PENNS WOODS BANCORP INC
Form 10-K
March 13, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC. 20549

FORM 10-K

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the transition period from to

Commission file number 0-17077

PENNS WOODS BANCORP, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2226454
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

300 Market Street, P.O. Box 967 Williamsport, Pennsylvania	17703-0967

Registrant’s telephone number, including area code (570) 322-1111

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange which registered
Common Stock, par value $8.33 per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes ý No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes ý No

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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

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

If an emerging growth company, indicate by check mark if 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. o

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

State the aggregate market value of the voting stock held by non-affiliates of the registrant $193,053,570 at June 30, 2017.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at March 1, 2018
Common Stock, $8.33 Par Value	4,689,563 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement prepared in connection with its annual meeting of shareholders to be held on April 24, 2018 are incorporated by reference in Part III hereof.

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PART I
ITEM 1 BUSINESS

A. General Development of Business and History

On January 7, 1983, Penns Woods Bancorp, Inc. (the “Company”) was incorporated under the laws of the Commonwealth of Pennsylvania as a bank holding company. In connection with the organization of the Company, Jersey Shore State Bank ("JSSB"), a Pennsylvania state-chartered bank, became a wholly owned subsidiary of the Company. On June 1, 2013, the Company acquired Luzerne Bank ("Luzerne") with Luzerne operating as a subsidiary of the Company (JSSB and Luzerne are collectively referred to as the "Banks"). The Company’s two other wholly-owned subsidiaries are Woods Real Estate Development Company, Inc. and Woods Investment Company, Inc. The Company is also a partner in United Insurance Solutions, LLC. The Company’s business has consisted primarily of managing and supervising the Banks, and its principal source of income has been dividends paid by the Banks and Woods Investment Company, Inc.

The Banks are engaged in commercial and retail banking which includes the acceptance of time, savings, and demand deposits, the funding of commercial, consumer, and mortgage loans, and safe deposit services. Utilizing a branch office network, ATMs, Internet, and telephone banking delivery channels, the Banks deliver their products and services to the communities they reside in.

In October 2000, JSSB acquired The M Group, Inc. D/B/A The Comprehensive Financial Group (“The M Group”). The M Group, which operates as a subsidiary of JSSB, offers insurance and securities brokerage services. Securities are offered by The M Group through Voya Financial, a registered broker-dealer.

Neither the Company nor the Banks anticipate that compliance with environmental laws and regulations will have any material effect on capital expenditures, earnings, or their competitive position. The Banks are not dependent on a single customer or a few customers, the loss of whom would have a material effect on the business of the Banks.

JSSB employed 242 persons, Luzerne employed 73 persons, and The M Group employed 4 persons as of December 31, 2017 in either a full-time or part-time capacity. The Company does not have any employees. The principal officers of the Banks also serve as officers of the Company.

Woods Investment Company, Inc., a Delaware holding company, maintains an investment portfolio that is managed for total return and to fund dividend payments to the Company.

Woods Real Estate Development Company, Inc. serves the Company through its acquisition and ownership of certain properties utilized by the Bank.

United Insurance Solutions, LLC., has been formed and will be offering property and casualty and auto insurance products within the Company's market footprint during 2018.

We post publicly available reports required to be filed with the SEC on our website, www.jssb.com, as soon as reasonably practicable after filing such reports with the SEC. The required reports are available free of charge through our website. Information available on our website is not part of or incorporated by reference into this Report or any other report filed by this Company with the SEC.

B. Regulation and Supervision

The Company is a registered bank holding company and, as such is subject to the provisions of the Bank Holding Company Act of 1956, as amended (the "BHCA") and to supervision and examination by the Board of Governors of the Federal Reserve System (the "FRB"). During 2017, the Company elected to become a financial holding company under the BHCA and the regulations of the FRB. The Banks are also subject to the supervision and examination by the Federal Deposit Insurance Corporation (the "FDIC"), as their primary federal regulator and as the insurer of the Banks' deposits. The Banks are also regulated and examined by the Pennsylvania Department of Banking and Securities (the "Department").

The insurance activities of The M Group are subject to regulation by the insurance departments of the various states in which The M Group conducts business, including principally the Pennsylvania Department of Insurance. The securities brokerage activities of The M Group are subject to regulation by federal and state securities commissions.

The insurance activities of United Insurance Solutions, LLC are subject to regulation by the Pennsylvania Department of Insurance.

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The FRB has issued regulations under the BHCA that require a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. As a result, the FRB, pursuant to such regulations, may require the Company to stand ready to use its resources to provide adequate capital funds to the Banks during periods of financial stress or adversity. The BHCA requires the Company to secure the prior approval of the FRB before it can acquire all or substantially all of the assets of any bank, or acquire ownership or control of 5% or more of any voting shares of any bank. Such a transaction would also require approval of the Department.

A bank holding company is prohibited under the BHCA from engaging in, or acquiring direct or indirect control of, more than 5% of the voting shares of any company engaged in non-banking activities unless the FRB, by order or regulation, has found such activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Under the BHCA, the FRB has the authority to require a bank holding company to terminate any activity or relinquish control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the FRB's determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

In July 2013, the federal bank regulatory agencies adopted revisions to the agencies' capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. The final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity tier 1 capital ratio of 4.5% (6.5% to be considered "well capitalized") and a tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered "well capitalized"); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered "well capitalized"). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements became effective on January 1, 2015. The capital contribution buffer requirements phase in over a three-year period that began on January 1, 2016.

In addition to the risk-based capital guidelines, the FRB requires each bank holding company to comply with the leverage ratio, under which the bank holding company must maintain a minimum level of Tier 1 capital to average total consolidated assets of 4.0% (5.0% to be considered "well capitalized"). The Banks are subject to similar capital requirements adopted by the FDIC.

Dividends

Federal and state laws impose limitations on the payment of dividends by the Banks. The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by the Banks to their additional paid-in capital.

In addition to the dividend restrictions described above, the banking regulators have the authority to prohibit or to limit the payment of dividends by the Banks if, in the banking regulator's opinion, payment of a dividend would constitute an unsafe or unsound practice in light of the financial condition of the Banks.

Under Pennsylvania law, the Company may not pay a dividend, if, after giving effect thereto, it would be unable to pay its debts as they become due in the usual course of business and, after giving effect to the dividend, the total assets of the Company would be less than the sum of its total liabilities plus the amount that would be needed, if the Company were to be dissolved at the time of distribution, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to those receiving the dividend.

It is also the policy of the FRB that a bank holding company generally may only pay dividends on common stock out of net income available to common shareholders over the past twelve months and only if the prospective rate of earnings retention appears consistent with a bank holding company's capital needs, asset quality, and overall financial condition. In the current financial and economic environment, the FRB has indicated that bank holding companies should carefully review their dividend policy and has discouraged dividend pay-out ratios at the 100% level unless both asset quality and capital are very strong. A bank holding company also should not maintain a dividend level that places undue pressure on the capital of such institution's subsidiaries, or that may undermine the bank holding company's ability to serve as a source of strength for such subsidiaries.

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C. Regulation of the Banks

The Banks are highly regulated by the FDIC and the Department. The laws that such agencies enforce limit the specific types of businesses in which the Banks may engage, and the products and services that the Banks may offer to customers. Generally, these limitations are designed to protect the insurance fund of the FDIC and/or the customers of the Banks, and not the Banks or their shareholders. From time to time, various types of new federal and state legislation have been proposed that could result in additional regulation of, and restrictions on, the business of the Banks. It cannot be predicted whether any such legislation will be adopted or how such legislation would affect business of the Banks. As a consequence of the extensive regulation of commercial banking activities in the United States, the Banks' business is particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business. Some of the major regulatory provisions that affect the business of the Banks are discussed briefly below.

Prompt Corrective Action

The FDIC has specified the levels at which an insured institution will be considered “well-capitalized,” “adequately capitalized,” “undercapitalized,” and “critically undercapitalized.” In the event an institution’s capital deteriorates to the “undercapitalized” category or below, the Federal Deposit Insurance Act (the “FDIA”) and FDIC regulations prescribe an increasing amount of regulatory intervention, including: (1) the institution of a capital restoration plan by a bank and a guarantee of the plan by a parent institution and liability for civil money damages for failure to fulfill its commitment on that guarantee; and (2) the placement of a hold on increases in assets, number of branches, or lines of business. If capital has reached the significantly or critically undercapitalized levels, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management and (in critically undercapitalized situations) appointment of a receiver. For well-capitalized institutions, the FDIA provides authority for regulatory intervention where the institution is deemed to be engaging in unsafe or unsound practices or receives a less than satisfactory examination report rating for asset quality, management, earnings or liquidity.

Deposit Insurance

The FDIC maintains the Deposit Insurance Fund ("DIF") by assessing depository institutions an insurance premium. The FDIC has set the amount of deposits it insures at $250,000.

As mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the assessment base that the FDIC uses to calculate assessment premiums is a bank’s average assets minus average tangible equity. The range of assessment rates is a low of 2.5 basis points to a high of 45 basis points, per $100 of assets.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the DIF to achieve a reserve ratio of 1.35% of insured deposits by September 2020. In addition, the FDIC has established a “designated reserve ratio” of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over $10 billion in asset size more than banks under that size. Under the Dodd-Frank Act, the FDIC is authorized to make reimbursements from the insurance fund to banks if the reserve ratio exceeds 1.50%, but the FDIC has adopted the “designated reserve ratio” of 2.0% and has announced that any reimbursements from the fund are indefinitely suspended.

Federal Home Loan Bank System

The Banks are members of the Federal Home Loan Bank of Pittsburgh (the "FHLB"), which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. At December 31, 2017, the Banks had $70,625,000 in FHLB advances.

As a member, the Banks are required to purchase and maintain stock in the FHLB. The amount of required stock varies based on the FHLB products utilized by the Banks and the amount of the products utilized. At December 31, 2017, the Banks had $12,826,600 in stock of the FHLB, which was in compliance with this requirement.

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Other Legislation

The 2010 Dodd-Frank Act significantly changed the bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The federal agencies are given significant discretion in drafting rules and regulations to implement the Dodd-Frank Act, and consequently, much of the impact of the Dodd-Frank Act may not be known for some time.

Certain provisions of the Dodd-Frank Act have already impacted the Company. For example, effective July 21, 2011, a provision of the Dodd-Frank Act eliminated the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on the Company's interest expense. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008.

Bank and thrift holding companies with assets of less than $15 billion as of December 31, 2009, such as the Company, will be permitted to include trust preferred securities that were issued before May 19, 2010, as Tier 1 capital; however, trust preferred securities issued by a bank or thrift holding company (other than those with assets of less than $500 million) after May 19, 2010, will no longer count as Tier 1 capital. Trust preferred securities still will be entitled to be treated as Tier 2 capital.

The Dodd-Frank Act requires publicly traded companies to give shareholders a non-binding vote on executive compensation and so-called "golden parachute" arrangements, and may allow greater access by shareholders to the company's proxy material by authorizing the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company's proxy materials. The legislation also directs the FRB to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets such as the Banks will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

The Sarbanes-Oxley Act of 2002 was enacted to enhance penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures under the federal securities laws. The Sarbanes-Oxley Act generally applies to all companies, including the Company, that file or are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934, or the Exchange Act. The legislation includes provisions, among other things, governing the services that can be provided by a public company's independent auditors and the procedures for approving such services, requiring the chief executive officer and principal accounting officer to certify certain matters relating to the

company's periodic filings under the Exchange Act, requiring expedited filings of reports by insiders of their securities transactions and containing other provisions relating to insider conflicts of interest, increasing disclosure requirements relating to critical financial accounting policies and their application, increasing penalties for securities law violations, and creating a new public accounting oversight board, a regulatory body subject to SEC jurisdiction with broad powers to set auditing, quality control, and ethics standards for accounting firms. In response to the legislation, the national securities exchanges and NASDAQ have adopted new rules relating to certain matters, including the independence of members of a company's audit committee as a condition to listing or continued listing.

Congress is often considering financial industry legislation, and the federal banking agencies routinely propose new regulations. The Company cannot predict how any new legislation, or new rules adopted by federal or state banking agencies, may affect the business of the Company and its subsidiaries in the future.

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Environmental Laws

Environmentally related hazards have become a source of high risk and potential liability for financial institutions relating to their loans. Environmentally contaminated properties owned by an institution’s borrowers may result in a drastic reduction in the value of the collateral securing the institution’s loans to such borrowers, high environmental clean up costs to the borrower affecting its ability to repay the loans, the subordination of any lien in favor of the institution to a state or federal lien securing clean up costs, and liability to the institution for clean up costs if it forecloses on the contaminated property or becomes involved in the management of the borrower. The Company is not aware of any borrower who is currently subject to any environmental investigation or clean up proceeding which is likely to have a material adverse effect on the financial condition or results of operations of the Company.

Effect of Government Monetary Policies

The earnings of the Company are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States Government and its agencies. The monetary policies of the FRB have had, and will likely continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The FRB has a major effect upon the levels of bank loans, investments, and deposits through its open market operations in the United States Government securities and through its regulation of, among other things, the discount rate on borrowings by member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

DESCRIPTION OF THE BANKS

History and Business

JSSB was incorporated under the laws of the Commonwealth of Pennsylvania as a state bank in 1934 and became a wholly owned subsidiary of the Company on July 12, 1983. As of December 31, 2017, JSSB had total assets of $1,092,014,000; total shareholders’ equity of $86,112,000; and total deposits of $809,955,000. JSSB's deposits are insured by the FDIC for the maximum amount provided under current law.

Luzerne was acquired by the Company on June 1, 2013. As of December 31, 2017, Luzerne had total assets of $398,786,000; total shareholders’ equity of $45,525,000; and total deposits of $338,121,000. Luzerne's deposits are insured by the FDIC for the maximum amount provided under current law.

The Banks engage in business as commercial banks, doing business at locations in Lycoming, Clinton, Centre, Montour, Union and Luzerne Counties, Pennsylvania. The Banks offer insurance, securities brokerage services, annuity and mutual fund investment products, and financial planning through the M Group.

Services offered by the Banks include accepting time, demand and savings deposits including Super NOW accounts, statement savings accounts, money market accounts, and fixed rate certificates of deposit. Their services also include making secured and unsecured business and consumer loans that include financing commercial transactions as well as construction and residential mortgage loans and revolving credit loans with overdraft protection.

The Banks' loan portfolio mix can be classified into three principal categories: commercial and agricultural, real estate, and consumer. Real estate loans can be further segmented into residential, commercial, and construction. Qualified borrowers are defined by our loan policy and our underwriting standards. Owner provided equity requirements range from 0% to 35%, depending on the collateral offered for the loan. Terms are generally restricted to 30 years or less with the exception of construction and land development, which are generally limited to one and

five years, respectively. Real estate appraisals, property construction verifications, and site visitations comply with our loan policy and with industry regulatory standards.

Prospective residential mortgage customer's repayment ability is determined from information contained in the application and recent income tax returns, or other verified income sources. Emphasis is on credit, employment, income, and residency verification. Broad hazard insurance is always required and flood insurance where applicable. In the case of construction mortgages, builders risk insurance is requested.

Agricultural loans for the purchase or improvement of real estate must meet the Banks' real estate underwriting criteria. Agricultural loans made for the purchase of equipment are usually payable in five years, but never more than ten, depending upon the useful life of the purchased asset. Minimum borrower equity ranges from 0% to 35% depending on the purpose. Livestock financing criteria depends upon the nature of the operation. Agricultural loans are also made for crop production purposes. Such loans are structured to repay within the production cycle and not carried over into a subsequent year.

Commercial loans are made for the acquisition and improvement of real estate, purchase of equipment, and for working capital purposes on a seasonal or revolving basis. General purpose working capital loans are also available with repayment expected within one year. Equipment loans are generally amortized over three to ten years. Insurance coverage with the Banks as loss payee is required, especially in the case where the equipment is rolling stock. It is also a general policy to collateralize non-real estate loans with the asset purchased and, depending upon loan terms, junior liens are filed on other available assets. Financial information required on all commercial mortgages includes the most current three years balance sheets and income statements and projections on income to be developed through the project. In the case of corporations and partnerships, the principals are often asked to personally guaranty the entity's debt.

Seasonal and revolving lines of credit are offered for working capital purposes. Collateral for such a loan may vary but often includes the pledge of inventory and/or receivables. Drawing availability is usually 50% of inventory and 80% of eligible receivables. Eligible receivables are defined as invoices less than 90 days delinquent. Exclusive reliance is very seldom placed on such collateral; therefore, other lienable assets are also taken into the collateral pool. Where reliance is placed on inventory and accounts receivable, the applicant must provide financial information including agings on a specified basis. In addition, the guaranty of the principals is usually obtained.

