AMERISERV FINANCIAL INC /PA/
Form 10-Q
May 09, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x	**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934** For the period ended March 31, 2014
o	**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934** For the transition period from to

Commission File Number 0-11204

AmeriServ Financial, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	25-1424278 (I.R.S. Employer Identification No.)
Main & Franklin Streets, P.O. Box 430, Johnstown, PA (Address of principal executive offices)	15907-0430 (Zip Code)

Registrant s telephone number, including area code **(814) 533-5300**

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. x Yes o No

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

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

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

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

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 May 1, 2014
Common Stock, par value $0.01	18,794,888

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AmeriServ Financial, Inc.

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Item 1. Financial Statements

AmeriServ Financial, Inc.

CONSOLIDATED BALANCE SHEETS
(In thousands except shares)
(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS		
Cash and due from depository institutions	$20,850	$20,288
Interest bearing deposits	2,968	2,967
Short-term investments in money market funds	6,051	6,811
Total cash and cash equivalents	29,869	30,066
Investment securities:		
Available for sale	136,746	141,978
Held to maturity (fair value $17,870 on March 31, 2014 and $17,788 on December 31, 2013)	18,008	18,187
Loans held for sale	2,808	3,402
Loans	787,401	783,927
Less: Unearned income	589	581
Allowance for loan losses	10,109	10,104
Net loans	776,703	773,242
Premises and equipment, net	13,056	13,119
Accrued interest income receivable	3,199	2,908
Goodwill	12,613	12,613
Bank owned life insurance	36,856	36,669
Net deferred tax asset	9,142	9,572
Federal Home Loan Bank stock	3,534	4,677
Federal Reserve Bank stock	2,125	2,125
Other assets	6,449	7,478
TOTAL ASSETS	$1,051,108	$1,056,036
LIABILITIES		
Non-interest bearing deposits	$157,616	$154,002
Interest bearing deposits	717,717	700,520
Total deposits	875,333	854,522
Short-term borrowings	12,483	41,555
Advances from Federal Home Loan Bank	28,000	25,000
Guaranteed junior subordinated deferrable interest debentures	13,085	13,085
Total borrowed funds	53,568	79,640
Other liabilities	7,617	8,567

TOTAL LIABILITIES	936,518	942,729
SHAREHOLDERS EQUITY		
Preferred stock, no par value; $1,000 per share liquidation preference; 2,000,000 shares authorized; 21,000 shares issued and outstanding on March 31, 2014 and December 31, 2013	21,000	21,000
Common stock, par value $0.01 per share; 30,000,000 shares authorized; 26,412,707 shares issued and 18,794,888 outstanding on March 31, 2014; 26,402,007 shares issued and 18,784,188 outstanding on December 31, 2013	264	264
Treasury stock at cost, 7,617,819 shares on March 31, 2014 and December 31, 2013	(74,829)	(74,829)
Capital surplus	145,222	145,190
Retained earnings	28,247	27,557
Accumulated other comprehensive loss, net	(5,314)	(5,875)
TOTAL SHAREHOLDERS EQUITY	114,590	113,307
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$1,051,108	$1,056,036

See accompanying notes to unaudited consolidated financial statements.

AmeriServ Financial, Inc. CONSOLIDATED BALANCE SHEETS(In thousands except shares) (Unaudited) 6

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except per share data) (Unaudited)

	Three months ended March 31,	
	2014	2013
INTEREST INCOME		
Interest and fees on loans	$9,032	$8,628
Interest bearing deposits	1	1
Short-term investments in money market funds	2	2
Investment securities:		
Available for sale	924	956
Held to maturity	136	115
Total Interest Income	10,095	9,702
INTEREST EXPENSE		
Deposits	1,211	1,350
Short-term borrowings	19	5
Advances from Federal Home Loan Bank	60	25
Guaranteed junior subordinated deferrable interest debentures	280	280
Total Interest Expense	1,570	1,660
NET INTEREST INCOME	8,525	8,042
Provision (credit) for loan losses		(250)
NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES	8,525	8,292
NON-INTEREST INCOME		
Trust fees	1,863	1,667
Investment advisory fees	169	214
Net realized gains on investment securities	57	71
Net gains on sale of loans	101	386
Service charges on deposit accounts	478	511
Bank owned life insurance	187	201
Other income	677	766
Total Non-Interest Income	3,532	3,816
NON-INTEREST EXPENSE		
Salaries and employee benefits	6,314	6,331
Net occupancy expense	839	773
Equipment expense	470	455
Professional fees	1,308	1,035
Supplies, postage and freight	183	211
Miscellaneous taxes and insurance	296	376
Federal deposit insurance expense	160	134

Other expense	1,168	1,307
Total Non-Interest Expense	10,738	10,622
PRETAX INCOME	1,319	1,486
Provision for income tax expense	389	430
NET INCOME	930	1,056
Preferred stock dividends	53	52
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$877	$1,004
PER COMMON SHARE DATA:		
Basic:		
Net income	$0.05	$0.05
Average number of shares outstanding	18,786	19,168
Diluted:		
Net income	$0.05	$0.05
Average number of shares outstanding	18,904	19,257
Cash dividends declared	$0.01	$0.00

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
COMPREHENSIVE INCOME		
Net income	$930	$1,056
Other comprehensive income (loss), before tax:		
Pension obligation change for defined benefit plan	392	489
Income tax effect	(133)	(166)
Unrealized holding gains (losses) on available for sale securities arising during period	514	(484)
Income tax effect	(175)	164
Reclassification adjustment for gains on available for sale securities included in net income	(57)	(71)
Income tax effect	20	24
Other comprehensive income (loss)	561	(44)
Comprehensive income	$1,491	$1,012

