

PEOPLES FINANCIAL SERVICES CORP.

Form 10-Q

May 08, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended March 31, 2015**

or

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

001-36388

(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State of incorporation)

23-2391852
(IRS Employer ID Number)

150 North Washington Avenue, Scranton, PA
(Address of principal executive offices)

18503
(Zip code)

(570) 346-7741

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of the registrant's common stock, as of the latest practicable date: 7,548,358 at April 30, 2015.

Exhibit index on page 48

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PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended March 31, 2015

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Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED BALANCE SHEETS (UNAUDITED)****(Dollars in thousands, except share data)**

| | March 31, 2015 | December 31, 2014 |
|---|---------------------------|------------------------------|
| Assets: | | |
| Cash and due from banks | \$ 24,193 | \$ 24,656 |
| Interest-bearing deposits in other banks | 6,813 | 6,770 |
| Federal funds sold | 8,625 | |
| Investment securities: | | |
| Available-for-sale | 280,300 | 339,586 |
| Held-to-maturity: Fair value March 31, 2015, \$14,729; December 31, 2014, \$15,215 | 14,172 | 14,665 |
| Total investment securities | 294,472 | 354,251 |
| Loans held for sale | 3,101 | 3,486 |
| Loans, net | 1,237,168 | 1,209,894 |
| Less: allowance for loan losses | 10,803 | 10,338 |
| Net loans | 1,226,365 | 1,199,556 |
| Premises and equipment, net | 26,117 | 25,433 |
| Accrued interest receivable | 4,922 | 5,580 |
| Goodwill | 63,370 | 63,370 |
| Intangible assets | 5,197 | 5,501 |
| Other assets | 50,786 | 53,066 |
| Total assets | \$ 1,713,961 | \$ 1,741,669 |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing | \$ 305,037 | \$ 313,498 |
| Interest-bearing | 1,111,241 | 1,112,060 |
| Total deposits | 1,416,278 | 1,425,558 |
| Short-term borrowings | | 19,557 |
| Long-term debt | 32,318 | 33,140 |
| Accrued interest payable | 460 | 574 |
| Other liabilities | 15,447 | 16,061 |
| Total liabilities | 1,464,503 | 1,494,890 |
| Stockholders equity: | | |
| Common stock: par value \$2.00, authorized 25,000,000 shares; issued 7,548,358 shares | 15,097 | 15,097 |

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| | | |
|--|--------------|--------------|
| Capital surplus | 140,232 | 140,214 |
| Retained earnings | 95,000 | 92,297 |
| Accumulated other comprehensive loss | (871) | (829) |
| Total stockholders' equity | 249,458 | 246,779 |
| Total liabilities and stockholders' equity | \$ 1,713,961 | \$ 1,741,669 |

See notes to consolidated financial statements

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)****(Dollars in thousands, except per share data)**

| For the Three Months Ended March 31, | 2015 | 2014 |
|--|---------------|---------------|
| Interest income: | | |
| Interest and fees on loans: | | |
| Taxable | \$ 13,340 | \$ 14,000 |
| Tax-exempt | 559 | 635 |
| Interest and dividends on investment securities: | | |
| Taxable | 900 | 928 |
| Tax-exempt | 805 | 829 |
| Dividends | 9 | 16 |
| Interest on interest-bearing deposits in other banks | 8 | 10 |
| Interest on federal funds sold | 7 | 14 |
| Total interest income | 15,628 | 16,432 |
| Interest expense: | | |
| Interest on deposits | 1,268 | 1,357 |
| Interest on short-term borrowings | 8 | 34 |
| Interest on long-term debt | 259 | 296 |
| Total interest expense | 1,535 | 1,687 |
| Net interest income | 14,093 | 14,745 |
| Provision for loan losses | 750 | 857 |
| Net interest income after provision for loan losses | 13,343 | 13,888 |
| Noninterest income: | | |
| Service charges, fees and commissions | 1,612 | 1,624 |
| Merchant services income | 790 | 894 |
| Commission and fees on fiduciary activities | 459 | 567 |
| Wealth management income | 205 | 187 |
| Mortgage banking income | 222 | 99 |
| Life insurance investment income | 189 | 189 |
| Net gain on sale of investment securities available-for-sale | 832 | |
| Total noninterest income | 4,309 | 3,560 |
| Noninterest expense: | | |
| Salaries and employee benefits expense | 5,233 | 5,168 |
| Net occupancy and equipment expense | 2,468 | 1,733 |