Letter of credit availability is usually limited to standby or performance letters of credit where the customer is well known to the Banks. The credit criteria is the same as that utilized in making a direct loan. Collateral is obtained in most cases.

Consumer loan products include residential mortgages, home equity loans and lines, automobile financing, personal loans and lines of credit, overdraft and check lines. Our policy includes standards used in the industry on debt service ratios and terms are consistent with prudent underwriting standards and the use of proceeds. Verifications are made of employment and residency, along with credit history.

Second mortgages are confined to equity borrowing and home improvements. Terms are generally fifteen years or less. Loan to collateral value criteria is 90% or less and verifications are made to determine values. Automobile financing is generally restricted to five years and done on both an indirect and direct basis. The Banks, as a practice, do not floor plan and therefore do not discount dealer paper. Small loan requests are to accommodate personal needs such as debt consolidation or the purchase of small appliances. Overdraft check lines are usually limited to $5,000 or less.

The Banks' investment portfolios are analyzed and priced on a monthly basis. Investments are made in U.S. Treasuries, U.S. Agency issues, bank qualified tax-exempt municipal bonds, taxable municipal bonds, corporate bonds, and corporate stocks which consist of Pennsylvania bank stocks. Bonds with BBB or better ratings are used, unless a local issue is purchased that has a lesser or no rating. Factors taken into consideration when investments are purchased include liquidity, the Company's tax position, tax equivalent yield, third party investment ratings, and the policies of the Asset/Liability Committee.

The banking environment in Lycoming, Clinton, Centre, Montour, Union and Luzerne Counties, Pennsylvania is highly competitive. The Banks operate twenty-five full service offices in these markets and compete for loans and deposits with numerous commercial banks, savings and loan associations, and other financial institutions. The economic base of the region is developed around small business, health care, educational facilities (college and public schools), light manufacturing industries, and agriculture.

The Banks have a relatively stable deposit base and no material amount of deposits is obtained from a single depositor or group of depositors, excluding public entities that account for approximately 11% of total deposits. Although the

Banks have regular opportunities to bid on pools of funds of $100,000 or more in the hands of municipalities, hospitals, and others, it does not rely on these monies to fund loans or intermediate or longer-term investments.

The Banks have not experienced any significant seasonal fluctuations in the amount of deposits. The Banks have experienced an outflow of deposits related to municipalities and school districts due to the ongoing Commonwealth of Pennsylvania budget impasse.

Supervision and Regulation

As referenced elsewhere, the banking business is highly regulated, and the Banks are only able to engage in business activities, and to provide products and services, that are permitted by applicable law and regulation. In addition, the earnings of the Banks are affected by the policies of regulatory authorities including the FDIC and the FRB. An important function of the FRB is to regulate the money supply and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government Securities, changes in reserve requirements against member bank deposits, and limitations on interest rates

that member banks may pay on time and savings deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, and their use may also affect interest rates charged on loans or paid for deposits.

The policies and regulations of the FRB have had and will probably continue to have a significant effect on the Banks' deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Banks' operation in the future. The effect of such policies and regulations upon the future business and earnings of the Banks cannot accurately be predicted.

ITEM 1A RISK FACTORS

The following sets forth several risk factors that may affect the Company's financial condition or results of operations.

Changes in interest rates could reduce our income, cash flows and asset values.

Our income and cash flows and the value of our assets depend to a great extent on the difference between the interest rates we earn on interest-earning assets, such as loans and investment securities, and the interest rates we pay on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, will influence not only the interest we receive on our loans and investment securities and the amount of interest we pay on deposits and borrowings but will also affect our ability to originate loans and obtain deposits and the value of our investment portfolio. If the rate of interest we pay on our deposits and other borrowings increases more than the rate of interest we earn on our loans and other investments, our net interest income, and therefore our earnings, could be adversely affected. Our earnings also could be adversely affected if the rates on our loans and other investments fall more quickly than those on our deposits and other borrowings.

Economic conditions either nationally or locally in areas in which our operations are concentrated may adversely affect our business.

Deterioration in local, regional, national, or global economic conditions could cause us to experience a reduction in deposits and new loans, an increase in the number of borrowers who default on their loans, and a reduction in the value of the collateral securing their loans, all of which could adversely affect our performance and financial condition. Unlike larger banks that are more geographically diversified, we provide banking and financial services locally. Therefore, we are particularly vulnerable to adverse local economic conditions.

Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance.

Despite our underwriting criteria, we may experience loan delinquencies and losses. In order to absorb losses associated with nonperforming loans, we maintain an allowance for loan losses based on, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Determination of the allowance inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. At any time there are likely to be loans in our portfolio that will result in losses but that have not been identified as nonperforming or potential problem credits. We cannot be sure that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit losses on those loans that are identified. We may be required to increase our allowance for loan losses for any of several reasons. Federal regulators, in reviewing our loan portfolio as part of a regulatory examination, may request that we increase our allowance for loan losses. Changes in

economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in our allowance. In addition, if charge-offs in future periods exceed our allowance for loan losses, we will need additional increases in our allowance for loan losses. Any increases in our allowance for loan losses will result in a decrease in our net income and, possibly, our capital, and may materially affect our results of operations in the period in which the allowance is increased.

Many of our loans are secured, in whole or in part, with real estate collateral which is subject to declines in value.

In addition to considering the financial strength and cash flow characteristics of a borrower, we often secure our loans with real estate collateral. Real estate values and the real estate market are generally affected by, among other things, changes in local, regional or national economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature. The real estate collateral provides an alternate source of repayment in the event of default by the borrower. If real estate prices in our markets decline, the value of the

real estate collateral securing our loans could be reduced. If we are required to liquidate real estate collateral securing loans during a period of reduced real estate values to satisfy the debt, our earnings and capital could be adversely affected.

Our information systems may experience an interruption or breach in security.
We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer-relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur; or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability; any of which could have a material adverse effect on our financial condition and results of operations.

We face the risk of cyber-attack to our computer systems.

Our computer systems, software and networks have been and will continue to be vulnerable to unauthorized access, loss or destruction of data (including confidential client information), account takeovers, unavailability of service, computer viruses or other malicious code, cyber-attacks and other events. These threats may derive from human error, fraud or malice on the part of employees or third parties, or may result from accidental technological failure. If one or more of these events occurs, it could result in the disclosure of confidential client information, damage to our reputation with our clients and the market, additional costs to us (such as repairing systems or adding new personnel or protection technologies), regulatory penalties and financial losses, to both us and our clients and customers. Such events could also cause interruptions or malfunctions in our operations (such as the lack of availability of our online banking system), as well as the operations of our clients, customers or other third parties. Although we maintain safeguards to protect against these risks, there can be no assurance that we will not suffer losses in the future that may be material in amount.

Competition may decrease our growth or profits.

We face substantial competition in all phases of our operations from a variety of different competitors, including commercial banks, savings and loan associations, mutual savings banks, credit unions, consumer finance companies, factoring companies, leasing companies, insurance companies, and money market mutual funds. There is very strong competition among financial services providers in our principal service area. Our competitors may have greater resources, higher lending limits, or larger branch systems than we do. Accordingly, they may be able to offer a broader range of products and services as well as better pricing for those products and services than we can.

In addition, some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on federally insured financial institutions. As a result, those non-bank competitors may be able to access funding and provide various services more easily or at less cost than we can, adversely affecting our ability to compete effectively.

The value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect our future earnings and regulatory capital.

Continued volatility in the market value for certain of our investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on our accumulated other comprehensive income/loss and shareholders’ equity depending on the direction of the fluctuations.

Furthermore, future downgrades or defaults in these securities could result in future classifications of investment securities as other than temporarily impaired. This could have a material impact on our future earnings.

We may be adversely affected by government regulation.

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance funds and depositors, not shareholders. Changes in the laws, regulations, and regulatory practices affecting the banking industry may increase our costs of doing business or otherwise adversely affect us and create competitive advantages for others. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition.

In response to the financial crisis that commenced in 2008, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the FDIC has taken actions to increase insurance coverage on deposit accounts. The Dodd-Frank Act provides for the creation of a consumer protection division at the Board of Governors of the Federal Reserve System that will have broad authority to issue regulations governing the services and products we provide consumers. This additional regulation could increase our compliance costs and otherwise adversely impact our operations. That legislation also contains provisions that, over time, could result in higher regulatory capital requirements (including through the implementation of the capital standards of Basel III) and loan loss provisions for the Banks, and may increase interest expense due to the ability granted in July 2011 to pay interest on all demand deposits. In addition, there have been proposals made by members of Congress and others that would reduce the amount delinquent borrowers are otherwise contractually obligated to pay under their mortgage loans and limit an institution’s ability to foreclose on mortgage collateral. These proposals could result in credit losses or increased expense in pursuing our remedies as a creditor.

The potential exists for additional federal or state laws and regulations, or changes in policy, affecting many aspects of our operations, including capital levels, lending and funding practices, and liquidity standards. New laws and regulations may increase our costs of regulatory compliance and of doing business and otherwise affect our operations, and may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge and our ongoing operations, costs and profitability.

We rely on our management and other key personnel, and the loss of any of them may adversely affect our operations.

We are and will continue to be dependent upon the services of our executive management team. In addition, we will continue to depend on our ability to retain and recruit key commercial loan officers. The unexpected loss of services of any key management personnel or commercial loan officers could have an adverse effect on our business and financial condition because of their skills, knowledge of our market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

Environmental liability associated with lending activities could result in losses.

In the course of our business, we may foreclose on and take title to properties securing our loans. If hazardous substances were discovered on any of these properties, we could be liable to governmental entities or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination. In addition, if we arrange for the disposal of hazardous or toxic substances at another site, we may be liable for the costs of cleaning up and removing those substances from the site even if we neither own nor operate the disposal site. Environmental laws may require us to incur substantial expenses and may materially limit use of properties we acquire through foreclosure, reduce their value or limit our ability to sell them in the event of a default on the loans they secure. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability.

Failure to implement new technologies in our operations may adversely affect our growth or profits.

The market for financial services, including banking services and consumer finance services, is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, Internet-based banking, and telebanking. Our ability to compete successfully in our markets may depend on the extent to which we are able to exploit such technological changes. However, we can provide no assurance that we will be able to properly or timely anticipate or implement such technologies or properly train our staff to use such technologies. Any failure to adapt to new technologies could adversely affect our business, financial condition, or operating results.

The Company is required to adopt the FASB's accounting standard which requires measurement of certain financial assets (including loans) using the current expected credit losses (CECL) beginning in calendar year 2020.
Current GAAP requires an incurred loss methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. The FASB's amendment replaces the current incurred loss methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonableness and supportable information to inform credit loss estimates. The Company is in the process of evaluating the impact of the adoption of this guidance on the Company's financial statements; however, it is anticipated that the allowance will increase upon the adoption of CECL and that the increased allowance level will have the effect of decreasing shareholders' equity and the Company's and Bank's regulatory capital ratios.

The effects of the Tax Cuts and Jobs Act of 2017 on our business have not yet been fully analyzed and could have an adverse effect on our net income.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was enacted into law. The Tax Cuts and Jobs Act makes significant changes to U.S. corporate income tax laws including a decrease in the corporate income tax rate from 35% to 21% effective January 1, 2018. As a result of the Tax Cuts and Jobs Act, the Company recorded an additional provisional income tax expense of $2,724,000 in the fourth quarter of 2017 due to a remeasurement of the Company’s deferred tax assets and liabilities. Reasonable estimates were made based on the Company’s analysis of the Tax Cuts and Jobs Act. This provisional amount may be adjusted in future periods during 2018 when additional information is obtained. Additional information that may affect the Company’s provisional amount would include further clarification and guidance on how the IRS will implement tax reform, further clarification and guidance on how state taxing authorities will implement tax reform and the related effect on the Company’s state income tax returns, completion of the Company’s 2017 tax return filings, and the potential for additional guidance from the SEC or the FASB related to the Tax Cuts and Jobs Act. The Company cannot determine at this time the full effects of the Tax Act on its business and financial results.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in our common stock is subject to the same market forces that affect the price of common stock in any company.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

The Company owns or leases its properties. Listed herewith are the locations of properties owned or leased as of December 31, 2017, in which the banking offices are located; all properties are in good condition and adequate for the Company's purposes:

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Jersey Shore State Bank & Subsidiaries

Office	Address	Ownership
Main Street	115 South Main Street, PO Box 5098 Jersey Shore, Pennsylvania 17740	Owned
Bridge Street	112 Bridge Street Jersey Shore, Pennsylvania 17740	Owned
DuBoistown	2675 Euclid Avenue Williamsport, Pennsylvania 17702	Owned
Williamsport	300 Market Street P.O. Box 967 Williamsport, Pennsylvania 17703-0967	Owned
Montgomery	9094 Rt. 405 Highway Montgomery, Pennsylvania 17752	Owned
Lock Haven	4 West Main Street Lock Haven, Pennsylvania 17745	Owned
Mill Hall	(Inside Wal-Mart), 173 Hogan Boulevard Mill Hall, Pennsylvania 17751	Under Lease
Spring Mills	3635 Penns Valley Road, P.O. Box 66 Spring Mills, Pennsylvania 16875	Under Lease
Centre Hall	2842 Earlystown Road Centre Hall, Pennsylvania 16828	Land Under Lease
Zion	100 Cobblestone Road Bellefonte, Pennsylvania 16823	Under Lease
State College	2050 North Atherton Street State College, Pennsylvania 16803	Land Under Lease
Montoursville	820 Broad Street Montoursville, Pennsylvania 17754	Under Lease
Danville	150 Continental Boulevard Danville, Pennsylvania 17821	Under Lease
Loyalsock	1720 East Third Street Williamsport, PA 17701	Owned
Lewisburg	550 North Derr Drive Lewisburg, PA 17837	Land Under Lease
Muncy-Hughesville	3081 Route 405 Highway	Owned

	Muncy, PA 17756	
Mansfield Mortgage Office	102 West Wellsboro Street, Suite 2 Mansfield, PA 16933	Under Lease
The M Group, Inc. D/B/A The Comprehensive Financial Group	1720 East Third Street Williamsport, PA 17701	Owned

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Luzerne Bank

Office	Address	Ownership
Dallas	509 Main Road Memorial Highway Dallas, PA 18612	Owned
Lake	Corners of Rt. 118 & 415 Dallas, PA 18612	Owned
Hazle Twp.	10 Dessen Drive Hazle Twp., PA 18202	Owned
Luzerne	118 Main Street Luzerne, PA 18709	Owned
Plains	1077 Hwy. 315 Wilkes Barre, PA 18702	Under Lease
Swoyersville	801 Main Street Swoyersville, PA 18704	Owned
Wilkes-Barre	67 Public Square Wilkes-Barre, PA 18701	Under Lease
Wyoming	324 Wyoming Ave. Wyoming, PA 18644	Owned
Conyngham Valley	669 State Route 93 STE 5 Sugarloaf, PA 18249	Under Lease

ITEM 3 LEGAL PROCEEDINGS

The Company is subject to lawsuits and claims arising out of its business in the ordinary course. In the opinion of management, after review and consultation with counsel, there are no legal proceedings currently pending or threatened that are reasonably likely to have a material adverse effect on the consolidated financial position or results of operations of the Company.

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5 MARKET FOR THE REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is listed on the NASDAQ Global Select Market under the symbol "PWOD". The following table sets forth (1) the quarterly high and low closing sale prices for a share of the Company's common stock during the periods indicated, and (2) quarterly dividends on a share of the common stock with respect to each quarter

since January 1, 2015.

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	Price Range High	Low	Dividends Declared
2017			
First quarter	$49.45	$43.28	$ 0.47
Second quarter	43.60	38.17	0.47
Third quarter	46.47	41.08	0.47
Fourth quarter	49.79	45.65	0.47
2016			
First quarter	$41.32	$36.73	$ 0.47
Second quarter	44.70	37.82	0.47
Third quarter	44.75	40.34	0.47
Fourth quarter	52.03	41.00	0.47
2015			
First quarter	$48.91	$44.41	$ 0.47
Second quarter	48.28	41.84	0.47
Third quarter	44.56	40.41	0.47
Fourth quarter	45.28	40.47	0.47

The Company has paid dividends since the effective date of its formation as a bank holding company. It is the present intention of the Company's board of directors to continue the dividend payment policy; however, further dividends must necessarily depend upon earnings, financial condition, appropriate legal restrictions, and other factors relevant at the time the board of directors of the Company considers dividend policy. Cash available for dividend distributions to shareholders of the Company primarily comes from dividends paid by Jersey Shore State Bank and Luzerne Bank to the Company. Therefore, the restrictions on the Banks' dividend payments are directly applicable to the Company. See also the information appearing in Note 20 to "Notes to Consolidated Financial Statements" for additional information related to dividend restrictions.