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three months ended March 31, 2014	2013
OPERATING ACTIVITIES		
Net income	$930	$1,056
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses		(250)
Depreciation expense	457	386
Net amortization of investment securities	96	226
Net realized gains on investment securities available for sale	(57)	(71)
Net gains on loans held for sale	(101)	(386)
Amortization of deferred loan fees	(75)	(82)
Origination of mortgage loans held for sale	(6,109)	(16,288)
Sales of mortgage loans held for sale	6,804	23,309
Increase in accrued interest income receivable	(291)	(345)
Decrease in accrued interest payable	(186)	(338)
Earnings on bank owned life insurance	(187)	(201)
Deferred income taxes	141	401
Stock based compensation expense	32	17
Decrease in prepaid Federal Deposit Insurance		120
Other, net	699	(736)
Net cash provided by operating activities	2,153	6,818
INVESTING ACTIVITIES		
Purchases of investment securities available for sale	(2,520)	(10,170)
Purchases of investment securities held to maturity	(151)	(3,423)
Proceeds from sales of investment securities available for sale	2,753	1,218
Proceeds from maturities of investment securities available for sale	5,428	13,305
Proceeds from maturities of investment securities held to maturity	321	755
Purchases of regulatory stock	(1,830)	
Proceeds from redemption of regulatory stock	2,973	614
Long-term loans originated	(37,426)	(34,833)
Principal collected on long-term loans	34,040	42,737
Loans purchased or participated		(3,000)
Loans sold or participated		1,000
Proceeds from sale of other real estate owned		113
Purchases of premises and equipment	(389)	(1,146)
Net cash provided by investing activities	3,199	7,170

FINANCING ACTIVITIES		
Net increase in deposit balances	20,763	11,460
Net decrease in other short-term borrowings	(29,072)	(15,660)
Principal borrowings on advances from Federal Home Loan Bank	3,000	9,000
Principal repayments on advances from Federal Home Loan Bank		(6,000)
Common stock dividends	(187)	
Preferred stock dividends	(53)	(52)
Net cash used in financing activities	(5,549)	(1,252)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(197)	12,736
CASH AND CASH EQUIVALENTS AT JANUARY 1	30,066	26,820
CASH AND CASH EQUIVALENTS AT MARCH 31	$29,869	$39,556

See accompanying notes to unaudited consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (the Bank), AmeriServ Trust and Financial Services Company (the Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a Pennsylvania state-chartered full service bank with 17 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at $1.7 billion that are not reported on the Company s balance sheet at March 31, 2014. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

In addition, the Parent Company is an administrative group that provides support in such areas as audit, finance, investments, loan review, general services, and marketing. Significant intercompany accounts and transactions have been eliminated in preparing the consolidated financial statements.

2. Basis of Preparation

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting of normal recurring entries considered necessary for a fair presentation have been included. They are not, however, necessarily indicative of the results of consolidated operations for a full-year.

For further information, refer to the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

3. Accounting Policies

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU did not have a significant impact on the Company s financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. Accounting Policies (continued)

recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. This ASU is not expected to have a significant impact on the Company s financial statements.

4. Earnings Per Common Share

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options to purchase 8,625 common shares, at exercise prices ranging from $4.60 to $5.75, and 103,570 common shares, at exercise prices ranging from $3.23 to $5.75, were outstanding as of March 31, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends on preferred shares are deducted from net income in the calculation of earnings per common share.

	Three months ended March 31,	
	2014	2013
	(In thousands, except per share data)	
Numerator:		
Net income	$ 930	$ 1,056
Preferred stock dividends	53	52
Net income available to common shareholders	$ 877	$ 1,004
Denominator:		
Weighted average common shares outstanding (basic)	18,786	19,168
Effect of stock options	118	89
Weighted average common shares outstanding (diluted)	18,904	19,257
Earnings per common share:		
Basic	$ 0.05	$ 0.05
Diluted	0.05	0.05

5. Consolidated Statement of Cash Flows

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits, federal funds sold and short-term investments in money market funds. The Company made $254,000 in income tax payments in the first three months of 2014 as compared to $27,000 for the first three months of 2013. The

Company made total interest payments of $1,756,000 in the first three months of 2014 compared to $1,998,000 in the same 2013 period. The Company had no non-cash transfers to other real estate owned (OREO) in the first three months of 2014 compared to $71,000 in the same 2013 period.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities

The cost basis and fair values of investment securities are summarized as follows (in thousands):

Investment securities available for sale (AFS):

	March 31, 2014			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,927	$ 42	$ (90)	$ 6,879
US Agency mortgage-backed securities	115,789	3,099	(861)	118,027
Corporate bonds	11,993	49	(202)	11,840
Total	$ 134,709	$ 3,190	$ (1,153)	$ 136,746

Investment securities held to maturity (HTM):

	March 31, 2014			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage-backed securities	$ 12,341	$ 309	$ (343)	$ 12,307
Taxable municipal	1,672	24	(75)	1,621
Corporate bonds and other securities	3,995		(53)	3,942
Total	$ 18,008	$ 333	$ (471)	$ 17,870

Investment securities available for sale (AFS):

	December 31, 2013			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,926	$ 35	$ (126)	$ 6,835
US Agency mortgage-backed securities	121,480	3,129	(1,227)	123,382
Corporate bonds	11,992	21	(252)	11,761
Total	$ 140,398	$ 3,185	$ (1,605)	$ 141,978

Investment securities held to maturity (HTM):

	December 31, 2013			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage-backed securities	$ 12,671	$ 289	$ (477)	$ 12,483
Taxable municipal	1,521		(120)	1,401
Corporate bonds and other securities	3,995		(91)	3,904
Total	$ 18,187	$ 289	$ (688)	$ 17,788

Maintaining investment quality is a primary objective of the Company s investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody s Investor s Service or Standard & Poor s rating of A. At March 31, 2014, 88.4% of the portfolio was rated AAA as compared to 89.0% at December 31, 2013. 2.0% of the portfolio was either rated below A or unrated at March 31, 2014. The Company has no exposure to subprime mortgage loans in the investment portfolio. At March 31, 2014, the Company s consolidated investment securities portfolio had an effective duration of approximately 3.23 years.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities (continued)

Total proceeds from the sale of AFS securities for the first three months of 2014 were $2.8 million resulting in $62,000 of gross investment security gains and $5,000 of gross security losses. Total proceeds from the sale of AFS securities for the first three months of 2013 were $1.2 million resulting in $71,000 of gross investment security gains.