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| | | |
|---|-----------|-----------|
| Merchant services expense | 533 | 565 |
| Amortization of intangible assets | 305 | 343 |
| Acquisition related expense | | 608 |
| Other expenses | 2,555 | 2,870 |
| Total noninterest expense | 11,094 | 11,287 |
| Income before income taxes | 6,558 | 6,161 |
| Income tax expense | 1,514 | 1,463 |
| Net income | 5,044 | 4,698 |
| Other comprehensive income (loss): | | |
| Unrealized gain on investment securities available-for-sale | 767 | 2,394 |
| Reclassification adjustment for net gain on sales included in net income | (832) | |
| Other comprehensive income (loss) | (65) | 2,394 |
| Income tax expense (benefit) related to other comprehensive income (loss) | (23) | 838 |
| Other comprehensive income (loss), net of income taxes | (42) | 1,556 |
| Comprehensive income | \$ 5,002 | \$ 6,254 |
| Per share data: | | |
| Net income: | | |
| Basic | \$ 0.67 | \$ 0.62 |
| Diluted | \$ 0.67 | \$ 0.62 |
| Average common shares outstanding: | | |
| Basic | 7,548,358 | 7,550,253 |
| Diluted | 7,548,358 | 7,580,480 |
| Dividends declared | \$ 0.31 | \$ 0.31 |
| See notes to consolidated financial statements | | |

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)**

(Dollars in thousands, except per share data)

| | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|--|-------------------------|----------------------------|------------------------------|--|---------------------------|--------------|
| Balance, January 1, 2015 | \$ 15,097 | \$ 140,214 | \$ 92,297 | \$ (829) | | \$ 246,779 |
| Net income | | | 5,044 | | | 5,044 |
| Other comprehensive loss, net of income taxes | | | | (42) | | (42) |
| Dividends declared: \$0.31 per share | | | (2,341) | | | (2,341) |
| Stock based compensation | | 18 | | | | 18 |
| Balance, March 31, 2015 | \$ 15,097 | \$ 140,232 | \$ 95,000 | (871) | | \$ 249,458 |
| Balance, January 1, 2014 | \$ 15,614 | \$ 146,109 | \$ 84,008 | \$ (698) | \$ (6,241) | \$ 238,792 |
| Net income | | | 4,698 | | | 4,698 |
| Other comprehensive income, net of income taxes | | | | 1,556 | | 1,556 |
| Dividends declared: \$0.31 per share | | | (2,341) | | | (2,341) |
| Shares retired: 3,386 shares | (7) | (102) | | | | (109) |
| Reissuance under option plan: 600 shares | | 28 | | | 11 | 39 |
| Repurchase and held: 1,800 shares | | | | | (70) | (70) |
| Balance, March 31, 2014 | \$ 15,607 | \$ 146,035 | \$ 86,365 | \$ 858 | \$ (6,300) | \$ 242,565 |

See notes to consolidated financial statements

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****(Dollars in thousands, except per share data)**

| For the Three Months Ended March 31, | 2015 | 2014 |
|---|-------------|-------------|
| Cash flows from operating activities: | | |
| Net income | \$ 5,044 | \$ 4,698 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation of premises and equipment | 388 | 574 |
| Amortization of deferred loan costs | 132 | 22 |
| Amortization of intangibles | 305 | 343 |
| Net accretion of purchase accounting adjustments on tangible assets | (292) | (864) |
| Provision for loan losses | 750 | 857 |
| Net gain on sale of other real estate owned | (30) | (22) |
| Net loss on disposal of equipment | | 63 |
| Loans originated for sale | (5,300) | (2,169) |
| Proceeds from sale of loans originated for sale | 5,907 | 2,104 |
| Net loss (gain) on sale of loans originated for sale | (222) | 6 |
| Net amortization of investment securities | 1,022 | 1,043 |
| Net gain on sale of investment securities | (832) | |
| Life insurance investment income | (189) | (189) |
| Deferred income tax benefit | (142) | |
| Stock based compensation | 18 | |
| Net change in: | | |
| Accrued interest receivable | 658 | 500 |
| Other assets | 710 | (1,962) |
| Accrued interest payable | (114) | (113) |
| Other liabilities | (452) | 2,239 |
| Net cash provided by operating activities | 7,361 | 7,130 |
| Cash flows from investing activities: | | |
| Proceeds from sales of investment securities available-for-sale | 50,981 | 60 |
| Proceeds from repayments of investment securities: | | |
| Available-for-sale | 9,835 | 12,634 |
| Held-to-maturity | 482 | 675 |
| Purchases of investment securities: | | |
| Available-for-sale | (1,774) | (13,841) |
| Held-to-maturity | | |
| Net redemption of restricted equity securities | 1,555 | |
| Net increase in lending activities | (27,689) | (798) |
| Purchases of premises and equipment | (1,097) | (122) |
| Proceeds from sale of other real estate owned | 338 | 193 |