Under the Pennsylvania Business Corporation Law of 1988 a corporation may not pay a dividend, if after giving effect thereto, the corporation would be unable to pay its debts as they become due in the usual course of business and after giving effect thereto the total assets of the corporation would be less than the sum of its total liabilities plus the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of the shareholders whose preferential rights are superior to those receiving the dividend.

As of March 1, 2017, the Company had approximately 1,285 shareholders of record.

Following is a schedule of the shares of the Company's common stock purchased by the Company during the fourth quarter of 2017.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Units) Purchased	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (October 1 - October 31, 2017)	—	$	——	342,446
Month #2 (November 1 - November 30, 2017)	—	—	—	342,446
Month #3 (December 1 - December 31, 2017)	—	—	—	342,446

Set forth below is a line graph comparing the yearly dollar changes in the cumulative shareholder return on the Company's common stock against the cumulative total return of the S&P 500 Stock Index, NASDAQ Composite,

Russell 2000, and SNL U.S. Bank NASDAQ Index for the period of five fiscal years assuming the investment of $100.00 on December 31, 2012 and assuming the reinvestment of dividends. The shareholder return shown on the graph below is not necessarily indicative of future performance.

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Index	Period Ending 12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
Penns Woods Bancorp, Inc.	100.00	143.07	143.94	129.53	160.84	153.22
S&P 500	100.00	132.39	150.51	152.59	170.84	208.14
NASDAQ Composite	100.00	140.12	160.78	171.97	187.22	242.71
SNL U.S. Bank NASDAQ	100.00	143.73	148.86	160.70	222.81	234.58
Russell 2000	100.00	138.82	145.62	139.19	168.85	193.58

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ITEM 6 SELECTED FINANCIAL DATA

The following table sets forth certain financial data for each of the years in the five-year period ended December 31, 2017:

(In Thousands, Except Per Share Data Amounts)	2017	2016	2015	2014	2013
Consolidated Statement of Income Data:					
Interest income	$49,977	$46,813	$46,124	$45,606	$43,299
Interest expense	5,897	5,567	5,219	4,962	5,264
Net interest income	44,080	41,246	40,905	40,644	38,035
Provision for loan losses	730	1,196	2,300	2,850	2,275
Net interest income after provision for loan losses	43,350	40,050	38,605	37,794	35,760
Non-interest income	10,744	12,113	12,765	14,508	12,042
Non-interest expense	36,862	35,091	33,736	33,890	30,267
Income before income tax provision	17,232	17,072	17,634	18,412	17,535
Income tax provision	7,459	4,597	3,736	3,804	3,451
Net income	$9,773	$12,475	$13,898	$14,608	$14,084
Consolidated Balance Sheet at End of Period:					
Total assets	$1,474,492	$1,348,590	$1,320,057	$1,245,011	$1,211,995
Loans	1,246,614	1,093,681	1,045,207	915,579	818,344
Allowance for loan losses	(12,858)	(12,896)	(12,044)	(10,579)	(10,144)
Deposits	1,146,320	1,095,214	1,031,880	981,419	973,002
Long-term debt	70,970	85,998	91,025	71,176	71,202
Shareholders' equity	138,192	138,249	136,279	135,967	127,815
Per Share Data:					
Earnings per share - basic	$2.08	$2.64	$2.91	$3.03	$3.19
Earnings per share - diluted	2.08	2.64	2.91	3.03	3.19
Cash dividends declared	1.88	1.88	1.88	1.88	2.13
Book value	29.47	29.20	28.71	28.30	26.52
Number of shares outstanding, at end of period	4,689,189	4,734,657	4,747,132	4,804,815	4,819,333
Weighted average number of shares outstanding - basic and diluted	4,705,602	4,735,457	4,772,239	4,816,149	4,410,626
Selected Financial Ratios:					
Return on average shareholders' equity	6.91%	8.96%	10.11%	10.79%	12.36%
Return on average total assets	0.69%	0.93%	1.08%	1.19%	1.32%
Net interest margin	3.47%	3.44%	3.61%	3.81%	4.13%
Dividend payout ratio	82.05%	71.37%	64.52%	61.99%	67.88%
Average shareholders' equity to average total assets	10.05%	10.36%	10.68%	11.05%	10.70%
Loans to deposits, at end of period	108.75%	99.86%	101.29%	93.29%	84.11%

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ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

NET INTEREST INCOME

Net interest income is determined by calculating the difference between the yields earned on interest-earning assets and the rates paid on interest-bearing liabilities. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to taxable equivalents based on the marginal corporate federal tax rate of 34%. The tax equivalent adjustments to net interest income for 2017, 2016, and 2015 were $1,281,000, $1,402,000, and $2,011,000, respectively.

2017 vs. 2016

Reported net interest income increased $2,834,000 to $44,080,000 for the year ended December 31, 2017 compared to the year ended December 31, 2016, as growth in the earning asset portfolio was coupled with the yield on earning assets increasing to 3.92% from 3.88%. Total interest income increased $3,164,000 as the impact of growth in the average balance of the loan portfolio was limited by a decline in the average balance of the investment portfolio as the investment portfolio is actively managed to reduce interest rate and market risk. Interest income on a tax equivalent basis recognized on the loan portfolio increased $3,801,000 due to a $92,281,000 increase in the average balance in the loan portfolio. Interest and dividend income generated from the investment portfolio on a tax equivalent basis decreased $808,000 due to a $14,277,000 decrease in the average balance in the investment portfolio and a 22 basis point ("bp") reduction in the average rate.

Interest expense increased $330,000 to $5,897,000 for the year ended December 31, 2017 compared to 2016. The increase in interest expense was driven by growth in total deposits, the primary source of funding for the earning asset portfolio growth. The impact of the growth in interest-bearing liabilities was limited by a minimal increase of 1 bp in cost of funds. The average rate paid on time deposits increased 13 bp as the time deposit portfolio was lengthened in preparation for a rising rate environment.

2016 vs. 2015

Reported net interest income increased $341,000 to $41,246,000 for the year ended December 31, 2016 compared to the year ended December 31, 2015, as the growth in the earning asset portfolio offset the impact of the yield on earning assets decreasing to 3.88% from 4.04%. Total interest income increased $689,000 as the impact of growth in the average balance of the loan portfolio was limited by a decline in the average balance of the investment portfolio as the portfolio is actively managed to reduce interest rate and market risk. Interest income on a tax equivalent basis recognized on the loan portfolio increased $2,981,000 due to a $81,592,000 increase in the average balance in the loan portfolio. Interest and dividend income generated from the investment portfolio on a tax equivalent basis decreased $3,076,000 due to a $61,820,000 decrease in the average balance in the investment portfolio and a 40 basis point ("bp") reduction in the average rate. The decrease in the portfolio was driven by a strategic plan that started in 2014 to sell off long-term municipal bonds with a maturity date greater than 10 years and securities with a call date within the next five years, in order to reduce interest rate risk and market risk.

Interest expense increased $348,000 to $5,567,000 for the year ended December 31, 2016 compared to 2015. Growth in total interest earning assets was funded primarily through the organic growth in total deposits, of which, the rate paid on time deposits was the primary driver of the increase in interest expense. The impact of the growth in interest-bearing liabilities was limited by a minimal increase of 2 bp in cost of funds. The average rate paid on time

deposits increased 16 bp as the time deposit portfolio was lengthened in preparation for a rising rate environment.

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AVERAGE BALANCES AND INTEREST RATES

The following tables set forth certain information relating to the Company's average balance sheet and reflect the average yield on assets and average cost of liabilities for the periods indicated and the average yields earned and rates paid. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented.

(Dollars In Thousands)	2017 Average Balance	Interest	Average Rate		2016 Average Balance	Interest	Average Rate		2015 Average Balance	Interest	Average Rate	
Assets:												
Tax-exempt loans	$49,982	$1,924	3.85	%	$47,782	$1,852	3.87	%	$43,395	$1,679	3.87	%
All other loans	1,099,465	44,563	4.05	%	1,009,384	40,834	4.05	%	932,179	38,026	4.08	%
Total loans	1,149,447	46,487	4.04	%	1,057,166	42,686	4.04	%	975,574	39,705	4.07	%
Taxable securities	84,079	2,689	3.20	%	94,887	3,072	3.24	%	127,052	4,183	3.29	%
Tax-exempt securities	50,169	1,845	3.68	%	53,638	2,270	4.23	%	83,293	4,235	5.08	%
Total securities	134,248	4,534	3.38	%	148,525	5,342	3.60	%	210,345	8,418	4.00	%
Interest-bearing deposits	22,461	237	1.06	%	36,592	187	0.51	%	4,238	12	0.28	%
Total interest-earning assets	1,306,156	51,258	3.92	%	1,242,283	48,215	3.88	%	1,190,157	48,135	4.04	%
Other assets	100,481				99,500				97,103			
Total assets	$1,406,637				$1,341,783				$1,287,260			
Liabilities and shareholders' equity:												
Savings	$157,851	62	0.04	%	$151,397	58	0.04	%	$143,055	56	0.04	%
Super Now deposits	200,436	528	0.26	%	187,106	458	0.24	%	187,396	491	0.26	%
Money market deposits	274,546	949	0.35	%	238,175	648	0.27	%	207,252	554	0.27	%
Time deposits	210,608	2,544	1.21	%	221,498	2,383	1.08	%	220,360	2,028	0.92	%
Total interest-bearing deposits	843,441	4,083	0.48	%	798,176	3,547	0.44	%	758,063	3,129	0.41	%
Short-term borrowings	25,984	234	0.89	%	18,518	46	0.25	%	38,909	116	0.30	%
Long-term borrowings	78,745	1,580	1.98	%	90,554	1,974	2.14	%	84,721	1,974	2.30	%
Total borrowings	104,729	1,814	1.71	%	109,072	2,020	1.82	%	123,630	2,090	1.67	%
	948,170	5,897	0.62	%	907,248	5,567	0.61	%	881,693	5,219	0.59	%

Total interest-bearing liabilities											
Demand deposits	302,651				279,130				251,029		
Other liabilities	14,398				16,152				17,047		
Shareholders' equity	141,418				139,253				137,491		
Total liabilities and shareholders' equity	$1,406,637				$1,341,783				$1,287,260		
Interest rate spread			3.30	%			3.27	%			3.45	%
Net interest income/margin		$45,361	3.47	%		$42,648	3.44	%		$42,916	3.61	%

· Fees on loans are included with interest on loans as follows: 2017 - $1,159,000; 2016 - $873,000; 2015 - $422,000.

· Information in this table has been calculated using average daily balance sheets to obtain average balances.

· Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.

· Income and rates on a fully taxable equivalent basis include an adjustment for the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate.

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Reconciliation of Taxable Equivalent Net Interest Income

(In Thousands)	2017	2016	2015
Total interest income	$49,977	$46,813	$46,124
Total interest expense	5,897	5,567	5,219
Net interest income	44,080	41,246	40,905
Tax equivalent adjustment	1,281	1,402	2,011
Net interest income (fully taxable equivalent)	$45,361	$42,648	$42,916

Rate/Volume Analysis

The table below sets forth certain information regarding changes in our interest income and interest expense for the periods indicated. For interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by old rate) and (ii) changes in rates (changes in rate multiplied by old average volume). Increases and decreases due to both interest rate and volume, which cannot be separated, have been allocated proportionally to the change due to volume and the change due to interest rate. Income and interest rates are on a taxable equivalent basis.

	Year Ended December 31,					
	2017 vs. 2016			2016 vs. 2015		
	Increase (Decrease) Due To			Increase (Decrease) Due To		
(In Thousands)	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Loans, tax-exempt	$73	$(1)	$72	$173	$—	$173
Loans	3,729	—	3,729	3,093	(285)	2,808
Taxable investment securities	(345)	(38)	(383)	(1,048)	(63)	(1,111)
Tax-exempt investment securities	(142)	(283)	(425)	(1,338)	(627)	(1,965)
Interest-bearing deposits	(36)	86	50	91	84	175
Total interest-earning assets	3,279	(236)	3,043	971	(891)	80
Interest expense:						
Savings deposits	4	—	4	4	(2)	2
Super Now deposits	29	41	70	(1)	(32)	(33)
Money market deposits	107	194	301	90	4	94
Time deposits	(35)	196	161	11	344	355
Short-term borrowings	25	163	188	(52)	(18)	(70)
Long-term borrowings	(250)	(144)	(394)	133	(133)	—
Total interest-bearing liabilities	(120)	450	330	185	163	348
Change in net interest income	$3,399	$(686)	$2,713	$786	$(1,054)	$(268)

PROVISION FOR LOAN LOSSES

2017 vs. 2016

The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Company. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, and historical loan loss experience. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

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Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at December 31, 2017, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy or employment and delays in receiving financial information from borrowers could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in interest income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review the Banks' loan loss allowance. The banking regulators could require additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

While determining the appropriate allowance level, management has attributed the allowance for loan losses to various portfolio segments; however, the allowance is available for the entire portfolio as needed.

The allowance for loan losses declined slightly from $12,896,000 at December 31, 2016 to $12,858,000 at December 31, 2017. At December 31, 2017, the allowance for loan losses was 1.03% of total loans compared to 1.18% of total loans at December 31, 2016.

The provision for loan losses totaled $730,000 for the year ended December 31, 2017 compared to $1,196,000 for the year ended December 31, 2016. The decrease in the provision was appropriate when considering the gross loan growth and low level of net charge-offs during 2017. Net charge-offs of $768,000 represented 0.07% of average loans for the year ended December 31, 2017 compared to net charge-offs of $344,000 or 0.03% of average loans for the year ended December 31, 2016. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. In addition, growth occurred in the indirect auto loan portfolio that has experienced minimal charge-offs. Nonperforming loans decreased $4,358,000 as a large nonperforming loan was paid-off during the third quarter of 2017. The majority of the nonperforming loans are centered on several loans that are either in a secured position and have sureties with a strong underlying financial position and/or a specific allowance within the allowance for loan losses. Internal loan review and analysis, coupled with the ratios and decreased level of nonperforming loans noted previously, dictated a decrease in the provision for loan losses. Utilizing both internal and external resources, as noted, senior management has concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in the loan portfolio.

2016 vs. 2015

The allowance for loan losses increased from $12,044,000 at December 31, 2015 to $12,896,000 at December 31, 2016. At December 31, 2016, the allowance for loan losses was 1.18% of total loans compared to 1.15% of total loans at December 31, 2015.

The provision for loan losses totaled $1,196,000 for the year ended December 31, 2016 compared to $2,300,000 for the year ended December 31, 2015. The decrease in the provision was appropriate when considering the gross loan growth and low level of net charge-offs during 2016. Net charge-offs of $344,000 represented 0.03% of average loans for the year ended December 31, 2016 compared to net charge-offs of $835,000 or 0.09% of average loans for the year ended December 31, 2015. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. While nonperforming loans increased, the majority of the nonperforming loans are centered on several loans that are either in a secured position and have sureties with a strong underlying financial position and/or a specific allowance within the allowance for loan losses. Internal loan review and analysis, coupled with the ratios noted previously, dictated a decrease in the provision for loan losses. Utilizing both internal and external resources, as noted, senior management has concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in

the loan portfolio.

NON-INTEREST INCOME

2017 vs. 2016

Total non-interest income decreased $1,369,000 from the year ended December 31, 2016 to December 31, 2017. Excluding net security gains, non-interest income decreased $292,000 year over year. Service charges decreased due to decreased level of overdraft income. Bank owned life insurance income decreased due to a decrease in the earnings rate. Insurance commissions decreased while brokerage commissions increased due to a shift in product mix. Gain on sale of loans decreased due to reduced volume. Debit card income increased to $1,960,000 for 2017 an increase of $64,000 or 3.38% from 2016.

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	2017		2016		Change	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	%
Service charges	$2,222	20.68 %	$2,249	18.57 %	$(27)	(1.20)%
Net securities gains, available for sale	600	5.58	1,611	13.30	(1,011)	(62.76)
Net securities (losses) gains, trading	(8)	(0.07)	58	0.48	(66)	113.79
Bank owned life insurance	666	6.20	684	5.65	(18)	(2.63)
Gain on sale of loans	1,674	15.58	2,102	17.35	(428)	(20.36)
Insurance commissions	496	4.62	795	6.56	(299)	(37.61)
Brokerage commissions	1,378	12.83	1,098	9.06	280	25.50
Debit card income	1,960	18.24	1,896	15.65	64	3.38
Other	1,756	16.34	1,620	13.38	136	8.40
Total non-interest income	$10,744	100.00 %	$12,113	100.00%	$(1,369)	(11.30)%

2016 vs. 2015

Total non-interest income decreased $652,000 from the year ended December 31, 2015 to December 31, 2016. Excluding net security gains, non-interest income increased $249,000 year over year. Service charges decreased due to a decreased level of overdraft income. Bank owned life insurance income decreased due to a decrease in the earnings rate. Insurance commissions and brokerage commissions increased in part due to the book of business that was purchased in 2016. Gain on sale of loans increased due to a shift product mix that began in the latter part of 2015 and the addition of mortgage loan originators. Debit card income increased to 1,896,000 for 2016 an increase of $204,000 or 12.06% from 2015.