The book value of securities, both available for sale and held to maturity, pledged to secure public and trust deposits, and certain Federal Home Loan Bank borrowings was $113,957,000 at March 31, 2014 and $110,780,000 at December 31, 2013.

The following tables present information concerning investments with unrealized losses as of March 31, 2014 and December 31, 2013 (in thousands):

Investment securities available for sale:

	March 31, 2014					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency	$2,910	$ (40)	$950	$ (50)	$3,860	$ (90)
US Agency mortgage-backed securities	33,850	(861)			33,850	(861)
Corporate bonds	3,932	(68)	3,864	(134)	7,796	(202)
Total	$40,692	$ (969)	$4,814	$ (184)	$45,506	$ (1,153)

Investment securities held to maturity:

	March 31, 2014					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency mortgage-backed securities	$5,535	$ (233)	$1,641	$ (110)	$7,176	$ (343)
Taxable municipal	1,088	(75)			1,088	(75)
Corporate bonds and other securities	2,952	(43)	990	(10)	3,942	(53)
Total	$9,575	$ (351)	$2,631	$ (120)	$12,206	$ (471)

Investment securities available for sale:

	December 31, 2013					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency	$3,812	$(64)	$938	$(62)	$4,750	$(126)
US Agency mortgage-backed securities	43,402	(1,224)	669	(3)	44,071	(1,227)
Corporate bonds	6,777	(215)	1,963	(37)	8,740	(252)
Total	$53,991	$(1,503)	$3,570	$(102)	$57,561	$(1,605)

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities (continued)

Investment securities held to maturity:

	December 31, 2013					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency mortgage-backed securities	$ 8,761	$ (477)	$	$	$ 8,761	$ (477)
Corporate bonds and other securities	3,801	(205)	994	(6)	4,795	(211)
Total	$ 12,562	$ (682)	$ 994	$ (6)	$ 13,556	$ (688)

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 50 positions that are considered temporarily impaired at March 31, 2014. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

Contractual maturities of securities at March 31, 2014 are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Investment securities available for sale:

	March 31, 2014			
Cost Basis	US Agency	US Agency Mortgage-Backed Securities	Corporate Bonds	Total Investment Securities Available For Sale
After 1 year but within 5 years	$ 5,927	$ 1,875	$ 6,995	$ 14,797
After 5 years but within 10 years	1,000	10,320	4,998	16,318
After 10 years but within 15 years		61,560		61,560
Over 15 years		42,034		42,034
Total	$ 6,927	$ 115,789	$ 11,993	$ 134,709

	March 31, 2014			
Fair Value	US Agency	US Agency Mortgage-Backed Securities	Corporate Bonds	Total Investment Securities Available For Sale
After 1 year but within 5 years	$5,928	$ 1,990	$6,998	$14,916
After 5 years but within 10 years	951	10,593	4,842	16,386
After 10 years but within 15 years		62,271		62,271
Over 15 years		43,173		43,173
Total	$6,879	$ 118,027	$11,840	$136,746

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities (continued)

Investment securities held to maturity:

	March 31, 2014		
Cost Basis	US Agency Mortgage-Backed Securities	Corporate Bonds and Other Securities	Total Investment Securities Held To Maturity
Within 1 year	$	$	$
After 1 year but within 5 years		3,000	3,000
After 5 years but within 10 years	1,751	151	1,902
After 10 years but within 15 years		1,011	1,011
Over 15 years	10,590	1,505	12,095
Total	$ 12,341	$ 5,667	$ 18,008

	March 31, 2014		
Fair Value	US Agency Mortgage-Backed Securities	Corporate Bonds and Other Securities	Total Investment Securities Held To Maturity
Within 1 year	$	$	$
After 1 year but within 5 years		2,960	2,960
After 5 years but within 10 years	1,641	144	1,785
After 10 years but within 15 years		943	943
Over 15 years	10,666	1,516	12,182
Total	$ 12,307	$ 5,563	$ 17,870

7. Loans

The loan portfolio of the Company consists of the following (in thousands):

	March 31, 2014	December 31, 2013
Commercial	$ 125,854	$ 120,102
Commercial loans secured by real estate	405,103	411,691
Real estate mortgage	239,545	235,689

Consumer	16,310	15,864
Loans, net of unearned income	$ 786,812	$ 783,346

Loan balances at March 31, 2014 and December 31, 2013 are net of unearned income of $589,000 and $581,000, respectively. Real estate-construction loans comprised 1.9% and 3.0% of total loans, net of unearned income at March 31, 2014 and December 31, 2013, respectively.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three month periods ending March 31, 2014 and 2013 (in thousands).

	Three months ended March 31, 2014				
	Balance at December 31, 2013	Charge-Offs	Recoveries	Provision (Credit)	Balance at March 31, 2014
Commercial	$ 2,844	$ (72)	$ 50	$ 243	$ 3,065
Commercial loans secured by real estate	4,885	(66)	153	(310)	4,662
Real estate-mortgage	1,260	(43)	14	42	1,273
Consumer	136	(36)	5	34	139
Allocation for general risk	979			(9)	970
Total	$ 10,104	$ (217)	$ 222	$	$ 10,109

	Three months ended March 31, 2013				
	Balance at December 31, 2012	Charge-Offs	Recoveries	Provision (Credit)	Balance at March 31, 2013
Commercial	$ 2,596	$	$ 11	$ 60	$ 2,667
Commercial loans secured by real estate	7,796	(1,480)	108	(435)	5,989
Real estate-mortgage	1,269	(29)	55	(28)	1,267
Consumer	150	(38)	12	23	147
Allocation for general risk	760			130	890
Total	$ 12,571	$ (1,547)	$ 186	$ (250)	$ 10,960

As a result of successful ongoing problem credit resolution efforts, the Company achieved further asset quality improvements in 2014 and 2013, specifically in the commercial loans secured by real estate category, which resulted in a credit provision in each period.

