$ 15,003	\$ 17,424	\$ 3,587	\$ 14,551	\$ 114	\$ 14,447	\$ 195

Included in the commercial loan and commercial and residential real estate categories are troubled debt restructurings that are classified as impaired. Troubled debt restructurings totaled \$2,701 at June 30, 2016, \$2,861 at December 31, 2015 and \$3,046 at June 30, 2015.

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Troubled debt restructured loans are loans with original terms, interest rate, or both, that have been modified as a result of a deterioration in the borrower's financial condition and a concession has been granted that the Company would not otherwise consider. Unless on nonaccrual, interest income on these loans is recognized when earned, using the interest method. The Company offers a variety of modifications to borrowers that would be considered concessions. The modification categories offered generally fall within the following categories:

- Rate Modification - A modification in which the interest rate is changed to a below market rate.
- Term Modification - A modification in which the maturity date, timing of payments or frequency of payments is changed.
- Interest Only Modification - A modification in which the loan is converted to interest only payments for a period of time.
- Payment Modification - A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.
- Combination Modification - Any other type of modification, including the use of multiple categories above.

There were no loans modified as troubled debt restructurings for the three months ended June 30, 2016. For the six months ended June 30, 2016, one loan was modified as a troubled debt restructuring in the amount of \$75. There were four loans modified as troubled debt restructurings for the three months ended June 30, 2015, in the amount of \$170. For the six months ended June 30, 2015, there were eight loans modified as troubled debt restructurings in the amount of \$554. During the three months ended June 30, 2016, there were no payment payment defaults on loans restructured within the last twelve months. During the six months ended June 30, 2016, there were two payment defaults on restructured residential real estate loans totaling \$208. During the three and six months ended June 30, 2015; there were no payment defaults on loans restructured within the last twelve months.

6. Other assets:

The components of other assets at June 30, 2016, and December 31, 2015 are summarized as follows:

	June 30, 2016	December 31, 2015
Other real estate owned	\$ 1,353	\$ 957
Investment in residential housing program	8,550	6,744
Mortgage servicing rights	489	465
Bank owned life insurance	32,677	30,782
Restricted equity securities	6,878	5,403
Other assets	15,306	14,136
Total	\$ 65,253	\$ 58,487

7. Fair value estimates:

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosure under GAAP. Fair value estimates are calculated without attempting to estimate the value of anticipated future business and the value of certain assets and liabilities that are not considered financial. Accordingly, such assets and liabilities are excluded from disclosure requirements.

In accordance with FASB ASC 820, "Fair Value Measurements and Disclosures," fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not

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available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets. In many cases, these values cannot be realized in immediate settlement of the instrument.

Current fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction that is not a forced liquidation or distressed sale between participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with GAAP, the Company groups its assets and liabilities generally measured at fair value into three levels based on market information or other fair value estimates in which the assets and liabilities are traded or valued and the reliability of the assumptions used to determine fair value. These levels include:

- Level 1: Unadjusted quoted prices of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

The following methods and assumptions were used by the Company to calculate fair values and related carrying amounts of financial instruments:

Cash and cash equivalents: The carrying values of cash and cash equivalents as reported on the balance sheet approximate fair value.

Investment securities: The fair values of U.S. Treasury securities and marketable equity securities are based on quoted market prices from active exchange markets. The fair values of debt securities are based on pricing from a matrix pricing model.

Loans held for sale: The fair values of loans held for sale are based upon current delivery prices in the secondary mortgage market.

Net loans: For adjustable-rate loans that re-price frequently and with no significant credit risk, fair values are based on carrying values. The fair values of other non-impaired loans are estimated using discounted cash flow analysis, using interest rates currently offered in the market for loans with similar terms to borrowers of similar credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis determined by the loan review function or underlying collateral values, where applicable.

Mortgage servicing rights: To determine the fair value, the Company estimates the present value of future cash flows incorporating assumptions such as cost of servicing, discount rates, prepayment speeds and default rates.