	2016		2015		Change	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	%
Service charges	$2,249	18.57 %	$2,383	18.67 %	$(134)	(5.62)%
Net securities gains, available for sale	1,611	13.30	2,592	20.31	(981)	(37.85)
Net securities gains (losses), trading	58	0.48	(22)	(0.17)	80	363.64
Bank owned life insurance	684	5.65	720	5.64	(36)	(5.00)
Gain on sale of loans	2,102	17.35	1,743	13.65	359	20.60
Insurance commissions	795	6.56	781	6.12	14	1.79
Brokerage commissions	1,098	9.06	1,064	8.34	34	3.20
Debit card income	1,896	15.65	1,692	13.25	204	12.06
Other	1,620	13.38	1,812	14.19	(192)	(10.60)
Total non-interest income	$12,113	100.00%	$12,765	100.00 %	$(652)	(5.11)%

NON-INTEREST EXPENSE

2017 vs. 2016

Total non-interest expenses increased $1,771,000 from the year ended December 31, 2016 to December 31, 2017. The increase in salaries and employee benefits was attributable to increased health insurance expense and annual wage increases. Occupancy expense increased primarily due to the opening of a new location that houses executive offices and select operations units. Furniture and equipment expenses increased due to the continued enhancement of systems. The increase in marketing expense was primarily related to the home equity and time deposit campaigns. Professional fees increased to $2,353,000 for 2017, an increase of $257,000 or 12.26% from 2016.

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(In Thousands)	2017 Amount	2017 % Total	2016 Amount	2016 % Total	Change Amount	Change %
Salaries and employee benefits	$18,999	51.54 %	$17,813	50.76 %	$1,186	6.66 %
Occupancy	2,447	6.64	2,223	6.33	224	10.08
Furniture and equipment	2,915	7.91	2,793	7.96	122	4.37
Software Amortization	974	2.64	1,256	3.58	(282)	(22.45)
Pennsylvania shares tax	925	2.51	873	2.49	52	5.96
Professional fees	2,353	6.38	2,096	5.97	257	12.26
Federal Deposit Insurance Corporation deposit insurance	669	1.81	767	2.19	(98)	(12.78)
Debit card expenses	602	1.63	604	1.72	(2)	(0.33)
Marketing	958	2.60	740	2.11	218	29.46
Intangible amortization	337	0.91	366	1.04	(29)	(7.92)
Other	5,683	15.43	5,560	15.85	123	2.21
Total non-interest expense	$36,862	100.00 %	$35,091	100.00 %	$1,771	5.05 %

2016 vs. 2015

Total non-interest expenses increased $1,355,000 from the year ended December 31, 2015 to December 31, 2016. The increase in salaries and employee benefits was attributable to increased health insurance expense and annual wage increases. Furniture and equipment expenses increased due to the continued enhancement of systems. Amortization of investment in limited partnerships decreased as two investments were fully amortized during 2016. The increase in marketing expense was primarily related to the home equity and time deposit campaigns conducted during 2016. Other expenses were impacted by a mass replacement of debit cards to implement EMV card technology to better protect the security of our customers. In addition, expenses increased due to a data breach at a national restaurant chain that impacted our customer base. Professional fees increased to $2,096,000 for 2016, an increase of $177,000 or 9.22% from 2015.

(In Thousands)	2016 Amount	2016 % Total	2015 Amount	2015 % Total	Change Amount	Change %
Salaries and employee benefits	$17,813	50.76 %	$17,023	50.46 %	$790	4.64 %
Occupancy	2,223	6.33	2,248	6.66	(25)	(1.11)
Furniture and equipment	2,793	7.96	2,622	7.77	171	6.52
Software Amortization	1,256	3.58	1,140	3.38	116	10.18
Pennsylvania shares tax	873	2.49	954	2.83	(81)	(8.49)
Professional fees	2,096	5.97	1,919	5.69	177	9.22
Federal Deposit Insurance Corporation deposit insurance	767	2.19	867	2.57	(100)	(11.53)
Debit card expenses	604	1.72	576	1.71	28	4.86
Marketing	740	2.11	612	1.81	128	20.92
Intangible amortization	366	1.04	311	0.92	55	17.68
Other	5,560	15.85	5,464	16.20	96	1.76
Total non-interest expense	$35,091	100.00 %	$33,736	100.00 %	$1,355	4.02 %

INCOME TAXES

2017 vs. 2016

The provision for income taxes for the year ended December 31, 2017 increased $2,862,000 and resulted in an effective income tax rate of 43.29% compared to 26.93% for 2016. The increase was driven by a revaluation of the Company's net deferred tax assets that resulted in a recognition of a provisional net income tax expense in the amount

of $2,724,000 for the year ended December 31,m 2017 due to the December 2017 passage of the Tax Cuts and Jobs Act.

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The Tax Cuts and Jobs Act, among other things, reduces the corporate income tax rate to 21%, effective January 1, 2018. The law is complex and has extensive implications for the Company's federal and state current and deferred taxes and income tax expense.

Under ASC 740, Income Taxes, the effect of income tax law changes on deferred taxes should be recognized as a component of income tax expense related to continuing operations in the period in which the law is enacted. This requirement applies not only to items initially recognized in continuing operations, but also to items initially recognized in other comprehensive income. Accordingly, the Company has conducted a revaluation of our net deferred tax assets and recorded the effects to reflect the changes associated with the law's provisions in its 2017 fourth quarter.

As a result of the reduction in the U.S. federal statutory income tax rate, we recognized a provisional net income tax expense totaling $2,724,000, determined as follows:

(In Thousands)	Amount recognized in tax expense
Deferred taxes related to items recognized in continuing operations	$ 1,906
Deferred taxes related to items recognized in other comprehensive income:	
Deferred taxes on net actuarial loss on defined benefit post- retirement benefit plan	809
Deferred taxes on net unrealized loss on securities available for sale	9
Net adjustment to deferred taxes	$ 2,724

The Tax Cuts and Jobs Act also:

- eliminates the corporate alternative minimum tax and allows the use of any net operating loss carryforward to offset regular tax liability for any taxable year;
- limits the deduction for net interest expense incurred by U.S. corporations;
- allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets;
- eliminates or reduces certain deductions related to meals and entertainment expenses; and
- modifies the corporate dividends received deductions.

The Company currently is in a deferred tax asset position. Management has reviewed the deferred tax asset and has determined that the asset will be utilized within the appropriate carryforward period and therefore does not require a valuation allowance.

The foregoing description of the impact of the Tax Cuts and Jobs Act on us should be read in conjunction with Note 12 - "Income Taxes" and Note 2 - "Accumulated Other Comprehensive Income (Loss)" of the "Notes to Consolidated Financial Statements" included in Item 8 of this Annual Report on Form 10-K.

2016 vs. 2015

The provision for income taxes for the year ended December 31, 2017 resulted in an effective income tax rate of 26.93% compared to 21.19% for 2016. This increase is primarily the result of decreased tax-exempt investment income and bank-owned life insurance income which has resulted in a greater percentage of the pre-tax income being taxable.

FINANCIAL CONDITION

INVESTMENTS

2017

The fair value of the investment portfolio decreased $8,885,000 from December 31, 2016 to December 31, 2017. The decrease in value is the result of the investment portfolio being actively managed in order to reduce interest rate and market risk. This is being undertaken primarily through the sale of long-term municipal bonds that have a maturity date greater than ten years and securities with a call date within the next five years. In addition, the decrease in corporate bond holdings is being undertaken to reduce risk and also in response to the changes in bank regulatory capital calculations per Basel III. The proceeds of the bond sales are primarily being deployed into loans. The strategy to sell a portion of the long-term bond portfolio does negatively impact

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current earnings, but this action plays a key role in our long-term asset/liability management strategy as the balance sheet is shortened to better prepare for a rising rate environment. The unrealized losses within the debt securities portfolio are the result of market activity, not credit issues/ratings, as approximately 83% of the debt securities portfolio on an amortized cost basis is currently rated A or higher by either S&P or Moody’s.

2016

The fair value of the investment portfolio decreased $42,680,000 from December 31, 2015 to December 31, 2016. The decrease in value is the result of the investment portfolio being actively managed in order to reduce interest rate and market risk. This process began in 2014 and is being undertaken primarily through the sale of long-term municipal bonds that have a maturity date greater than ten years and securities with a call date within the next five years. In addition, the decrease in corporate bond holdings is being undertaken to reduce risk and also in response to the changes in bank regulatory capital calculations per Basel III. The proceeds of the bond sales are primarily being deployed into loans. The strategy to sell a portion of the long-term bond portfolio does negatively impact current earnings, but this action plays a key role in our long-term asset/liability management strategy as the balance sheet is shortened to better prepare for a rising rate environment. The unrealized losses within the debt securities portfolio are the result of market activity, not credit issues/ratings, as approximately 88% of the debt securities portfolio on an amortized cost basis is currently rated A or higher by either S&P or Moody’s.

The carrying amounts of investment securities are summarized as follows for the years ended December 31, 2017, 2016, and 2015:

(In Thousands)	2017 Balance	% Portfolio	2016 Balance	% Portfolio	2015 Balance	% Portfolio
U.S. Government agency securities:						
Available for sale	$—	— %	$—	— %	$3,549	2.01 %
Mortgage-backed securities:						
Available for sale	4,213	3.38	9,313	6.97	10,009	5.68
Asset-backed securities:						
Available for sale	—	—	109	0.08	1,940	1.10
State and political securities (tax-exempt):						
Available for sale	45,149	36.22	45,506	34.08	73,110	41.49
State and political securities (taxable):						
Available for sale	11,359	9.11	15,428	11.55	13,445	7.63
Other bonds, notes and debentures:						
Available for sale	47,907	38.43	51,118	38.28	57,772	32.78
Total bonds, notes and debentures	108,628	87.14	121,474	90.96	159,825	90.69
Financial institution equity securities:						
Available for sale	14,596	11.71	10,535	7.89	11,483	6.52
Other equity securities:						
Available for sale	1,251	1.00	1,483	1.11	4,849	2.75
Trading	190	0.15	58	0.04	73	0.04
Total equity securities	16,037	12.86	12,076	9.04	16,405	9.31
Total	$124,665	100.00 %	$133,550	100.00 %	$176,230	100.00 %

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The following table shows the maturities and repricing of investment securities, at amortized cost and the weighted average yields (for tax-exempt obligations on a fully taxable basis assuming a 34% tax rate) at December 31, 2017:

(In Thousands)	Three Months or Less		Over Three Months Through One Year		Over One Year Through Five Years		Over Five Years Through Ten Years		Over Ten Years		Amortized Cost Total	
Mortgage-backed securities:												
AFS Amount	$—		$197		$1,701		$—		$2,375		$4,273	
Yield	—	%	5.824	%	3.112	%	—	%	2.568	%	2.93	%
State and political securities (tax-exempt):												
AFS Amount	5,861		6,954		25,645		6,497		—		44,957	
Yield	2.77	%	2.25	%	2.12	%	2.56	%	—	%	2.29	%
State and political securities (taxable):												
AFS Amount	—		1,668		5,946		3,724		—		11,338	
Yield	—	%	5.72	%	3.67	%	3.48	%	—	%	3.91	%
Other bonds, notes, and debentures:												
AFS Amount	221		545		17,981		30,060		—		48,807	
Yield	4.48	%	2.10	%	2.90	%	3.01	%	—	%	2.97	%
Total Amount	$6,082		$9,364		$51,273		$40,281		$2,375		109,375	
Total Yield	2.83	%	2.92	%	2.61	%	2.98	%	2.57	%	2.80	%
Equity Securities												
AFS Amount											15,168	
Trading Amount											212	
Total Investment Portfolio Value											$124,755	
Total Investment Portfolio Yield											2.45	%

All yields represent weighted average yields expressed on a tax equivalent basis. They are calculated on the basis of the cost, adjusted for amortization of premium and accretion of discount, and effective yields weighted for the scheduled maturity of each security. The taxable equivalent adjustment represents the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate (derived by dividing tax-exempt interest by 66%).

The distribution of credit ratings by amortized cost and estimated fair value for the debt security portfolio at December 31, 2017 follows:

(In Thousands)	A- to AAA		B- to BBB+		C to CCC+		Not Rated		Total	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale										
Mortgage-backed securities	$4,273	$4,213	$—	$—	$ —	$ —	$—	$—	$4,273	$4,213
Asset-backed securities	—	—	—	—	—	—	—	—	—	—
State and political securities	55,775	55,988	—	—	—	—	520	520	56,295	56,508
Other debt securities	30,927	30,425	12,933	12,659	—	—	4,947	4,823	48,807	47,907
Total debt securities	$90,975	$90,626	$12,933	$12,659	$ —	$ —	$5,467	$5,343	$109,375	$108,628

LOAN PORTFOLIO

2017

Gross loans of $1,246,614,000 at December 31, 2017 represented an increase of $152,933,000 from December 31, 2016. Indirect auto lending, which was introduced in the latter portion of 2016, was the primary driver of the growth in the loan portfolio. Real estate mortgage loans increased as growth in home equity lines of credit continued to be an emphasis. Indirect auto lending and home equity lines are part of the overall strategy to shorten the duration of the earning asset portfolio in preparation for a rising interest rate environment.

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2016

Gross loans of $1,093,681,000 at December 31, 2016 represented an increase of $48,474,000 from December 31, 2015. The continued emphasis on well collateralized real estate loans was the primary driver of the overall increase in loans outstanding, with home equity loans and lines of credit leading the way. The emphasis to add home equity lines of credit is part of the overall strategy to shorten the duration of the earning asset portfolio in preparation for a rising interest rate environment. Indirect auto lending was introduced during the latter portion of 2016 and contributed to the increase in installment loans to individuals.

The amounts of loans outstanding at the indicated dates are shown in the following table according to type of loan at December 31, 2017, 2016, 2015, 2014, and 2013:

(In Thousands)	2017 Amount	% Total	2016 Amount	% Total	2015 Amount	% Total	2014 Amount	% Total	2013 Amount	% To
Commercial, financial, and agricultural	$178,885	14.35 %	$146,110	13.36 %	$164,072	15.70 %	$124,156	13.56 %	$105,029	12.8
Real estate mortgage:										
Residential	597,077	47.90	564,740	51.63	526,183	50.34	457,760	50.00	399,781	48.8
Commercial	332,019	26.63	306,182	28.00	302,539	28.95	291,348	31.82	282,476	34.5
Construction	31,683	2.54	34,650	3.17	26,824	2.57	21,996	2.40	17,282	2.11
Installment loans to individuals	106,678	8.56	43,256	3.96	27,001	2.58	21,509	2.35	14,647	1.79
Net deferred loan fees and discounts	272	0.02	(1,257)	(0.12)	(1,412)	(0.14)	(1,190)	(0.13)	(871)	(0.1
Gross loans	$1,246,614	100.00%	$1,093,681	100.00 %	$1,045,207	100.00 %	$915,579	100.00 %	$818,344	100.

The amounts of domestic loans at December 31, 2017 are presented below by category and maturity:

(In Thousands)	Commercial, financial, and agricultural	Real Estate Residential	Commercial	Construction	Installment Loans to Individuals	Total
Loans with variable interest rates:						
1 year or less	$ 17,812	$12,523	$ 13,792	$ 2,304	$ 1,069	$47,500
1 through 5 years	6,928	3,931	7,996	63	8	18,926
5 through 10 years	39,223	26,155	50,797	2,144	—	118,319
After 10 years	64,249	527,084	244,314	22,332	2,532	860,511
Total floating interest rate loans	128,212	569,693	316,899	26,843	3,609	1,045,256
Loans with fixed interest rates:						
1 year or less	1,571	728	2,568	1,218	1,073	7,158
1 through 5 years	22,835	6,125	7,174	1,710	41,119	78,963
5 through 10 years	25,136	11,494	4,472	399	59,331	100,832
After 10 years	1,131	9,037	906	1,513	1,546	14,133
Total predetermined interest rate loans	50,673	27,384	15,120	4,840	103,069	201,086
Total	$ 178,885	$597,077	$ 332,019	$ 31,683	$ 106,678	1,246,342

Net deferred loan fees and discounts	272
	$1,246,614

· The loan maturity information is based upon original loan terms and is not adjusted for "rollovers." In the ordinary course of business, loans maturing within one year may be renewed, in whole or in part, at interest rates prevailing at the date of renewal.
· Scheduled repayments are reported in maturity categories in which the payment is due.