The following tables summarize the loan portfolio and allowance for loan loss by the primary segments of the loan portfolio (in thousands).

Loans:

	At March 31, 2014				
	Commercial	Commercial Loans	Real Estate-	Consumer	Total

		Secured by Real Estate	Mortgage		
Individually evaluated for impairment	$	$ 2,241	$	$	$ 2,241
Collectively evaluated for impairment	125,854	402,862	239,545	16,310	784,571
Total loans	$ 125,854	$ 405,103	$ 239,545	$ 16,310	$ 786,812

Allowance for loan losses:

	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Specific reserve allocation	$	$ 706	$	$	$	$ 706
General reserve allocation	3,065	3,956	1,273	139	970	9,403
Total allowance for loan losses	$ 3,065	$ 4,662	$ 1,273	$ 139	$ 970	$ 10,109

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

Loans:

At December 31, 2013

	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Total
Individually evaluated for impairment	$	$ 3,005	$	$ 61	$ 3,066
Collectively evaluated for impairment	120,102	408,686	235,689	15,803	780,280
Total loans	$ 120,102	$ 411,691	$ 235,689	$ 15,864	$ 783,346

Allowance for loan losses:

	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Specific reserve allocation	$	$ 812	$	$ 1	$	$ 813
General reserve allocation	2,844	4,073	1,260	135	979	9,291
Total allowance for loan losses	$ 2,844	$ 4,885	$ 1,260	$ 136	$ 979	$ 10,104

The segments of the Company s loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The loan segments used are consistent with the internal reports evaluated by the Company s management and Board of Directors to monitor risk and performance within various segments of its loan portfolio and therefore, no further disaggregation into classes is necessary. The overall risk profile for the commercial loan segment is impacted by non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, as a meaningful but declining portion of the commercial portfolio is centered in these types of accounts. The residential mortgage loan segment is comprised of first lien amortizing residential mortgage loans and home equity loans. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates for possible impairment any individual loan in the commercial or commercial real estate segment with a loan balance in excess of $100,000 that is in nonaccrual status or classified as a Troubled Debt Restructure (TDR). Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a TDR.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan s effective interest rate; (b) the loan s observable market price; or (c) the fair value of the collateral less selling costs for collateral dependent loans. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

The need for an updated appraisal on collateral dependent loans is determined on a case-by-case basis. The useful life of an appraisal or evaluation will vary depending upon the circumstances of the property and the economic conditions in the marketplace. A new appraisal is not required if there is an existing appraisal which, along with other information, is sufficient to determine a reasonable value for the property and to support an appropriate and adequate allowance for loan losses. At a minimum, annual documented reevaluation of the property is completed by the Bank s internal Assigned Risk Department to support the value of the property.

When reviewing an appraisal associated with an existing collateral real estate dependent transaction, the Bank s internal Assigned Risk Department must determine if there have been material changes to the underlying assumptions in the appraisal which affect the original estimate of value. Some of the factors that could cause material changes to reported values include:

lB2 the passage of time;
lB2 the volatility of the local market;
lB2 the availability of financing;
lB2 natural disasters;
lB2 the inventory of competing properties;
lB2 new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the Bank;
lB2 changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and/or
lB2 environmental contamination.

The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the Assigned Risk Department personnel determine that a reasonable value cannot be derived based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the Bank s Assigned Risk Department personnel rests with the Assigned Risk Department and not the originating account officer.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands).

	March 31, 2014				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial loans secured by real estate	$ 2,241	$ 706	$	$ 2,241	$ 2,288
Total impaired loans	$ 2,241	$ 706	$	$ 2,241	$ 2,288

	December 31, 2013				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial loans secured by real estate	$ 3,005	$ 812	$	$ 3,005	$ 3,118
Consumer	61	1		61	61
Total impaired loans	$ 3,066	$ 813	$	$ 3,066	$ 3,179

The following table presents the average recorded investment in impaired loans and related interest income recognized for the periods indicated (in thousands).

	Three months ended March 31,	
	2014	2013
Average loan balance:		
Commercial loans secured by real estate	$ 2,623	$ 3,572
Consumer		12
Average investment in impaired loans	$ 2,623	$ 3,584
Interest income recognized:		
Commercial loans secured by real estate	$ 1	$
Interest income recognized on a cash basis on impaired loans	$ 1	$

Management uses a nine point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five Pass categories are aggregated, while the Pass-6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. Loans in the Doubtful category have all the weaknesses inherent in a credit classified Substandard with weaknesses pronounced to a point where collection or liquidation in full, on the basis of current facts, conditions, and value is highly questionable, but the extent of loss is not currently determinable. All loans greater than 90 days past due, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process, which dictates that, at a minimum, credit reviews are mandatory for all commercial and commercial mortgage loan relationships with aggregate balances in excess of $250,000 within a 12-month period. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, delinquency, or death occurs to raise awareness of a possible credit event. The Company s commercial relationship managers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. Risk ratings are assigned by the account officer, but require independent review and rating concurrence from the Company s internal Loan Review Department. The Loan Review Department is an experienced independent function which reports directly to the Board s Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The approved scope of coverage for 2014 required review of a minimum range of 50% to 55% of the commercial loan portfolio.

In addition to loan monitoring by the account officer and Loan Review Department, the Company also requires presentation of all credits rated Pass-6 with aggregate balances greater than $1,000,000, all credits rated Special Mention or Substandard with aggregate balances greater than $250,000, and all credits rated Doubtful with aggregate balances greater than $100,000 on an individual basis to the Company s Loan Loss Reserve Committee on a quarterly basis. Additionally, the Asset Quality Task Force, which is a group comprised of senior level personnel, meets bi-weekly to monitor the status of problem loans.

The following table presents the classes of the commercial loan portfolios summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system (in thousands).