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| | | |
|---|-----------|-----------|
| Net cash provided by (used in) investing activities | 32,631 | (1,199) |
| Cash flows from financing activities: | | |
| Net (decrease) increase in deposits | (9,081) | 24,855 |
| Repayment of long-term debt | (808) | (890) |
| Net increase (decrease) in short-term borrowings | (19,557) | 487 |
| Redemption of common stock | | (70) |
| Purchase of treasury stock | | (70) |
| Cash dividends paid | (2,341) | (2,341) |
| Net cash provided by (used in) financing activities | (31,787) | 21,971 |
| Net increase in cash and cash equivalents | 8,205 | 27,902 |
| Cash and cash equivalents at beginning of year | 31,426 | 51,310 |
| Cash and cash equivalents at end of year | \$ 39,631 | \$ 79,212 |

Table of Contents**Peoples Financial Services Corp.****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****(Dollars in thousands, except per share data)**

| For the Three Months Ended March 31, | 2015 | 2014 |
|---|-------------|-------------|
| Supplemental disclosures: | | |
| Cash paid during the period for: | | |
| Interest | \$ 1,649 | \$ 2,110 |
| Income taxes | | |
| Noncash items: | | |
| Transfers of loans to other real estate | \$ 71 | \$ 201 |
| Retirement of treasury shares | | |
| Acquisition: | | |
| Fair value of assets acquired: | | |
| Loans, net | \$ 104 | \$ 580 |
| Premises and equipment | (25) | (25) |
| Core deposit and other intangible assets | (304) | (343) |
| | \$ (225) | \$ 212 |
| Fair value of liabilities assumed: | | |
| Deposits | \$ 199 | \$ 296 |
| Long-term debt | 14 | 13 |
| | \$ 213 | \$ 309 |

See notes to consolidated financial statements

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Summary of significant accounting policies:

Nature of operations:

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company (Peoples Bank), including its subsidiaries, Peoples Advisors, LLC and Penseco Realty, Inc. (collectively, the Company or Peoples). The Company services its retail and commercial customers through twenty-six full-service community banking offices located within the Lackawanna, Lehigh, Luzerne, Monroe, Susquehanna, Wayne and Wyoming Counties of Pennsylvania and Broome County of New York.

Basis of presentation:

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform to the current year presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three months ended and as of March 31, 2015, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, impairment of goodwill and fair value of assets acquired and liabilities assumed in business combinations. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, reference is made to the Company s Annual Report on Form 10-K for the period ended December 31, 2014.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of March 31, 2015, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Recent accounting standards:

In January 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-01 which eliminates the requirement in Subtopic 225-20 to consider whether an underlying event or transaction is extraordinary, and if so, to separately present the item in the income statement net of tax, after income from continuing operations. Items that are either unusual in nature or infrequently occurring will continue to be reported as a separate component of income from continuing operations. Alternatively, these amounts may still be disclosed in the notes to the financial statements. The same requirement has been expanded to include items that are both unusual and infrequent, i.e., they should be separately presented as a component of income from continuing operations or disclosed in the footnotes. The ASU is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted from the beginning of the fiscal year of adoption. The adoption of ASU 2015-01 is not expected to have a material effect on the operating results or financial position of the Company.

In February 2015, the FASB issued ASU 2015-02 which changes the consolidation analysis for all reporting entities. The changes primarily affect the consolidation of limited partnerships and their equivalents (e.g., limited liability corporations), as well as structured vehicles such as collateralized debt obligations. The ASU simplifies U.S. GAAP by eliminating entity specific consolidation guidance for limited partnerships. It also revises other aspects of the consolidation analysis, including how kick-out rights, fee arrangements and related parties are assessed. The amendments rescind the indefinite deferral of FASB Statement 167 for certain investment funds and replace it with a permanent scope exception for money market funds. The ASU is effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of ASU 2015-02 is not expected to have a material effect on the operating results or financial position of the Company.