The Banks do not make loans that provide for negative amortization, nor do any loans contain conversion features. The Banks did not have any foreign loans outstanding at December 31, 2017.

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The following table shows the amount of accrual and nonaccrual TDRs at December 31, 2017 and 2016:

	2017			2016			2015		
(In Thousands)	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total
Commercial, financial, and agricultural	$5	$ 114	$119	$109	$ 132	$241	$320	$ 149	$469
Real estate mortgage:									
Residential	2,151	273	2,424	1,491	541	2,032	1,428	353	1,781
Commercial	4,429	2,076	6,505	4,723	2,184	6,907	5,085	2,312	7,397
Construction	—	—	—	—	—	—	—	—	—
Installment loans to individuals	—	—	—	—	—	—	—	—	—
	$6,585	$ 2,463	$9,048	$6,323	$ 2,857	$9,180	$6,833	$ 2,814	$9,647

ALLOWANCE FOR LOAN LOSSES

2017

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio as of the consolidated balance sheet date. All loan losses are charged to the allowance and all recoveries are credited to it per the allowance method of providing for loan losses. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based upon management’s quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Banks. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management’s consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, and historical loan loss experience. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

The allowance for loan losses decreased slightly from $12,896,000 at December 31, 2016 to $12,858,000 at December 31, 2017. At December 31, 2017, the allowance for loan losses was 1.03% of total loans compared to 1.18% of total loans at December 31, 2016 as loan portfolio growth outpaced the provision for loan losses net of charge-offs. The growth in the loan portfolio was driven by home equity product growth, which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. In addition, the growth in the indirect auto portfolio has incurred minimal losses. Net loan charge-offs of $768,000 or 0.06% of average loans for the year ended December 31, 2017 limited the impact of the provision for loan losses of $730,000. Management concluded that the allowance for loan losses is adequate to provide for probable losses inherent in its loan portfolio as of the balance sheet date as noted in the provision for loan losses discussion.

Based on management’s loan-by-loan review, the past performance of the borrowers, and current economic conditions, including recent business closures and bankruptcy levels, management does not anticipate any current losses related to nonaccrual, nonperforming, or classified loans above those that have already been considered in its overall judgment of the adequacy of the allowance for loan losses.

2016

The allowance for loan losses increased from $12,044,000 at December 31, 2015 to $12,896,000 at December 31, 2016. At December 31, 2016, the allowance for loan losses was 1.18% of total loans compared to 1.15% of total loans at December 31, 2015. The increase in the allowance for loan losses to total loans was the result of the increased allowance for loan losses that was partially offset by the increase in loan growth. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. Net loan charge-offs of $344,000 or 0.03% of average loans for the year ended December 31, 2016 limited the impact of the provision for loan losses of $1,196,000.

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Allocation of The Allowance For Loan Losses

	December 31, 2017		December 31, 2016		December 31, 2015		December 31, 2014		December 31, 2013	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total
Balance at end of period applicable to:										
Commercial, financial, and agricultural	$1,177	14.35 %	$1,554	13.34 %	$1,532	15.68 %	$1,124	13.54 %	$474	12.82 %
Real estate mortgage:										
Residential	5,679	47.91	5,383	51.58	5,116	50.27	3,755	49.93	3,917	48.80
Commercial	4,277	26.64	4,975	27.96	4,217	28.91	4,205	31.78	4,079	34.48
Construction	155	2.54	178	3.17	160	2.56	786	2.40	741	2.11
Installment loans to individuals	1,075	8.56	416	3.95	243	2.58	245	2.35	139	1.79
Unallocated	495	—	390	—	776	—	464	—	794	—
	$12,858	100.00%	$12,896	100.00%	$12,044	100.00%	$10,579	100.00%	$10,144	100.00%

NONPERFORMING LOANS

The decrease in nonperforming loans during 2017 is primarily the result of a large commercial real estate loan that was paid-off during the third quarter of 2017. The majority of the nonperforming loans are centered on several loans that are either in a secured position and have sureties with a strong underlying financial position and/or a specific allowance within the allowance for loan losses.

The following table presents information concerning nonperforming loans. The accrual of interest will be discontinued when the principal or interest of a loan is in default for 90 days or more, or as soon as payment is questionable, unless the loan is well secured and in the process of collection. Consumer loans and residential real estate loans secured by 1 to 4 family dwellings are not ordinarily subject to those guidelines. The reversal of previously accrued but uncollected interest applicable to any loan placed in a nonaccrual status and the treatment of subsequent payments of either principal or interest is handled in accordance with GAAP. These principles do not require a write-off of previously accrued interest if principal and interest are ultimately protected by sound collateral values. A nonperforming loan may be restored to accruing status when:

1. Principal and interest is no longer due and unpaid;
2. It becomes well secured and in the process of collection; and
3. Prospects for future contractual payments are no longer in doubt.

	Total Nonperforming Loans		
(In Thousands)	90 Days Past Due	Nonaccrual	Total
2017	$ 509	$ 6,759	$ 7,268
2016	870	10,756	11,626
2015	979	8,467	9,446
2014	387	11,861	12,248
2013	604	9,074	9,678

The level of non-accruing loans continues to fluctuate annually and is attributed to the various economic factors experienced both regionally and nationally. Overall, the portfolio is well secured with a majority of the balance

making regular payments or scheduled to be satisfied in the near future. Presently, there are no significant loans where serious doubts exist as to the ability of the borrower to comply with the current loan payment terms which are not included in the nonperforming categories as indicated above.

Management's judgment in determining the amount of the additions to the allowance charged to operating expense considers the following factors with no single factor being determinative:

1. Economic conditions and the impact on the loan portfolio;
2. Analysis of past loan charge-offs experienced by category and comparison to outstanding loans;
3. Effect of problem loans on overall portfolio quality; and
4. Reports of examination of the loan portfolio by the Department and the FDIC.

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DEPOSITS

2017 vs. 2016

Total average deposits increased $68,786,000 or 6.39% from 2016 to 2017. The growth is a result of an emphasis to increase and solidify deposit relationships by focusing on core deposits, not time deposits. The actions caused average core deposits, which exclude time deposits, to increase to 79.98% in 2017 from 79.44% for 2016.

2016 vs. 2015

Total average deposits increased $68,214,000 or 6.76% from 2015 to 2016. The growth is a result of an emphasis to increase and solidify deposit relationships by focusing on core deposits, not time deposits. The actions caused average core deposits, which exclude time deposits, to increase to 79.44% in 2016 from 78.16% for 2015.

The average amount and the average rate paid on deposits are summarized below for the years ended December 31, 2017, 2016, and 2015:

	2017		2016		2015	
(In Thousands)	Average Amount	Rate	Average Amount	Rate	Average Amount	Rate
Noninterest-bearing	$302,651	0.00%	$279,130	0.00%	$251,029	0.00%
Savings	157,851	0.04	151,397	0.04	143,055	0.04
Super Now	200,436	0.26	187,106	0.24	187,396	0.26
Money Market	274,546	0.35	238,175	0.27	207,252	0.27
Time	210,608	1.21	221,498	1.08	220,360	0.92
Total average deposits	$1,146,092	0.36%	$1,077,306	0.33%	$1,009,092	0.31%

SHAREHOLDERS’ EQUITY

2017

Shareholders’ equity decreased $57,000 to $138,192,000 at December 31, 2017 compared to December 31, 2016. Since December 31, 2016, treasury stock purchases of $1,881,000 for 47,698 shares were completed as part of the stock repurchase plan. The change in accumulated other comprehensive loss from $4,928,000 at December 31, 2016 to $4,974,000 at December 31, 2017 is a result of a decrease in unrealized losses on available for sale securities from an unrealized loss of $639,000 at December 31, 2016 to an unrealized loss of $54,000 at December 31, 2017. The amount of accumulated other comprehensive loss at December 31, 2017 was also impacted by the change in net excess of the projected benefit obligation over the fair value of the plan assets of the defined benefit pension plan resulting in a $631,000 increase in the net loss to $4,920,000 at December 31, 2017. The current level of shareholders’ equity equates to a book value per share of $29.47 at December 31, 2017 compared to $29.20 at December 31, 2016 and an equity to asset ratio of 9.37% at December 31, 2017 compared to 10.25% at December 31, 2016. Excluding goodwill and intangibles, book value per share was $25.51 at December 31, 2017 compared to $25.21 at December 31, 2016. Dividends declared for twelve months ended December 31, 2017 and 2016 were $1.88 per share.

2016

Shareholders’ equity increased $1,970,000 to $138,249,000 at December 31, 2016 compared to December 31, 2015. Since December 31, 2015, treasury stock purchases of $574,000 for 14,600 shares were completed as part of the stock repurchase plan. The change in accumulated other comprehensive loss from $3,799,000 at December 31, 2015 to $4,928,000 at December 31, 2016 is a result of an increase in unrealized losses on available for sale securities from an

unrealized gain of $258,000 at December 31, 2015 to an unrealized loss of $639,000 at December 31, 2016. The amount of accumulated other comprehensive loss at December 31, 2016 was also impacted by the change in net excess of the projected benefit obligation over the fair value of the plan assets of the defined benefit pension plan resulting in a $232,000 increase in the net loss to $4,289,000 at December 31, 2016. The current level of shareholders' equity equates to a book value per share of $29.20 at December 31, 2016 compared to $28.71 at December 31, 2015 and an equity to asset ratio of 10.25% at December 31, 2016 compared to 10.32% at December 31, 2015. Excluding goodwill and intangibles, book value per share was $25.21 at December 31, 2016 compared to $24.84 at December 31, 2015. Dividends declared for each of the three and twelve months ended December 31, 2016 and 2015 were $0.47 and $1.88 per share.

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Bank regulators have risk based capital guidelines. Under these guidelines the Company and each Bank are required to maintain minimum ratios of core capital and total qualifying capital as a percentage of risk weighted assets and certain off-balance sheet items. At December 31, 2017, both the Company's and each Bank's required ratios were well above the minimum ratios (and including the current capital conservation buffer where applicable) as follows:

	Company	Jersey Shore State Bank	Luzerne Bank	Minimum Standards
Common equity tier 1 capital to risk-weighted assets	11.254 %	10.120 %	9.731 %	5.750 %
Tier 1 capital to risk-weighted assets	11.254 %	10.120 %	9.731 %	7.250 %
Total capital to risk-weighted assets	11.844 %	10.677 %	10.174 %	9.250 %
Tier 1 capital to average assets	8.766 %	8.235 %	8.384 %	4.000 %

For a more comprehensive discussion of these requirements, see "Regulation and Supervision" in Item 1 of the Annual Report on Form 10-K. Management believes that the Company and the Banks will continue to exceed regulatory capital requirements.

RETURN ON EQUITY AND ASSETS

The ratio of net income to average total assets and average shareholders' equity, and other certain equity ratios are presented as follows:

	2017	2016	2015
Percentage of net income to:			
Average total assets	0.69 %	0.93 %	1.08 %
Average shareholders' equity	6.91 %	8.96 %	10.11 %
Percentage of dividends declared to net income	90.42 %	71.37 %	64.52 %
Percentage of average shareholders' equity to average total assets	10.05 %	10.38 %	10.68 %

LIQUIDITY, INTEREST RATE SENSITIVITY, AND MARKET RISK

The Asset/Liability Committee addresses the liquidity needs of the Company to ensure that sufficient funds are available to meet credit demands and deposit withdrawals as well as to the placement of available funds in the investment portfolio. In assessing liquidity requirements, equal consideration is given to the current position as well as the future outlook.

The following liquidity measures are monitored for compliance and were within the limits cited at December 31, 2017, except for Net Loans to Total Deposits which was at 107.6%:

1. Net Loans to Total Assets, 85% maximum
2. Net Loans to Total Deposits, 100% maximum
3. Cumulative 90 day Maturity GAP %, +/- 20% maximum
4. Cumulative 1 Year Maturity GAP %, +/- 25% maximum

Fundamental objectives of the Company's asset/liability management process are to maintain adequate liquidity while minimizing interest rate risk. The maintenance of adequate liquidity provides the Company with the ability to meet its financial obligations to depositors, loan customers, and shareholders. Additionally, it provides funds for normal operating expenditures and business opportunities as they arise. The objective of interest rate sensitivity management is to increase net interest income by managing interest sensitive assets and liabilities in such a way that they can be repriced in response to changes in market interest rates.

The Company, like other financial institutions, must have sufficient funds available to meet its liquidity needs for deposit withdrawals, loan commitments, and expenses. In order to control cash flow, the Company estimates future flows of cash from deposits and loan payments. The primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, as well as FHLB borrowings. Funds generated are used principally to fund loans and purchase investment securities. Management believes the Company has adequate resources to meet its normal funding requirements.

Management monitors the Company's liquidity on both a short and long-term basis, thereby providing management necessary information to react to current balance sheet trends. Cash flow needs are assessed and sources of funds are determined. Funding strategies consider both customer needs and economical cost. Both short and long term funding needs are addressed by maturities and sales of available for sale investment securities, loan repayments and maturities, and liquidating money market investments

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such as federal funds sold. The use of these resources, in conjunction with access to credit, provides core ingredients to satisfy depositor, borrower, and creditor needs.

Management monitors and determines the desirable level of liquidity. Consideration is given to loan demand, investment opportunities, deposit pricing and growth potential, as well as the current cost of borrowing funds. The Company has a current borrowing capacity at the FHLB of $556,656,000 with $163,495,000 utilized, leaving $393,160,000 available. In addition to this credit arrangement, the Company has additional lines of credit with correspondent banks of $52,000,000. The Company's management believes that it has sufficient liquidity to satisfy estimated short-term and long-term funding needs.

Interest rate sensitivity, which is closely related to liquidity management, is a function of the repricing characteristics of the Company's portfolio of assets and liabilities. Asset/liability management strives to match maturities and rates between loan and investment security assets with the deposit liabilities and borrowings that fund them. Successful asset/liability management results in a balance sheet structure which can cope effectively with market rate fluctuations. The matching process is affected by segmenting both assets and liabilities into future time periods (usually 12 months or less) based upon when repricing can be effected. Repriceable assets are subtracted from repriceable liabilities for a specific time period to determine the "gap" or difference. Once known, the gap is managed based on predictions about future market interest rates. Intentional mismatching, or gapping, can enhance net interest income if market rates move as predicted. However, if market rates behave in a manner contrary to predictions, net interest income will suffer. Gaps, therefore, contain an element of risk and must be prudently managed. In addition to gap management, the Company has an asset liability management policy which incorporates a market value at risk calculation which is used to determine the effects of interest rate movements on shareholders' equity and a simulation analysis to monitor the effects of interest rate changes on the Company's balance sheet.

The Company currently maintains a gap position of being asset sensitive. The Company has strategically taken this position as it has decreased the duration of the earning asset portfolio by adding quality short and intermediate term loans such as home equity loans and the selling of long-term municipal bonds. Lengthening of the liability portfolio is being undertaken to build protection in a rising rate environment.

A market value at risk calculation is utilized to monitor the effects of interest rate changes on the Company's balance sheet and more specifically shareholders' equity. The Company does not manage the balance sheet structure in order to maintain compliance with this calculation. The calculation serves as a guideline with greater emphasis placed on interest rate sensitivity. Changes to calculation results from period to period are reviewed as changes in results could be a signal of future events.

INTEREST RATE SENSITIVITY

In this analysis the Company examines the result of various changes in market interest rates in 100 basis point increments and their effect on net interest income. It is assumed that the change is instantaneous and that all rates move in a parallel manner. Assumptions are also made concerning prepayment speeds on mortgage loans and mortgage securities.

The following is a rate shock forecast for the twelve month period ending December 31, 2018 assuming a static balance sheet as of December 31, 2017.

	Parallel Rate Shock in Basis Points						
(In Thousands)	(200)	(100)	Static	100	200	300	400
Net interest income	$43,884	$46,399	$48,009	$48,809	$49,415	$49,825	$50,276
Change from static	(4,125)	(1,610)	—	800	1,406	1,816	2,267
Percent change from static	-8.59 %	-3.35 %	—	1.67 %	2.93 %	3.78 %	4.72 %

The model utilized to create the report presented above makes various estimates at each level of interest rate change regarding cash flow from principal repayment on loans and mortgage-backed securities and/or call activity on investment securities. Actual results could differ significantly from these estimates which would result in significant differences in the calculated projected change. In addition, the limits stated above do not necessarily represent the level of change under which management would undertake specific measures to realign its portfolio in order to reduce the projected level of change. Generally, management believes the Company is well positioned to respond expeditiously when the market interest rate outlook changes.