	March 31, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 116,733	$ 3,691	$ 5,430	$	$ 125,854
Commercial loans secured by real estate	392,213	3,723	8,859	308	405,103
Total	$ 508,946	$ 7,414	$ 14,289	$ 308	$ 530,957

	December 31, 2013				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 108,623	$ 8,880	$ 2,599	$	$ 120,102
Commercial loans secured by real estate	396,788	6,961	7,482	460	411,691
Total	$ 505,411	$ 15,841	$ 10,081	$ 460	$ 531,793

It is generally the policy of the bank that the outstanding balance of any residential mortgage loan that exceeds 90-days past due as to principal and/or interest is transferred to non-accrual status and an evaluation is completed to determine the fair value of the collateral less selling costs, unless the balance is minor. A charge down is recorded for any deficiency balance determined from the collateral evaluation. The remaining non-accrual balance is reported as impaired with no specific allowance. It is the policy of the bank that the outstanding balance of any consumer loan that exceeds 90-days past due as to principal and/or interest is charged off. The following tables present the performing and non-performing outstanding balances of the residential and consumer portfolios (in thousands).

	March 31, 2014	
	Performing	Non-Performing
Real estate-mortgage	$ 238,323	$ 1,222
Consumer	16,310	
Total	$ 254,633	$ 1,222

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

	December 31, 2013	
	Performing	Non-Performing
Real estate-mortgage	$ 234,450	$ 1,239
Consumer	15,803	61
Total	$ 250,253	$ 1,300

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans (in thousands).

	March 31, 2014						
	Current	30 59 Days Past Due	60 89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial	$125,854	$	$	$	$	$125,854	$
Commercial loans secured by real estate	404,219	299	253	332	884	405,103	
Real estate-mortgage	236,729	1,229	530	1,057	2,816	239,545	
Consumer	16,264	43	3		46	16,310	
Total	$783,066	$1,571	$786	$1,389	$3,746	$786,812	$

	December 31, 2013						
	Current	30 59 Days Past Due	60 89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial	$120,102	$	$	$	$	$120,102	$
Commercial loans secured by real estate	410,619	457		615	1,072	411,691	
Real estate-mortgage	231,740	2,232	670	1,047	3,949	235,689	
Consumer	15,804	33	27		60	15,864	
Total	$778,265	$2,722	$697	$1,662	$5,081	$783,346	$

An allowance for loan losses (ALL) is maintained to absorb losses from the loan portfolio. The ALL is based on management s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are complemented by consideration of other qualitative factors.

Management tracks the historical net charge-off activity at each risk rating grade level for the entire commercial portfolio and at the aggregate level for the consumer, residential mortgage and small business portfolios. A historical charge-off factor is calculated utilizing a rolling 12 consecutive historical quarters for the commercial portfolios. This historical charge-off factor for the consumer, residential mortgage and small business portfolios are based on a three year historical average of actual loss experience.

The Company uses a comprehensive methodology and procedural discipline to maintain an ALL to absorb inherent losses in the loan portfolio. The Company believes this is a critical accounting policy since it involves significant estimates and judgments. The allowance consists of three elements: 1) an allowance established on specifically identified problem loans, 2) formula driven general reserves established for loan

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. Allowance for Loan Losses (continued)

categories based upon historical loss experience and other qualitative factors which include delinquency, non-performing and TDR loans, loan trends, economic trends, concentrations of credit, trends in loan volume, experience and depth of management, examination and audit results, effects of any changes in lending policies, and trends in policy, financial information, and documentation exceptions, and 3) a general risk reserve which provides support for variance from our assessment of the previously listed qualitative factors, provides protection against credit risks resulting from other inherent risk factors contained in the Company s loan portfolio, and recognizes the model and estimation risk associated with the specific and formula driven allowances. The qualitative factors used in the formula driven general reserves are evaluated quarterly (and revised if necessary) by the Company s management to establish allocations which accommodate each of the listed risk factors.

Pass rated credits are segregated from Criticized and Classified credits for the application of qualitative factors.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

9. Non-performing Assets Including Troubled Debt Restructurings (TDR)

The following table presents information concerning non-performing assets including TDR (in thousands, except percentages):

	March 31, 2014	December 31, 2013
Non-accrual loans		
Commercial loans secured by real estate	$957	$1,632
Real estate-mortgage	1,222	1,239
Total	2,179	2,871
Other real estate owned		
Commercial loans secured by real estate	344	344
Real estate-mortgage	673	673
Total	1,017	1,017
TDR s not in non-accrual	78	221
Total non-performing assets including TDR	$3,274	$4,109
Total non-performing assets as a percent of loans, net of unearned income, and other real estate owned	0.41 %	0.52 %

The Company had no loans past due 90 days or more for the periods presented which were accruing interest.

The following table sets forth, for the periods indicated, (1) the gross interest income that would have been recorded if non-accrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period, (2) the amount of interest income actually recorded on such loans, and (3) the net reduction in interest income attributable to such loans (in thousands).

	Three months ended March 31,	
	2014	2013
Interest income due in accordance with original terms	$ 33	$ 63
Interest income recorded		
Net reduction in interest income	$ 33	$ 63

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)

Consistent with accounting and regulatory guidance, the Bank recognizes a TDR when the Bank, for economic or legal reasons related to a borrower s financial difficulties, grants a concession to the borrower that would not normally be considered. Regardless of the form of concession granted, the Bank s objective in offering a troubled debt restructure is to increase the probability of repayment of the borrower s loan.

To be considered a TDR, both of the following criteria must be met:

- the borrower must be experiencing financial difficulties; and
- the Bank, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower that would not otherwise be considered.

Factors that indicate a borrower is experiencing financial difficulties include, but are not limited to:

- the borrower is currently in default on their loan(s);
- the borrower has filed for bankruptcy;
- the borrower has insufficient cash flows to service their loan(s); and
- the borrower is unable to obtain refinancing from other sources at a market rate similar to rates available to a non-troubled debtor.

Factors that indicate that a concession has been granted include, but are not limited to:

- the borrower is granted an interest rate reduction to a level below market rates for debt with similar risk; or
- the borrower is granted a material maturity date extension, or extension of the amortization plan to provide payment relief. For purposes of this policy, a material maturity date extension will generally include any maturity date extension, or the aggregate of multiple consecutive maturity date extensions, that exceed 120 days. A restructuring that results in an insignificant delay in payment, i.e. 120 days or less, is not necessarily a TDR. Insignificant payment delays occur when the amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value, and will result in an insignificant shortfall in the originally scheduled contractual amount due, and/or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the original maturity or the original amortization.