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Accrued interest receivable: The carrying value of accrued interest receivable as reported on the balance sheet approximates fair value.

Restricted equity securities: The carrying values of restricted equity securities approximate fair value, due to the lack of marketability for these securities.

Deposits: The fair values of noninterest-bearing deposits and savings, NOW and money market accounts are the amounts payable on demand at the reporting date. The fair value estimates do not include the benefit that results from such low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. The carrying values of adjustable-rate, fixed-term time deposits approximate their fair values at the reporting date. For fixed-rate time deposits, the present value of future cash flows is used to estimate fair values. The discount rates used are the current rates offered for time deposits with similar maturities.

Short-term borrowings: The carrying values of short-term borrowings approximate fair value.

Long-term debt: The fair value of fixed-rate long-term debt is based on the present value of future cash flows. The discount rate used is the current rate offered for long-term debt with the same maturity.

Accrued interest payable: The carrying value of accrued interest payable as reported on the balance sheet approximates fair value.

Off-balance sheet financial instruments:

The majority of commitments to extend credit, unused portions of lines of credit and standby letters of credit carry current market interest rates if converted to loans. Because such commitments are generally unassignable to either the Company or the borrower, they only have value to the Company and the borrower. None of the commitments are subject to undue credit risk. The estimated fair values of off-balance sheet financial instruments are based on fees

currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of off-balance sheet financial instruments was not material at June 30, 2016 and December 31, 2015.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2016 and December 31, 2015 are summarized as follows:

	Fair Value Measurement Using			
	Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2016				
U.S. Government-sponsored enterprises	\$ 58,745	\$	\$ 58,745	\$
State and Municipals:				
Taxable	15,949		15,949	
Tax-exempt	123,155		123,155	
Mortgage-backed securities:				
U.S. Government agencies	26,054		26,054	
U.S. Government-sponsored enterprises	27,479		27,479	
Total	\$ 251,382	\$	\$ 251,382	\$

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	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
U.S. Treasury securities	\$ 9,999	\$ 9,999		\$
U.S. Government-sponsored enterprises State and Municipals:	69,060		\$ 69,060	
Taxable	16,545		16,545	
Tax-exempt	124,924		124,924	
Mortgage-backed securities:				
U.S. Government agencies	31,568		31,568	
U.S. Government-sponsored enterprises	32,839		32,839	
Total	\$ 284,935	\$ 9,999	\$ 274,936	\$

Assets and liabilities measured at fair value on a nonrecurring basis at June 30, 2016 and December 31, 2015 are summarized as follows:

	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2016				
Impaired loans	\$ 5,801			\$ 5,801
Other real estate owned	\$ 1,256			\$ 1,256

	Amount	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
Impaired loans	\$ 4,944			\$ 4,944

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Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 Inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The carrying and fair values of the Company's financial instruments at June 30, 2016 and December 31, 2015 and their placement within the fair value hierarchy are as follows:

	Carrying Value	Fair Value	Fair Value Hierarchy Quoted Prices in Active Markets for Identical Assets (level 1)	Significant Other Observable Inputs (level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2016					
Financial assets:					
Cash and cash equivalents	\$ 30,077	\$ 30,077	\$ 30,077		
Investment securities:					
Available-for-sale	251,382	251,382		\$ 251,382	
Held-to-maturity	11,262	12,065		12,065	
Loans held for sale					
Net loans	1,450,009	1,465,095			\$ 1,465,095
Accrued interest receivable	5,952	5,952		5,952	
Mortgage servicing rights	489	1,543		1,543	
Restricted equity securities	6,878	6,878		6,878	
Total	\$ 1,756,049	\$ 1,772,992			
Financial liabilities:					
Deposits	\$ 1,496,863	\$ 1,499,201		1,499,201	
Short-term borrowings	86,300	86,282		86,282	
Long-term debt	59,232	61,334		61,334	
Accrued interest payable	453	453		\$ 453	

Total	\$ 1,642,848	\$ 1,647,270
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Fair Value Hierarchy
Quoted
Prices in
Active Significant
Markets for