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INFLATION

The asset and liability structure of a financial institution is primarily monetary in nature; therefore, interest rates rather than inflation have a more significant impact on the Company's performance. Interest rates are not always affected in the same direction or magnitude as prices of other goods and services, but are reflective of fiscal policy initiatives or economic factors that are not measured by a price index.

CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are integral to understanding the results reported. The accounting policies are described in detail in Note 1 of the "Notes to Consolidated Financial Statements" included in Item 8 of this Annual Report on Form 10-K. Our most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments, and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Other Than Temporary Impairment of Debt and Equity Securities

Debt and equity securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reason underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. For a full discussion of the Company's methodology of assessing impairment, refer to Note 4 of the "Notes to Consolidated Financial Statements" included in Item 8 of this Annual Report on Form 10-K.

Allowance for Loan Losses

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The Company's allowance for loan losses provides for probable losses based upon evaluations of known and inherent risks in the loan portfolio.

Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment; as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company's methodology of assessing the adequacy of the reserve for allowance for loan losses, refer to Note 1 of the "Notes to Consolidated Financial Statements" included in Item 8 of this Annual Report on Form 10-K.

Goodwill and Other Intangible Assets

As discussed in Note 8 of the "Notes to Consolidated Financial Statements," the Company must assess goodwill and other intangible assets each year for impairment. This assessment involves estimating cash flows for future periods. If the future cash flows were less than the recorded goodwill and other intangible assets balances, we would be required to take a charge against earnings to write down the assets to the lower value.

Deferred Tax Assets

Management uses an estimate of future earnings to support their position that the benefit of their deferred tax assets will be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and the Company's net income will be reduced. The Company's deferred tax assets are described further in Note 12 of the "Notes to Consolidated Financial Statements" included in Item 8 of this Annual Report on Form 10-K.

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Pension Benefits

Pension costs and liabilities are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, benefits earned, interest costs, expected return on plan assets, mortality rates, and other factors. In accordance with GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation of future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect the Company’s pension obligations and future expense. Our pension benefits are described further in Note 13 of the “Notes to Consolidated Financial Statements” included in Item 8 of this Annual Report on Form 10-K.

CONTRACTUAL OBLIGATIONS

The Company has various financial obligations, including contractual obligations which may require future cash payments. The following table presents, as of December 31, 2017, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the “Notes to Consolidated Financial Statements” included in Item 8 of this Annual Report on Form 10-K.

	Payments Due In				
(In Thousands)	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$916,853	$ —	$ —	$ —	$916,853
Time deposits	115,659	85,025	27,356	1,427	229,467
Repurchase agreements	7,878	—	—	—	7,878
Short-term borrowings	92,870	—	—	—	92,870
Long-term borrowings	12,028	45,654	13,029	288	70,999
Operating leases	599	943	630	1,246	3,418

The Company’s operating lease obligations represent short and long-term lease and rental payments for branch facilities and equipment. The Bank leases certain facilities under operating leases which expire on various dates through 2027. Renewal options are available on the majority of these leases.

CAUTIONARY STATEMENT FOR PURPOSES OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Report contains certain “forward-looking statements” including statements concerning plans, objectives, future events or performance and assumptions and other statements which are other than statements of historical fact. The Company wishes to caution readers that the following important factors, among others in addition to the factors discussed in Item 1 - "Business" and in Item 1A - "Risk Factors", may have affected and could in the future affect the Company’s actual results and could cause the Company’s actual results for subsequent periods to differ materially from those expressed in any forward-looking statement made by or on behalf of the Company herein: (i) the effect of changes in laws and regulations, including federal and state banking laws and regulations, with which the Company must comply, and the associated costs of compliance with such laws and regulations either currently or in the future as applicable; (ii) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as by the Financial Accounting Standards Board, or of changes in the Company’s organization, compensation and benefit plans; (iii) the effect on the Company’s competitive position within its market area of the increasing consolidation within the banking and financial services industries, including the increased competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services; (iv) the effect of changes in interest rates; and (v) the effect of changes in the business cycle and downturns

in the local, regional or national economies.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk for the Company is comprised primarily from interest rate risk exposure and liquidity risk. Interest rate risk and liquidity risk management is performed at the Banks' level as well as the Company level. The Company’s interest rate sensitivity is monitored by management through selected interest rate risk measures produced internally. Additional information and details are provided in the Interest Sensitivity section of Item 7 - "Management’s Discussion and Analysis of Financial Condition and Results of Operations."

Generally, management believes the Company is well positioned to respond expeditiously when the market interest rate outlook changes.

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ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of Penns Woods Bancorp, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Penns Woods Bancorp, Inc. and subsidiaries (the "Company") as of December 31, 2017 and 2016; the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2017; and the related notes to the consolidated financial statements (collectively, the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 13, 2018, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks.

Basis for Opinion

Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 1999.

Cranberry Township, Pennsylvania
March 13, 2018

PENNS WOODS BANCORP, INC.
CONSOLIDATED BALANCE SHEET

(In Thousands, Except Share Data)	December 31, 2017	2016
ASSETS:		
Noninterest-bearing balances	$25,692	$26,766
Interest-bearing deposits in other financial institutions	1,551	16,905
Total cash and cash equivalents	27,243	43,671
Investment securities available for sale, at fair value	124,475	133,492
Investment securities, trading	190	58
Loans held for sale	1,196	1,953
Loans	1,246,614	1,093,681
Allowance for loan losses	(12,858)	(12,896)
Loans, net	1,233,756	1,080,785
Premises and equipment, net	27,386	24,275
Accrued interest receivable	4,321	3,672
Bank-owned life insurance	27,982	27,332
Goodwill	17,104	17,104
Intangibles	1,462	1,799
Deferred tax asset	4,388	8,397
Other assets	4,989	6,052
TOTAL ASSETS	$1,474,492	$1,348,590
LIABILITIES:		
Interest-bearing deposits	$843,004	$791,937
Noninterest-bearing deposits	303,316	303,277
Total deposits	1,146,320	1,095,214
Short-term borrowings	100,748	13,241
Long-term borrowings	70,970	85,998
Accrued interest payable	502	455
Other liabilities	17,758	15,433
TOTAL LIABILITIES	1,336,298	1,210,341
SHAREHOLDERS' EQUITY:		
Preferred stock, no par value, 3,000,000 shares authorized; no shares issued	—	—
Common stock, par value $8.33, 15,000,000 shares authorized; 5,009,339 and 5,007,109 shares issued; 4,689,189 and 4,734,657 shares outstanding	41,744	41,726
Additional paid-in capital	50,173	50,075
Retained earnings	63,364	61,610
Accumulated other comprehensive loss:		
Net unrealized loss on available for sale securities	(54)	(639)
Defined benefit plan	(4,920)	(4,289)

Treasury stock at cost, 320,150 and 272,452 shares	(12,115)	(10,234)
TOTAL PENNS WOODS BANCORP, INC. SHAREHOLDERS’ EQUITY	138,192	138,249
Non controlling interest	2	—
TOTAL SHAREHOLDERS' EQUITY	138,194	138,249
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$1,474,492	$1,348,590

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF INCOME

	Year Ended December 31,		
(In Thousands, Except Per Share Data)	2017	2016	2015
INTEREST AND DIVIDEND INCOME:			
Loans, including fees	$45,833	$ 42,056	$ 39,134
Investment securities:			
Taxable	2,182	2,424	3,426
Tax-exempt	1,218	1,498	2,795
Dividend and other interest income	744	835	769
TOTAL INTEREST AND DIVIDEND INCOME	49,977	46,813	46,124
INTEREST EXPENSE:			
Deposits	4,083	3,547	3,129
Short-term borrowings	234	46	116
Long-term borrowings	1,580	1,974	1,974
TOTAL INTEREST EXPENSE	5,897	5,567	5,219
NET INTEREST INCOME	44,080	41,246	40,905
PROVISION FOR LOAN LOSSES	730	1,196	2,300
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	43,350	40,050	38,605
NON-INTEREST INCOME:			
Service charges	2,222	2,249	2,383
Securities gains, available for sale	600	1,611	2,592
Securities (losses) gains, trading	(8)	58	(22)
Bank-owned life insurance	666	684	720
Gain on sale of loans	1,674	2,102	1,743
Insurance commissions	496	795	781
Brokerage commissions	1,378	1,098	1,064
Debit card income	1,960	1,896	1,692
Other	1,756	1,620	1,812
TOTAL NON-INTEREST INCOME	10,744	12,113	12,765
NON-INTEREST EXPENSE:			
Salaries and employee benefits	18,999	17,813	17,023
Occupancy	2,447	2,223	2,248
Furniture and equipment	2,915	2,793	2,622
Software amortization	974	1,256	1,140
Pennsylvania shares tax	925	873	954
Professional Fees	2,353	2,096	1,919
Federal Deposit Insurance Corporation deposit insurance	669	767	867
Debit card expenses	602	604	576
Marketing	958	740	612
Intangible amortization	337	366	311
Other	5,683	5,560	5,464
TOTAL NON-INTEREST EXPENSE	36,862	35,091	33,736

INCOME BEFORE INCOME TAX PROVISION	17,232	17,072	17,634
INCOME TAX PROVISION	7,459	4,597	3,736
NET INCOME	$ 9,773	$ 12,475	$ 13,898
EARNINGS PER SHARE - BASIC AND DILUTED	$ 2.08	$ 2.64	$ 2.91
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC AND DILUTED	4,705,602	4,735,457	4,772,239
DIVIDENDS PER SHARE	$ 1.88	$ 1.88	$ 1.88

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Year Ended December 31,		
(In Thousands)	2017	2016	2015
Net Income	$9,773	$12,475	$13,898
Other comprehensive income (loss):			
Change in unrealized gain (loss) on available for sale securities	1,500	252	(1,457)
Tax effect	(510)	(85)	495
Net realized gain included in net income	(600)	(1,611)	(2,592)
Tax effect	204	547	882
Amortization (accretion) of unrecognized pension and post-retirement items	270	(352)	817
Tax effect	(92)	120	(277)
Total other comprehensive income (loss)	772	(1,129)	(2,132)
Comprehensive income	$10,545	$11,346	$11,766

*No other comprehensive income is allocated to noncontrolling interest

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(In Thousands, Except Per Share Data)	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE (LOSS)	TREASURY STOCK	NON-CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
Balance, December 31, 2014	5,002,649	$41,688	$49,896	$53,107	$(1,667)	$(7,057)	$ —	$135,967
Net income				13,898				13,898
Other comprehensive loss					(2,132)			(2,132)
Stock-based compensation recognized in earnings			9					9
Dividends declared, ($1.88 per share)				(8,967)				(8,967)
Common shares issued for employee stock purchase plan	2,335	20	87					107
Purchase of treasury stock (60,018 shares)						(2,603)		(2,603)
Balance, December 31, 2015	5,004,984	41,708	49,992	58,038	(3,799)	(9,660)	—	136,279
Net income				12,475				12,475
Other comprehensive loss					(1,129)			(1,129)
Stock-based compensation recognized in earnings			19					19
Dividends declared, ($1.88 per share)				(8,903)				(8,903)
Common shares issued for employee stock purchase plan	2,125	18	64					82
Purchase of treasury stock (14,600 shares)						(574)		(574)
Balance, December 31, 2016	5,007,109	41,726	50,075	61,610	(4,928)	(10,234)	—	138,249
Net income				9,773				9,773
Reclassification of certain income tax effects from accumulated other comprehensive loss				818	(818)			—
Other comprehensive income					772			772
Stock-based compensation recognized in earnings			29					29
Dividends declared, ($1.88 per share)				(8,837)				(8,837)
Noncontrolling investment in joint venture							2	2
Common shares issued for employee stock purchase plan	2,230	18	69					87
Purchase of treasury stock (47,698 shares)						(1,881)		(1,881)
Balance, December 31, 2017	5,009,339	$41,744	$50,173	$63,364	$(4,974)	$(12,115)	$ 2	$138,194

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
(In Thousands)	2017	2016	2015
OPERATING ACTIVITIES:			
Net Income	$9,773	$12,475	$13,898
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,632	3,146	3,366
Amortization of intangible assets	337	366	311
Provision for loan losses	730	1,196	2,300
Amortization of investment security discounts and premiums, net	893	870	873
Securities gains, net	(600)	(1,611)	(2,592)
Originations of loans held for sale	(53,407)	(68,362)	(56,058)
Proceeds of loans held for sale	55,838	69,268	57,594
Gain on sale of loans	(1,674)	(2,102)	(1,743)
Net securities losses (gains), trading	8	(58)	22
Proceeds from sales of trading securities	426	3,826	709
Purchases of trading securities	(566)	(3,753)	(804)
Earnings on bank-owned life insurance	(666)	(684)	(720)
Decrease in deferred tax asset	1,769	1,543	209
Other, net	2,200	(7)	(1,630)
Net cash provided by operating activities	17,693	16,113	15,735
INVESTING ACTIVITIES:			
Investment securities available for sale:			
Proceeds from sales	25,528	44,829	65,672
Proceeds from calls and maturities	11,564	25,558	22,859
Purchases	(22,986)	(28,322)	(32,776)
Net increase in loans	(152,806)	(49,590)	(130,803)
Acquisition of bank premises and equipment	(4,999)	(4,061)	(2,285)
Proceeds from the sale of foreclosed assets	1,108	859	1,868
Purchase of bank-owned life insurance	(34)	(27)	(30)
Capital contribution from non-controlling interest	2	—	—
Proceeds from redemption of regulatory stock	7,677	3,160	10,790
Purchases of regulatory stock	(12,158)	(3,178)	(12,818)
Net cash used for investing activities	(147,104)	(10,772)	(77,523)
FINANCING ACTIVITIES:			
Net increase in interest-bearing deposits	51,067	40,140	13,756
Net increase in noninterest-bearing deposits	39	23,194	36,705
Proceeds from long-term borrowings	30,000	—	30,625
Repayment of long-term borrowings	(45,028)	(5,027)	(10,776)
Net increase (decrease) in short-term borrowings	87,507	(33,397)	5,820
Dividends paid	(8,837)	(8,903)	(8,967)
Issuance of common stock	116	101	116
Purchase of treasury stock	(1,881)	(574)	(2,603)
Net cash provided by financing activities	112,983	15,534	64,676
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(16,428)	20,875	2,888
CASH AND CASH EQUIVALENTS, BEGINNING	43,671	22,796	19,908
CASH AND CASH EQUIVALENTS, ENDING	$27,243	$43,671	$22,796

See accompanying notes to the consolidated financial statements.

	Year Ended December 31,		
(In Thousands)	2017	2016	2015
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Interest paid	$ 5,850	$ 5,538	$ 5,174
Income taxes paid	4,450	4,025	2,933
Transfer of loans to foreclosed real estate	593	772	340

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Penns Woods Bancorp, Inc. and its wholly owned subsidiaries, Jersey Shore State Bank (“JSSB”), Luzerne Bank ("Luzerne" and collectively with JSSB , the "Banks"), Woods Real Estate Development Co., Inc., Woods Investment Company, Inc., The M Group Inc. D/B/A The Comprehensive Financial Group (“The M Group”), a wholly owned subsidiary of JSSB and an eighty percent owned partnership, United Solutions, LLC, (collectively, the “Company”). All significant intercompany balances and transactions have been eliminated.

Nature of Business

The Banks engage in a full-service commercial banking business, making available to the community a wide range of financial services including, but not limited to, installment loans, credit cards, mortgage and home equity loans, lines of credit, construction financing, farm loans, community development loans, loans to non-profit entities and local government, and various types of demand and time deposits including, but not limited to, checking accounts, savings accounts, money market deposit accounts, certificates of deposit, and IRAs. Deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) to the extent provided by law.

The financial services are provided by the Banks to individuals, partnerships, non-profit organizations, and corporations through their twenty-six offices located in Clinton, Lycoming, Centre, Montour, Union, and Luzerne Counties, Pennsylvania.

Woods Real Estate Development Co., Inc. engages in real estate transactions on behalf of Penns Woods Bancorp, Inc. and the Banks.

Woods Investment Company, Inc., a Delaware holding company, is engaged in investing activities.

The M Group engages in securities brokerage and financial planning services, which include the sale of life insurance products, annuities, and estate planning services.

United Insurance Solutions, LLC will be offering property and casualty and auto insurance products within the Company's market footprint beginning in 2018.

Operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all financial service operations are considered by management to be aggregated in one reportable operating segment.