The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the modification. No single factor is determinative of whether a restructuring is a TDR. An overall general decline in the economy or some deterioration in a borrower s financial condition does not automatically mean that the borrower is experiencing financial difficulty. Accordingly, determination of whether a modification is a TDR involves a large degree of judgment.

The following table details the loans modified as TDRs during the three month period ended March 31, 2014 (dollars in thousands).

Loans in non-accrual status	Concession Granted

	# of Loans	Current Balance	
Commercial loan secured by real estate	1	$ 265	Extension of maturity date

The following table details the loans modified as TDRs during the three month period ended March 31, 2013 (dollars in thousands).

Loans in accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	2	$ 168	Extension of maturity date
Consumer	1	12	Extension of maturity date

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9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)

Loans in non-accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	2	$ 1,314	Extension of maturity date

In all instances where loans have been modified in troubled debt restructurings the pre- and post-modified balances are the same. The specific ALL reserve for loans modified as TDR s was $365,000 and $412,000 as of March 31, 2014 and 2013, respectively.

Once a loan is classified as a TDR, this classification will remain until documented improvement in the financial position of the borrower supports confidence that all principal and interest will be paid according to terms. Additionally, the customer must have re-established a track record of timely payments according to the restructured contract terms for a minimum of six consecutive months prior to consideration for removing the loan from non-accrual TDR status. However, a loan will continue to be on non-accrual status until, consistent with our policy, the borrower has made a minimum of an additional six consecutive monthly payments in accordance with the terms of the loan.

The following table presents the recorded investment in loans that were classified as TDR s or were subsequently modified during each 12-month period prior to the reporting periods preceding January 1, 2014 and January 1, 2013, respectively, in the table below and subsequently defaulted during these reporting periods (in thousands).

	Three months ended March 31,	
	2014	2013
Recorded investment of defaults		
Commercial loan secured by real estate	$	$ 1,320
Total	$	$ 1,320

All TDR s are individually evaluated for impairment and a related allowance is recorded, as needed. All TDR s which defaulted in the above table had a related allowance adequate to reserve for anticipated losses.

The Company is unaware of any additional loans which are required to either be charged-off or added to the non-performing asset totals disclosed above. Other real estate owned is recorded at fair value minus estimated costs to sell.

10. Federal Home Loan Bank Borrowings

Total Federal Home Loan Bank (FHLB) borrowings and advances consist of the following (in thousands, except percentages):

Type	At March 31, 2014 Maturing	Amount	Weighted Average Rate
Open Repo Plus	Overnight	$ 12,483	0.25 %
Advances	2015	4,000	0.52
	2016	12,000	0.81
	2017	9,000	1.04
	2018	3,000	1.45
Total advances		28,000	0.91
Total FHLB borrowings		$ 40,483	0.71 %

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

10. Federal Home Loan Bank Borrowings (continued)

	At December 31, 2013			
Type	Maturing	Amount	Weighted Average Rate	
Open Repo Plus	Overnight	$ 41,555	0.25	%
Advances	2015	4,000	0.52	
	2016	12,000	0.81	
	2017	7,000	1.07	
	2018	2,000	1.47	
Total advances		25,000	0.89	
Total FHLB borrowings		$ 66,555	0.49	%

The rate on Open Repo Plus advances can change daily, while the rates on the advances are fixed until the maturity of the advance.

11. Preferred Stock

On August 11, 2011, pursuant to the Small Business Lending Fund (SBLF), the Company issued and sold to the US Treasury 21,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series E (Series E Preferred Stock) for the aggregate proceeds of $21 million. The SBLF is a voluntary program sponsored by the US Treasury that encourages small business lending by providing capital to qualified community banks at favorable rates. The initial interest rate on the Series E Preferred Stock has been initially set at 5% per annum and may be decreased to as low as 1% per annum if growth thresholds are met for qualified outstanding small business loans. The Company used the proceeds from the Series E Preferred Stock issued to the US Treasury to repurchase all 21,000 shares of its outstanding preferred shares previously issued to the US Treasury under the TARP Capital Purchase Program.

The Series E Preferred Stock has an aggregate liquidation preference of approximately $21 million and qualifies as Tier 1 Capital for regulatory purposes. The terms of the Series E Preferred Stock provide for the payment of non-cumulative dividends on a quarterly basis. The dividend rate, as a percentage of the liquidation amount, may fluctuate while the Series E Preferred Stock is outstanding based upon changes in the level of qualified small business lending (QSBL) by the Bank from its average level of QSBL at each of the four quarter ends leading up to June 30, 2010 (the Baseline) as follows:

DIVIDEND PERIOD ANNUALIZED BEGINNING	ENDING	ANNUALIZED DIVIDEND RATE	
August 11, 2011	December 31, 2011	5.0	%
January 1, 2012	December 31, 2013	1.0% to 5.0	%
January 1, 2014	February 7, 2016	1.0% to 7.0	%[1]
February 8, 2016	Redemption	9.0	%[2]

(1) Between January 1, 2014 and February 7, 2016, the dividend rate will be fixed at a rate in such range based upon the level of percentage change in QSBL between September 30, 2013 and the Baseline.

(2) Beginning on February 8, 2016, the dividend rate will be fixed at nine percent (9%) per annum.

In addition to the applicable dividend rates described above, beginning on January 1, 2014 and on all dividend payment dates thereafter ending on April 1, 2016, if we fail to increase our level of QSBL compared to the Baseline, we will be required to pay a quarterly lending incentive fee of 0.5% of the liquidation value. As of September 30, 2013, the Company had increased its QSBL to a level that reduced the dividend rate to 1%. Accordingly, this 1% rate will continue through February 7, 2016.