Use of Estimates

The preparation of financial statements 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. Actual results may differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, valuation of net deferred tax assets, impairment of goodwill, other than temporary impairment of debt and equity securities, fair value of financial instruments, and the valuation of real estate acquired through, or in lieu of, foreclosure on settlement of debt.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and in banks and federal funds sold. Interest-earning deposits mature within 90 days and are carried at cost. Net cash flows are reported for loan, deposit, and short-term borrowing transactions.

Restrictions on Cash and Cash Equivalents

Based on deposit levels, the Banks must maintain cash and other reserves with the Federal Reserve Bank of Philadelphia ("FRB").

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Investment Securities

Investment securities are classified at the time of purchase, based on management’s intention and ability, as securities held to maturity, securities available for sale, or securities held for trading. Debt securities acquired with the intent and ability to hold to maturity are stated at cost, adjusted for amortization of premium and accretion of discount, which are computed using the interest method and recognized as adjustments of interest income. Certain other debt securities have been classified as available for sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available for sale securities are reported as a separate component of shareholders’ equity, net of tax, until realized. Unrealized holding gains and losses for equity securities held for trading are recognized as a separate component within the income statement. Realized security gains and losses are computed using the specific identification method for debt securities and the average cost method for marketable equity securities. Interest and dividends on investment securities are recognized as income when earned.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security’s ability to recover any decline in its fair value, whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in fair value, and a review of the Company’s capital adequacy, interest rate risk position, and liquidity. The assessment of a security’s ability to recover any decline in fair value, the ability of the issuer to meet contractual obligations, and management’s intent and ability requires considerable judgment. A decline in value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statement of Income.

Fair values of investment securities are based on observed market prices. Certain investment securities do not have observed bid prices and their fair value is based on instruments with similar risk elements. Since regulatory stock is redeemable at par, the Company carries it at cost.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are stated at the principal amount outstanding, net of deferred fees and discounts, unamortized loan fees and costs, and the allowance for loan losses. Interest on loans is recognized as income when earned on the accrual method. The Company’s general policy has been to stop accruing interest on loans when it is determined a reasonable doubt exists as to the collectability of additional interest. Income is subsequently recognized only to the extent that cash payments are received provided the loan is not delinquent in payment and, in management’s judgment, the borrower has the ability and intent to make future principal payments. Otherwise, payments are applied to the unpaid principal balance of the loan. Loans are restored to accrual status if certain conditions are met, including but not limited to, the repayment of all unpaid interest and scheduled principal due, ongoing performance consistent with the contractual agreement, and the future expectation of continued, timely payments.

Loan origination and commitment fees as well as certain direct loan origination costs are being deferred and amortized as an adjustment to the related loan’s yield over the contractual lives of the related loans.

Allowance for Loan Losses

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio as of the Consolidated Balance Sheet date. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The

provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Bank. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, historical loan loss experience, and general economic conditions. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at December 31, 2017, future adjustments could be necessary if circumstances or economic conditions

differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy, rising unemployment, or negative performance trends in financial information from borrowers could be indicators of subsequent increased levels of nonperforming assets and possible charge-offs, which would normally require increased loan loss provisions. An integral part of the periodic regulatory examination process is the review of the adequacy of the Banks' loan loss allowance. The regulatory agencies could require the Banks, based on their evaluation of information available at the time of their examination, to provide additional loan loss provisions to further supplement the allowance.

Impaired loans are commercial and commercial real estate loans for which it is probable the Banks will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Banks individually evaluate such loans for impairment and do not aggregate loans by major risk classifications. The definition of “impaired loans” is not the same as the definition of “nonaccrual loans,” although the two categories overlap. The Banks may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired if the loan is not a commercial or commercial real estate loan. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower’s prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Loan Charge-off Policies

Loans are generally fully or partially charged down to the fair value of collateral securing the asset when:

- management judges the asset to be uncollectible;
- repayment is deemed to be protracted beyond reasonable time frames;
- the asset has been classified as a loss by either the internal loan review process or external examiners;
- the borrower has filed bankruptcy and the loss becomes evident due to a lack of assets; or
- the loan is 180 days past due unless both well secured and in the process of collection.

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower’s financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a troubled debt restructuring ("TDR"). Management strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

In addition to the allowance for the pooled portfolios, management has developed a separate allowance for loans that are identified as impaired through a TDR. These loans are excluded from pooled loss forecasts and a separate reserve

is provided under the accounting guidance for loan impairment. Consumer loans whose terms have been modified in a TDR are also individually analyzed for estimated impairment.

Loans Held for Sale

In general, fixed rate residential mortgage loans originated by the Banks are held for sale and are carried at cost due to their short holding period, which can range from less than two weeks to a maximum of thirty days. Sold loans are not serviced by the Banks. Proceeds from the sale of loans in excess of the carrying value are accounted for as a gain. Total gains on the sale of loans are shown as a component of non-interest income within the Consolidated Statement of Income.

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Foreclosed Assets

Foreclosed assets are carried at the lower of cost or fair value less estimated selling costs. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged against operating expenses. Net operating expenses and gains and losses realized from disposition are included in non-interest expense and income, respectively, within the Consolidated Statement of Income.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using straight-line and accelerated methods over the estimated useful lives of the related assets, which range from five to ten years for furniture, fixtures, and equipment and fifteen to forty years for buildings and improvements. Costs incurred for routine maintenance and repairs are charged to operations as incurred. Costs of major additions and improvements are capitalized.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain officers and directors. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized. Increases in the cash surrender value are recognized as a component of non-interest income within the Consolidated Statement of Income.

Goodwill

The Company performs an annual impairment analysis of goodwill for its purchased subsidiaries, Luzerne and The M Group. Based on the fair value of these reporting units, estimated using the expected present value of future cash flows, no impairment of goodwill was recognized in 2017, 2016, or 2015.

Intangible Assets

At December 31, 2017, the Company had intangible assets of $641,000 as a result of the acquisition of Luzerne National Bank Corporation, which is net of accumulated amortization of $1,373,000. These intangible assets will continue to be amortized using the sum-of-the-years digits method of amortization over ten years. The Company also had intangible assets of $821,000, which is net of accumulated amortization of $192,000, as a result of the purchase of two books of business related to investment product sales. The book of business intangible is being amortized using the straight-line method over a period of ten years.

Investments in Limited Partnerships

The Company is a limited partner in three partnerships at December 31, 2017 that provide low income elderly housing in the Company’s geographic market area. The carrying value of the Company’s investments in limited partnerships was $402,000 at December 31, 2017 and $586,000 at December 31, 2016. The investments are being amortized over the ten-year tax credit receipt period utilizing the straight-line method. The partnerships are amortized once the projects reach the level of occupancy needed to begin the ten year tax credit recognition period. Amortization of limited partnership investments amounted to $184,000, $312,000, and $661,000 for 2017, 2016 and 2015, respectively.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company enters into off-balance sheet financial instruments. Those instruments consist of commitments to extend credit and standby letters of credit. When those instruments are funded or become payable, the Company reports the amounts in its financial statements.

Marketing Cost

Marketing costs are generally expensed as incurred.

Income Taxes

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the

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appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

Deferred tax assets and liabilities result from temporary differences in financial and income tax methods of accounting, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company analyzed its deferred tax asset position and determined that there was not a need for a valuation allowance due to the Company's ability to generate future ordinary and capital taxable income.

On December 22, 2017 the Tax Cut and Jobs Act was signed into law. ASC 740 (Income Taxes) requires the recognition of the effect of changes in tax laws or rates in the period in which the legislation is enacted. The changes in the deferred tax assets and liabilities remeasured at the new 21% federal tax rate are reflected in income tax expense for fiscal year 2017.

The Company when applicable recognizes interest and penalties on income taxes as a component of income tax provision.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated utilizing net income as reported in the numerator and weighted average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options are adjusted in the denominator.

Employee Benefits

Pension and employee benefits include contributions, determined actuarially, to a defined benefit retirement plan covering the eligible employees of JSSB. The plan is funded on a current basis to the extent that it is deductible under existing federal tax regulations. Pension and other employee benefits also include contributions to a defined contribution Section 401(k) plan covering eligible employees. Contributions matching those made by eligible employees are funded throughout the year. In addition, an elective contribution may be made annually at the discretion of the board of directors for the employees of JSSB with no contributions made since 2015.

The M Group Products and Income Recognition

The M Group product line is comprised primarily of annuities, life insurance, and mutual funds. The revenues generated from life insurance sales are commission only, as The M Group does not underwrite the policies. Life insurance sales include permanent and term policies with the majority of the policies written being permanent. Term life insurance policies are written for 10, 15, 20, and 30 year terms with the majority of the policies being written for 20 years. None of these products are offered as an integral part of lending activities.

Commissions from the sale of annuities are recognized at the time notice is received from the third party broker/dealer or an insurance company that the transaction has been accepted and approved, which is also the time when

commission income is received.

Life insurance commissions are recognized at varying points based on the payment option chosen by the customer. Commissions from monthly and annual payment plans are recognized at the start of each annual period for the life insurance, while quarterly and semi-annual premium payments are recognized quarterly and semi-annually when the earnings process is complete. For example, semi-annual payments on the first of January and July would result in commission income recognition on the first of January and July, while payments on the first of January, April, July, and October would result in commission income recognition on those dates. The potential for chargebacks only exists for those policies on a monthly payment plan since income is recognized at the beginning of the annual coverage period versus at the time of each monthly payment. No liability is maintained for chargebacks as these are removed from income at the time of the occurrence.

Accumulated Other Comprehensive Income (Loss)

The Company is required to present accumulated other comprehensive income (loss) in a full set of general-purpose financial statements for all periods presented. Accumulated other comprehensive income (loss) is comprised of unrealized holding gains

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(losses) on the available for sale securities portfolio and the unrecognized components of net periodic benefit costs of the defined benefit pension plan.

Segment Reporting

The Company has determined that its only reportable segment is Community Banking.

Reclassification of Comparative Amounts

Certain items previously reported have been reclassified to conform to the current year’s reporting format. Such reclassifications did not affect net income or shareholders’ equity.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update’s core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this Update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Since the guidance scopes out revenue associated with financial instruments, including loan receivables and investment securities, we do not expect the adoption of the new standard, or any of the amendments, to result in a material change from our current accounting for revenue because the majority of the Company's revenue is not within the scope of Topic 606. However, we do expect that the standard will result in new disclosure requirements, which are currently being evaluated.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606). The amendments in this Update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is evaluating the effect of adopting this new accounting Update.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) 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; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred

tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. ASU 2016-01 will be effective for us on January 1, 2018 and will not have a significant impact on our financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease

payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a 1 percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.
In March 2016, the FASB issued ASU 2016-04, Liabilities - Extinguishments of Liabilities (Subtopic 405-20). The standard provides that liabilities related to the sale of prepaid stored-value products within the scope of this Update are financial liabilities. The amendments in the Update provide a narrow-scope exception to the guidance in Subtopic 405-20 to require that breakage for those liabilities be accounted for consistent with the breakage guidance in Topic 606. The amendments in this Update are effective for public business entities, certain not-for-profit entities, and certain employee benefit plans for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Earlier application is permitted, including adoption in an interim period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services (that are an output of the entity's ordinary activities) in exchange for consideration. The amendments in this Update do not change the core principle of the guidance in Topic 606; they simply clarify the implementation guidance on principal versus agent considerations. The amendments in this Update are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements of Update 2014-09. ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services in exchange for consideration. The amendments in this Update do not change the core principle for revenue recognition in Topic 606. Instead, the amendments provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The amendments are expected to reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the potential for diversity arising in practice and reduce the cost and complexity of applying the guidance. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606), which among other things clarifies the objective of the collectability criterion in Topic 606, as well as certain narrow aspects of Topic 606. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. This Update is not expected to have a significant impact on the Company's financial statements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the

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remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses eight specific cash flow issues with the objective of reducing diversity in practice. Among these include recognizing cash payments for debt prepayment or debt extinguishment as cash outflows for financing activities; cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage; and cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash inflows from investing activities while the cash payments for premiums on bank-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments in this Update should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s statement of cash flows.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740), which requires recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset (excluding inventory) when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those annual reporting periods. For all other entities, the amendments are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. That is, earlier adoption should be in the first interim period if an entity issues interim financial statements. The amendments in this Update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. This update is not expected to have a significant impact on the Company's financial statements.

In October 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), which requires that a statement of cash flows explains the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is

permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in this Update should be applied using a retrospective transition method to each period presented. The Company is currently evaluating the impact the adoption of the standard will have on the Company's statement of cash flows.

In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. This Update, among others things, clarifies that guarantee fees within the scope of Topic 460, Guarantees, (other than product or service warranties) are not within the scope of Topic 606. The effective date and transition requirements for ASU 2016-20 are the same as the effective date and transition requirements for the new revenue recognition guidance. For public entities with a calendar year-end, the new guidance is effective in the quarter and year beginning January 1, 2018. For all other entities with a calendar year-end, the new guidance is effective in the year ending December 31, 2019, and interim periods in 2020. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

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In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business, which provides a more robust framework to use in determining when a set of assets and activities (collectively referred to as a “set”) is a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. All other entities should apply the amendments to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied prospectively on or after the effective date. This Update is not expected to have a significant impact on the Company’s financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the FASB eliminated Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting units fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A public business entity that is a U.S. Securities and Exchange Commission ("SEC") filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. A public business entity that is not an SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2020. All other entities, including not-for-profit entities, that are adopting the amendments in this Update should do so for their annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. This Update is not expected to have a significant impact on the Company’s financial statements.

In February 2017, the FASB issued ASU 2017-05, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20). The amendments in this Update clarify what constitutes a financial asset within the scope of Subtopic 610-20. The amendments also clarify that entities should identify each distinct nonfinancial asset or in substance nonfinancial asset that is promised to a counterparty and to derecognize each asset when the counterparty obtains control. There is also additional guidance provided for partial sales of a nonfinancial asset and when derecognition, and the related gain or loss, should be recognized. The amendments in this Update are effective at the same time as the amendments in Update 2014-09. Therefore, for public entities, the amendments are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. For all other entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. This Update is not expected to have a significant impact on the Company’s financial statements.

In February 2017, the FASB issued ASU 2017-06, Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), and Health and Welfare Benefit Plans (Topic 965). This Update relates primarily to the reporting by an employee benefit plan for its interest in a master trust, which is a trust for which a regulated financial institution serves as a trustee or custodian and in which assets of more than one plan sponsored by a single employer or by a group of employers under common control are held. For each master trust in which a plan holds an interest, the amendments in this Update require a plan's interest in that master trust and any change in that interest to be presented in separate line items in the statement of net assets available for benefits and in the statement of changes in net assets available for benefits, respectively. The amendments in this Update remove the

requirement to disclose the percentage interest in the master trust for plans with divided interests and require that all plans disclose the dollar amount of their interest in each of those general types of investments, which supplements the existing requirement to disclose the master trusts balances in each general type of investments. There are also increased disclosure requirements for investments in master trusts. The amendments in this Update are effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation-Retirement Benefits (Topic 715). The amendments in this Update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in this Update are effective for public business entities for annual periods beginning after December 15, 2017,

including interim periods within those annual periods. For other entities, the amendments in this Update are effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20). The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718), which affects any entity that changes the terms or conditions of a share-based payment award. This Update amends the definition of modification by qualifying that modification accounting does not apply to changes to outstanding share-based payment awards that do not affect the total fair value, vesting requirements, or equity/liability classification of the awards. The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for (1) public business entities for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. This Update is not expected to have a significant impact on the Company's financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), and Derivative and Hedging (Topic 815). The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down-round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down-round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down-round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to recognize the effect of the down-round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common shareholders in basic EPS. Convertible instruments with embedded conversion options that have down- round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt-Debt with Conversion and Other Options), including related EPS guidance (in Topic 260). The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Accounting Standards Codification, to a scope exception. Those amendments do not have an accounting effect. For public

business entities, the amendments in Part I of this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments in Part I of this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in Part I of this Update should be applied either retrospectively to outstanding financial instruments with a down-round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first fiscal year and interim period(s) in which the pending content that links to this paragraph is effective or retrospectively to outstanding financial instruments with a down-round feature for each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10. The amendments in Part II of this Update do not require any transition guidance because those amendments do not have an accounting effect. This Update is not expected to have a significant impact on the Company's financial statements.

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In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 850), the objective of which is to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, the amendments in this Update make certain targeted improvements to simplify the application and disclosure of the hedge accounting guidance in current general accepted accounting principles. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods beginning after December 15, 2020. Early application is permitted in any period after issuance. For cash flow and net investment hedges existing at the date of adoption, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year that an entity adopts the amendments in this Update. The amended presentation and disclosure guidance is required only prospectively. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842), which provides an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current lease guidance in Topic 840. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date the entity adopts Topic 842; otherwise, an entity should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in ASU 2016-02. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which gave entities the option to reclassify tax effects stranded in accumulated other comprehensive income (loss) as a result of the recent tax reform, to retained earnings (accumulated deficit). The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted for reporting periods for which financial statements have not yet been issued or made available for issuance. The Company has elected to early adopt this standard and has chosen to apply this adjustment in 2017. As a result, the Company reclassified $809,000 and $9,000 of tax liability from accumulated other comprehensive income to retained earnings, the adjusted line items are defined benefit plan and net unrealized loss on available for sale securities, respectively, and are reflected in the accompanying consolidated financial statements.

NOTE 2 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in accumulated other comprehensive income (loss) by component shown, net of tax and parenthesis indicating debits to net income, as of December 31, 2017, 2016, and 2015 were as follows:

	Twelve Months Ended December 31, 2017			Twelve Months Ended December 31, 2016			Twelve Months Ended December 31, 2015		
(In Thousands)	Net Unrealized Gain(Loss) on Available for Sale Securities	Defined Benefit Plan	Total	Net Unrealized Gain (Loss) on Available for Sale Securities*	Defined Benefit Plan*	Total*	Net Unrealized Gain (Loss) on Available for Sale Securities*	Defined Benefit Plan*	Total*
Beginning balance *	$(639)	$(4,289)	$(4,928)	$258	$(4,057)	$(3,799)	$2,930	$(4,597)	$(1,667)
	990	63	1,053	167	(333)	(166)	(962)	435	(527)

Other comprehensive income (loss) before reclassifications *									
Amounts reclassified from accumulated other comprehensive (loss) income *	(396)	115	(281)	(1,064)	101	(963)	(1,710)	105	(1,605)
Net current-period other comprehensive income (loss)*	594	178	772	(897)	(232)	(1,129)	(2,672)	540	(2,132)
Reclassification of certain income tax effects from accumulated other comprehensive loss	(9)	(809)	(818)	—	—	—	—	—	—
Ending balance	$(54)	$(4,920)	$(4,974)	$(639)	$(4,289)	$(4,928)	$258	$(4,057)	$(3,799)

* Amounts net of 34% tax rate

The preceding table includes current guidance issued related to Income Statement- Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("ASU 2018-02"). The Company has

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elected to reclassify the portion in accumulated other comprehensive income (AOCI) that would have been otherwise stranded. Amounts were reclassified for both components included in AOCI and their ending balance as of December 31, 2017 is net of tax at the 21% corporate tax rate.

The reclassifications out of accumulated other comprehensive income shown, net of tax and parenthesis indicating debits to net income, as of December 31, 2017, 2016, and 2015 were as follows:

(In Thousands)	Amount Reclassified from Accumulated Other Comprehensive Income			
Details about Accumulated Other Comprehensive Income Components	Twelve Months Ended			Affected Line Item in the Consolidated Statement of Income
	December 31, 2017	December 31, 2016	December 31, 2015	
Net realized gain on available for sale securities	600	$ 1,611	$ 2,592	Securities gains, net
Income tax effect	(204)	(547)	(882)	Income tax provision
	$ 396	1,064	1,710	
Net unrecognized pension costs	(174)	(153)	(159)	Salaries and employee benefits
Income tax effect	59	52	54	Income tax provision
	$ (115)	$ (101)	$ (105)	

NOTE 3 - PER SHARE DATA

There are no convertible securities which would affect the denominator in calculating basic and dilutive earnings per share; therefore, net income as presented on the consolidated statement of income will be used as the numerator. The following table sets forth the composition of the weighted average common shares (denominator) used in the basic and dilutive per share computation.

	Year Ended December 31,		
	2017	2016	2015
Weighted average common shares issued	5,008,073	5,005,971	5,003,691
Average treasury stock shares	(302,471)	(270,514)	(231,452)
Weighted average common shares used to calculate basic and diluted earnings per share	4,705,602	4,735,457	4,772,239

There were a total of 93,500 non-qualified employee stock options (Note 14) outstanding on December 31, 2017 that had a weighted average strike price of $43.59. Options on December 31, 2016 had an average strike price of $42.03 with a total of 26,500 options outstanding. Grants outstanding at year-end 2015 totaled to 34,750 options with an average strike price of $42.03. These options were excluded, on a weighted average basis, in the computation of diluted earnings per share for all periods presented due to the average market price of common shares being less than the strike price of the options.

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NOTE 4 - INVESTMENT SECURITIES

The amortized cost, gross gains and losses, and fair values of investment securities at December 31, 2017 and 2016 are as follows:

	2017			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale (AFS):				
Mortgage-backed securities	$4,273	$ 51	$ (111)	$4,213
Asset-backed securities	—	—	—	—
State and political securities	56,295	411	(198)	56,508
Other debt securities	48,807	180	(1,080)	47,907
Total debt securities	109,375	642	(1,389)	108,628
Financial institution equity securities	13,868	728	—	14,596
Other equity securities	1,300	—	(49)	1,251
Total equity securities	15,168	728	(49)	15,847
Total investment securities AFS	$124,543	$ 1,370	$ (1,438)	$124,475

	2016			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale (AFS):				
Mortgage-backed securities	$9,295	$ 182	$ (164)	$9,313
Asset-backed securities	109	—	—	109
State and political securities	60,777	666	(509)	60,934
Other debt securities	53,046	137	(2,065)	51,118
Total debt securities	123,227	985	(2,738)	121,474
Financial institution equity securities	9,566	969	—	10,535
Other equity securities	1,667	—	(184)	1,483
Total equity securities	11,233	969	(184)	12,018
Total investment securities AFS	$134,460	$ 1,954	$ (2,922)	$133,492

The amortized cost and fair values of trading investment securities at December 31, 2017 and 2016 are as follows.

	2017			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trading:				
Financial institution equity securities	$20	$ —	$ —	$ 20
Other equity securities	192	2	(24)	170
Total trading securities	$212	$ 2	$ (24)	$ 190

	2016			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trading:				

Financial institution equity securities	$—	$ —	$ —	$ —
Other equity securities	56	2	—	58
Total trading securities	$56	$ 2	$ —	$ 58

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The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2017 and 2016.

	2017					
	Less than Twelve Months		Twelve Months or Greater		Total	
(In Thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for Sale (AFS)						
Mortgage-backed securities	$981	$ (12)	$ 2,276	$ (99)	$3,257	$ (111)
State and political securities	15,691	(104)	3,018	(94)	18,709	(198)
Other debt securities	7,512	(148)	28,517	(932)	36,029	(1,080)
Total debt securities	24,184	(264)	33,811	(1,125)	57,995	(1,389)
Other equity securities	1,251	(49)	—	—	1,251	(49)
Total equity securities	1,251	(49)	—	—	1,251	(49)
Total Investment Securities AFS	$25,435	$ (313)	$ 33,811	$ (1,125)	$59,246	$ (1,438)

	2016					
	Less than Twelve Months		Twelve Months or Greater		Total	
(In Thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for Sale (AFS)						
Mortgage-backed securities	$3,572	$ (106)	$ 3,627	$ (58)	$7,199	$ (164)
State and political securities	26,113	(509)	—	—	26,113	(509)
Other debt securities	28,140	(1,179)	12,240	(886)	40,380	(2,065)
Total debt securities	57,825	(1,794)	15,867	(944)	73,692	(2,738)
Other equity securities	727	(140)	756	(44)	1,483	(184)
Total equity securities	727	(140)	756	(44)	1,483	(184)
Total Investment Securities AFS	$58,552	$ (1,934)	$ 16,623	$ (988)	$75,175	$ (2,922)

At December 31, 2017 there were 37 individual securities in a continuous unrealized loss position for less than twelve months and 22 individual securities in a continuous unrealized loss position for greater than twelve months.

The Company reviews its position quarterly and has asserted that at December 31, 2017 and 2016, the declines outlined in the above table represent temporary declines and the Company does not intend to sell and does not believe they will be required to sell these securities before recovery of their cost basis, which may be at maturity. The Company has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

The amortized cost and fair value of debt securities at December 31, 2017, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities since borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In Thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 4,696	$4,684
Due after one year to five years	43,748	43,609
Due after five years to ten years	49,777	49,063

Due after ten years	11,154	11,272
Total	$ 109,375	$ 108,628

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Total gross proceeds from sales of securities available for sale were $25,528,000, $44,829,000, and $65,672,000 for 2017, 2016, and 2015, respectively. The following table represents gross realized gains and losses on those transactions:

	Year Ended December 31,		
(In Thousands)	2017	2016	2015
Gross realized gains:			
U.S. Government and agency securities	$ —	$ 11	$ —
Mortgage-backed securities	69	35	—
State and political securities	408	787	1,571
Other debt securities	53	283	825
Financial institution equity securities	288	572	183
Other equity securities	—	217	132
Total gross realized gains	$ 818	$ 1,905	$ 2,711
Gross realized losses:			
U.S. Government and agency securities	$ —	$ 5	$ —
Asset-backed securities	—	13	—
State and political securities	18	1	22
Other debt securities	51	189	54
Financial institution equity securities	—	—	—
Other equity securities	149	86	43
Total gross realized losses	$ 218	$ 294	$ 119

There were no impairment charges included in gross realized losses for the years ended December 31, 2017, 2016, and 2015.

Investment securities with a carrying value of approximately $89,736,000 and $95,199,000 at December 31, 2017 and 2016, respectively, were pledged to secure certain deposits, repurchase agreements, and for other purposes as required by law.

There is no concentration of investments that exceed ten percent of shareholders' equity for any individual issuer, excluding those guaranteed by the U.S. Government.

NOTE 5 - FEDERAL HOME LOAN BANK STOCK

The Banks are members of the Federal Home Loan Bank ("FHLB") of Pittsburgh and as such, are required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for impairment as necessary. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB.

Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. Management considered that the FHLB maintains regulatory capital ratios in excess of all regulatory capital requirements, liquidity appears adequate, new shares of FHLB stock continue to change hands at the $100 par value, and the payment of dividends.

NOTE 6 - LOAN CREDIT QUALITY AND RELATED ALLOWANCE FOR LOAN LOSSES

Management segments the Banks' loan portfolio to a level that enables risk and performance monitoring according to similar risk characteristics. Loans are segmented based on the underlying collateral characteristics. Categories include commercial, financial,
and agricultural, real estate, and installment loans to individuals. Real estate loans are further segmented into three categories: residential, commercial, and construction.

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The following table presents the related aging categories of loans, by segment, as of December 31, 2017 and 2016:

2017					
(In Thousands)	Current	Past Due 30 To 89 Days	Past Due 90 Days Or More & Still Accruing	Non-Accrual	Total
Commercial, financial, and agricultural	$178,022	$ 663	$ 86	$ 114	$178,885
Real estate mortgage:					
Residential	588,278	6,853	318	1,628	597,077
Commercial	325,148	1,823	80	4,968	332,019
Construction	31,547	116	20	—	31,683
Installment loans to individuals	106,335	289	5	49	106,678
	1,229,330	$ 9,744	$ 509	$ 6,759	1,246,342
Net deferred loan fees and discounts	272				272
Allowance for loan losses	(12,858)				(12,858)
Loans, net	$1,216,744				$1,233,756

2016					
(In Thousands)	Current	Past Due 30 To 89 Days	Past Due 90 Days Or More & Still Accruing	Non-Accrual	Total
Commercial, financial, and agricultural	$145,179	$785	$ 14	$ 132	$146,110
Real estate mortgage:					
Residential	553,053	9,112	587	1,988	564,740
Commercial	296,537	786	268	8,591	306,182
Construction	33,879	771	—	—	34,650
Installment loans to individuals	43,008	202	1	45	43,256
	1,071,656	$11,656	$ 870	$ 10,756	1,094,938
Net deferred loan fees and discounts	(1,257)				(1,257)
Allowance for loan losses	(12,896)				(12,896)
Loans, net	$1,057,503				$1,080,785

Purchased loans acquired are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

Upon acquisition, the Company evaluated whether each acquired loan (regardless of size) was within the scope of ASC 310-30. Purchased credit-impaired loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. The fair value of purchased credit-impaired loans, on the acquisition date, was determined primarily based on the fair value of loan collateral.

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The following table presents the interest income if interest had been recorded based on the original loan agreement terms and rate of interest for non-accrual loans and interest income recognized on a cash basis for non-accrual loans as of December 31, 2017, 2016, and 2015:

	Year Ended December 31,					
	2017		2016		2015	
(In Thousands)	Interest Income That Would Have Been Recorded Based on Original Term and Rate	Interest Income Recorded on a Cash Basis	Interest Income That Would Have Been Recorded Based on Original Term and Rate	Interest Income Recorded on a Cash Basis	Interest Income That Would Have Been Recorded Based on Original Term and Rate	Interest Income Recorded on a Cash Basis
Commercial, financial, and agricultural	$23	$ 15	$ 6	$ —	$ 48	$ 53
Real estate mortgage:						
Residential	147	98	151	101	53	38
Commercial	390	238	496	105	281	54
Construction	—	—	—	—	16	—
Installment loans to individuals	5	3	3	2	—	—
	$565	$ 354	$ 656	$ 208	$ 398	$ 145

Impaired Loans

Impaired loans are loans for which it is probable the Banks will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Banks individually evaluate such loans for impairment and do not aggregate loans by major risk classifications. The definition of "impaired loans" is not the same as the definition of "non-accrual loans," although the two categories overlap. The Banks may choose to place a loan on non-accrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loan. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than $100,000 and if the loan is either on non-accrual status or has a risk rating of substandard or worse. Management may also elect to measure an individual loan for impairment if less than $100,000 on a case by case basis.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively with the exception of loans identified as troubled debt restructurings. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed. Interest income for impaired loans is recorded consistent to the Banks' policy on non-accrual loans.

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The following table presents the recorded investment, unpaid principal balance, and related allowance of impaired loans by segment as of December 31, 2017 and 2016:

	2017		
(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial, financial, and agricultural	$1,033	$1,033	$ —
Real estate mortgage:			
Residential	1,428	1,428	—
Commercial	1,465	1,465	—
Construction	—	—	—
	3,926	3,926	—
With an allowance recorded:			
Commercial, financial, and agricultural	235	235	96
Real estate mortgage:			
Residential	2,304	2,353	367
Commercial	7,981	8,031	1,721
Construction	—	—	—
	10,520	10,619	2,184
Total:			
Commercial, financial, and agricultural	1,268	1,268	96
Real estate mortgage:			
Residential	3,732	3,781	367
Commercial	9,446	9,496	1,721
Construction	—	—	—
	$14,446	$14,545	$ 2,184

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(In Thousands)	2016 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial, financial, and agricultural	$109	$ 109	$ —
Real estate mortgage:			
Residential	1,584	1,584	—
Commercial	1,833	1,833	—
Construction	—	—	—
	3,526	3,526	—
With an allowance recorded:			
Commercial, financial, and agricultural	132	132	74
Real estate mortgage:			
Residential	1,893	1,893	437
Commercial	10,425	10,520	1,668
Construction	—	—	—
	12,450	12,545	2,179
Total:			
Commercial, financial, and agricultural	241	241	74
Real estate mortgage:			
Residential	3,477	3,477	437
Commercial	12,258	12,353	1,668
Construction	—	—	—
	$15,976	$ 16,071	$ 2,179

The following table presents the average recorded investment in impaired loans and related interest income recognized for December 31, 2017, 2016, and 2015:

(In Thousands)	2017 Average Investment in Impaired Loans	Interest Income Recognized on an Accrual Basis on Impaired Loans	Interest Income Recognized on a Cash Basis on Impaired Loans
Commercial, financial, and agricultural	$727	$ 41	$ 7
Real estate mortgage:			
Residential	3,233	75	91
Commercial	11,551	186	233
Construction	—	—	—
Installment loans to individuals	5	—	1
	$15,516	$ 302	$ 332

(In Thousands)	2016 Average Investment in Impaired Loans	Interest Income Recognized on an Accrual Basis on Impaired Loans	Interest Income Recognized on a Cash Basis on Impaired Loans
Commercial, financial, and agricultural	$400	$ 16	$ 1
Real estate mortgage:			
Residential	3,471	89	101
Commercial	12,887	187	110
Construction	138	—	—

$16,896	$ 292	$ 212

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(In Thousands)	2015 Average Investment in Impaired Loans	Interest Income Recognized on an Accrual Basis on Impaired Loans	Interest Income Recognized on a Cash Basis on Impaired Loans
Commercial, financial, and agricultural	$1,031	$ 21	$ 10
Real estate mortgage:			
Residential			