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11. Preferred Stock (continued)

As long as shares of Series E Preferred Stock remain outstanding, we may not pay dividends to our common shareholders (nor may we repurchase or redeem any shares of our common stock) during any quarter in which we fail to declare and pay dividends on the Series E Preferred Stock and for the next three quarters following such failure. In addition, under the terms of the Series E Preferred Stock, we may only declare and pay dividends on our common stock (or repurchase shares of our common stock), if, after payment of such dividend, the dollar amount of our Tier 1 capital would be at least ninety percent (90%) of Tier 1 capital as of June 30, 2011, excluding any charge-offs and redemptions of the Series E Preferred Stock (the Tier 1 Dividend Threshold). The Tier 1 Dividend Threshold is subject to reduction, beginning January 1, 2014, based upon the extent by which, if at all, the QSBL at September 30, 2013 has increased over the Baseline.

We may redeem the Series E Preferred Stock at any time at our option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends, subject to the approval of our federal banking regulator.

12. Accumulated Other Comprehensive Loss

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended March 31, 2014 (in thousands):

Three months ended March 31, 2014	Net Unrealized Gains and Losses on Investment Securities AFS(1)	Defined Benefit Pension Items(1)	Total(1)
Balance at January 1, 2014	$ 1,043	$ (6,918)	$ (5,875)
Other comprehensive income before reclassifications	339	259	598
Amounts reclassified from accumulated other comprehensive loss	(37)		(37)
Net current period other comprehensive income	302	259	561
Balance at March 31, 2014	$ 1,345	$ (6,659)	$ (5,314)

(1) Amounts in parentheses indicate debits.

The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss for the three months ended March 31, 2014 (in thousands):

Details about accumulated other comprehensive loss components	Amount reclassified from accumulated other comprehensive loss[1]	Affected line item in the statement of operations
Unrealized gains and losses on sale of securities	$ (57)	Net realized gains on investment securities
	20	Provision for income tax expense
	$ (37)	Net of tax
Total reclassifications for the period	$ (37)	Net of tax

(1) Amounts in parentheses indicate credits.

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12. Accumulated Other Comprehensive Loss (continued)

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended March 31, 2013 (in thousands):

Three months ended March 31, 2013	Net Unrealized Gains and Losses on Investment Securities AFS(1)	Defined Benefit Pension Items(1)	Total(1)
Balance at January 1, 2013	$ 4,141	$ (9,520)	$ (5,379)
Other comprehensive income before reclassifications	(320)	103	(217)
Amounts reclassified from accumulated other comprehensive loss	(47)	220	173
Net current period other comprehensive income	(367)	323	(44)
Balance at March 31, 2013	$ 3,774	$ (9,197)	$ (5,423)

(1) Amounts in parentheses indicate debits.

The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss for the three months ended March 31, 2013 (in thousands):

Details about accumulated other comprehensive loss components	Amount reclassified from accumulated other comprehensive loss(1)	Affected line item in the statement of operations
Unrealized gains and losses on sale of securities		
	$ (71)	Net realized gains on investment securities
	24	Provision for income tax expense
	$ (47)	Net of tax
Amortization of defined benefit items(2)		
Estimated net loss	$ 341	Salaries and employee benefits
Prior service cost	(5)	Salaries and employee benefits
Transition asset	(2)	Salaries and employee benefits
	334	Total before tax

		(114)	Provision for income tax expense
	$	220	Net of tax
Total reclassifications for the period	$	(173)	Net of tax

(1) Amounts in parentheses indicate credits.

(2) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (see Note 16 for additional details).

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13. Regulatory Capital

The Company is subject to various capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company s consolidated financial statements.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of March 31, 2014, the Federal Reserve categorized the Company as Well Capitalized under the regulatory framework for prompt corrective action. The Company believes that no conditions or events have occurred that would change this conclusion. To be categorized as Well Capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. Additionally, while not a regulatory capital ratio, the Company s tangible common equity ratio was 7.80% at March 31, 2014 (in thousands, except ratios).

	At March 31, 2014					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (To Risk Weighted Assets) Consolidated	$129,696	15.34%	$67,628	8.00%	$84,535	10.00%
AmeriServ Financial Bank	104,187	12.47	66,820	8.00	83,525	10.00
Tier 1 Capital (To Risk Weighted Assets) Consolidated	119,124	14.09	33,814	4.00	50,721	6.00
AmeriServ Financial Bank	93,740	11.22	33,410	4.00	50,115	6.00
Tier 1 Capital (To Average Assets) Consolidated	119,124	11.50	41,451	4.00	51,813	5.00
AmeriServ Financial Bank	93,740	9.30	40,324	4.00	50,405	5.00

	At December 31, 2013					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio

Total Capital (To Risk Weighted Assets) Consolidated	$128,469	15.28%	$67,247	8.00%	$84,059	10.00%
AmeriServ Financial Bank	103,009	12.39	66,506	8.00	83,132	10.00
Tier 1 Capital (To Risk Weighted Assets) Consolidated	117,957	14.03	33,624	4.00	50,435	6.00
AmeriServ Financial Bank	92,611	11.14	33,253	4.00	49,879	6.00
Tier 1 Capital (To Average Assets) Consolidated	117,957	11.45	41,204	4.00	51,505	5.00
AmeriServ Financial Bank	92,611	9.23	40,124	4.00	50,155	5.00

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13. Regulatory Capital (continued)

On July 2, 2013, the Board of Governors of the Federal Reserve System approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act, which will require institutions to, among other things, have more capital and a higher quality of capital by increasing the minimum regulatory capital ratios, and requiring capital buffers. The new rules become effective for the Company and the Bank on January 1, 2015, with an implementation period that stretches to 2019. For a more detailed discussion see the Capital Resources section of the MD&A.

14. Segment Results

The financial performance of the Company is also monitored by an internal funds transfer pricing profitability measurement system which produces line of business results and key performance measures. The Company s major business units include retail banking, commercial lending, trust, and investment/parent. The reported results reflect the underlying economics of the business segments. Expenses for centrally provided services are allocated based upon the cost and estimated usage of those services. The businesses are match-funded and interest rate risk is centrally managed and accounted for within the investment/parent business segment. The key performance measure the Company focuses on for each business segment is net income contribution.

Retail banking includes the deposit-gathering branch franchise and lending to both individuals and small businesses. Lending activities include residential mortgage loans, direct consumer loans, and small business commercial loans. Commercial banking to businesses includes commercial loans, and commercial real-estate loans. The trust segment contains our wealth management businesses which include the Trust Company, West Chester Capital Advisors, our registered investment advisory firm and financial services. Wealth management includes personal trust products and services such as personal portfolio investment management, estate planning and administration, custodial services and pre-need trusts. Also, institutional trust products and services such as 401(k) plans, defined benefit and defined contribution employee benefit plans, and individual retirement accounts are included in this segment. Financial services include the sale of mutual funds, annuities, and insurance products. The Wealth management businesses also includes the union collective investment funds, namely the ERECT and BUILD funds which are designed to use union pension dollars in construction projects that utilize union labor. The investment/parent includes the net results of investment securities and borrowing activities, general corporate expenses not allocated to the business segments, interest expense on guaranteed junior subordinated deferrable interest debentures, and centralized interest rate risk management. Inter-segment revenues were not material.

The contribution of the major business segments to the Consolidated Results of Operations for the three months ended March 31, 2014 and 2013 were as follows (in thousands):

	Three months ended March 31, 2014	March 31, 2014
		Total assets

	Total revenue	Net income (loss)	
Retail banking	$ 6,117	$ 348	$ 339,405
Commercial banking	4,327	1,096	554,593
Trust	2,114	308	4,713
Investment/Parent	(501)	(822)	152,397
Total	$ 12,057	$ 930	$ 1,051,108

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14. Segment Results (continued)

	Three months ended March 31, 2013		December 31, 2013
	Total revenue	Net income (loss)	Total assets
Retail banking	$ 6,749	$ 823	$ 347,823
Commercial banking	3,887	1,045	545,556
Trust	1,985	176	4,722
Investment/Parent	(763)	(988)	157,935
Total	$ 11,858	$ 1,056	$ 1,056,036

15. Commitments and Contingent Liabilities

The Company had various outstanding commitments to extend credit approximating $164.0 million and standby letters of credit of $13.2 million as of March 31, 2014. The Company s exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Bank uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

Additionally, the Company is also subject to a number of asserted and unasserted potential claims encountered in the normal course of business. In the opinion of the Company, neither the resolution of these claims nor the funding of these credit commitments will have a material adverse effect on the Company s consolidated financial position, results of operation or cash flows.

16. Pension Benefits

The Company has a noncontributory defined benefit pension plan covering certain employees who work at least 1,000 hours per year. The participants shall have a vested interest in their accrued benefit after five full years of service. The benefits of the plan are based upon the employee s years of service and average annual earnings for the highest five consecutive calendar years during the final ten year period of employment. Plan assets are primarily debt securities (including US Treasury and Agency securities, corporate notes and bonds), listed common stocks (including shares of AmeriServ Financial, Inc. common stock which is limited to 10% of the plan s assets), mutual funds, and short-term cash equivalent instruments. The net periodic pension cost for the three months ended March 31, 2014 and 2013 were as follows (in thousands):

	Three months ended March 31,	
	2014	2013

Components of net periodic benefit cost		
Service cost	$ 430	$ 453
Interest cost	331	291
Expected return on plan assets	(498)	(440)
Amortization of prior year service cost	(5)	(5)
Amortization of transition asset		(2)
Recognized net actuarial loss	272	341
Net periodic pension cost	$ 530	$ 638

The Company implemented a soft freeze of its defined benefit pension plan to provide that non-union employees hired on or after January 1, 2013 and union employees hired on or after January 1, 2014 are not eligible to participate in the pension plan. Instead, such employees are eligible to participate in a qualified 401(k) plan. This change was made to help reduce pension costs in future periods.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

17. Disclosures About Fair Value Measurements

The following disclosures establish a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined within this hierarchy are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

Level III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

Assets and Liability Measured on a Recurring Basis

Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the US Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things.

The following tables present the assets reported on the consolidated balance sheets at their fair value as of March 31, 2014 and December 31, 2013, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Assets and liability measured at fair value on a recurring basis are summarized below (in thousands):

	Fair Value Measurements at March 31, 2014 Using			
	Total	(Level 1)	(Level 2)	(Level 3)
US Agency securities	$ 6,879	$	$ 6,879	$
US Agency mortgage-backed securities	118,027		118,027	
Corporate bonds	11,840		11,840	

	Fair Value Measurements at December 31, 2013 Using			
	Total	(Level 1)	(Level 2)	(Level 3)

US Agency securities	$ 6,835	$	$ 6,835	$
US Agency mortgage-backed securities	123,382		123,382	
Corporate bonds	11,761		11,761	

Assets Measured on a Non-recurring Basis

Loans considered impaired are loans for which, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. As detailed in the allowance for loan loss footnote, impaired loans are reported at fair value of the underlying collateral if the repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on observable market data which at times are discounted. At March 31, 2014, impaired loans with a carrying value of $2.2 million were reduced by a specific valuation allowance totaling $706,000 resulting in a net fair value of $1.5 million. At December 31, 2013, impaired loans with a carrying value of $3.1 million were reduced by a specific valuation allowance totaling $813,000 million resulting in a net fair value of $2.3 million.

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17. Disclosures About Fair Value Measurements (continued)

Other real estate owned is measured at fair value based on appraisals, less cost to sell at the date of foreclosure. Valuations are periodically performed by management. Income and expenses from operations and changes in valuation allowance are included in the net expenses from OREO.

Assets measured at fair value on a non-recurring basis are summarized below (in thousands, except range data):

	Fair Value Measurements at March 31, 2014 Using			
	Total	(Level 1)	(Level 2)	(Level 3)
Impaired loans	$ 1,535	$	$	$ 1,535
Other real estate owned	1,017			1,017

Fair Value Measurements at December 31, 2013 Using