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****2. Other comprehensive income (loss):**

The components of other comprehensive income (loss) and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive loss included in the Consolidated Balance Sheets relates to net unrealized gains and losses on investment securities available-for-sale and benefit plan adjustments.

The components of accumulated other comprehensive loss included in stockholders' equity at March 31, 2015 and December 31, 2014 is as follows:

| | March 31, 2015 | December 31, 2014 |
|---|---------------------------|------------------------------|
| Net unrealized gain on investment securities available-for-sale | \$ 6,227 | \$ 6,292 |
| Related income taxes | 2,179 | 2,202 |
| Net of income taxes | 4,048 | 4,090 |
| Benefit plan adjustments | (7,567) | (7,567) |
| Related income taxes | (2,648) | (2,648) |
| Net of income taxes | (4,919) | (4,919) |
| Accumulated other comprehensive loss | \$ (871) | \$ (829) |

Other comprehensive income (loss) and related tax effects for the three months ended March 31, 2015 and 2014 is as follows:

| Three months ended March 31 | 2015 | 2014 |
|--|-------------|-------------|
| Unrealized gain on investment securities available-for-sale | \$ 767 | \$ 2,394 |
| Net gain on the sale of investment securities available-for-sale (1) | (832) | |
| Other comprehensive income (loss) gain before taxes | (65) | 2,394 |
| Income taxes expense (benefit) | (23) | 838 |

| | | |
|-----------------------------------|---------|----------|
| Other comprehensive income (loss) | \$ (42) | \$ 1,556 |
|-----------------------------------|---------|----------|

- (1) Represents amounts reclassified out of accumulated comprehensive income and included in gains on sale of investment securities on the consolidated statements of income.

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****3. Earnings per share:**

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

| For the three months ended March 31 | 2015 | | 2014 | |
|--|--------------|----------------|--------------|----------------|
| | Basic | Diluted | Basic | Diluted |
| Net Income (Numerator) | \$ 5,044 | \$ 5,044 | \$ 4,698 | \$ 4,698 |
| Average common shares outstanding (Denominator) | 7,548,358 | 7,548,358 | 7,550,253 | 7,580,480 |
| Earnings per share | \$ 0.67 | \$ 0.67 | \$ 0.62 | \$ 0.62 |

4. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at March 31, 2015 and December 31, 2014 are summarized as follows:

| March 31, 2015 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---------------------------------------|-----------------------|---------------------------------------|--|-----------------------|
| Available-for-sale: | | | | |
| U.S. Government-sponsored enterprises | \$ 95,683 | \$ 487 | \$ 22 | \$ 96,148 |
| State and municipals: | | | | |
| Taxable | 16,447 | 1,063 | 15 | 17,495 |
| Tax-exempt | 83,133 | 4,563 | 47 | 87,649 |
| Mortgage-backed securities: | | | | |
| U.S. Government agencies | 35,339 | 154 | 93 | 35,400 |
| U.S. Government-sponsored enterprises | 43,471 | 286 | 149 | 43,608 |
| Total | \$ 274,073 | \$ 6,553 | \$ 326 | \$ 280,300 |
| Held-to-maturity: | | | | |
| Tax-exempt state and municipals | \$ 7,370 | \$ 103 | \$ 33 | \$ 7,440 |
| Mortgage-backed securities: | | | | |

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|---------------------------------------|-----------|--------|-------|-----------|
| U.S. Government agencies | 96 | 1 | 97 | |
| U.S. Government-sponsored enterprises | 6,706 | 486 | 7,192 | |
| Total | \$ 14,172 | \$ 590 | \$ 33 | \$ 14,729 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

4. Investment securities (continued):

| December 31, 2014 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---------------------------------------|-----------------------|---------------------------------------|--|-----------------------|
| Available-for-sale: | | | | |
| U.S. Treasury securities | \$ 48,393 | \$ 157 | | \$ 48,550 |
| U.S. Government-sponsored enterprises | 95,990 | 337 | \$ 82 | 96,245 |
| State and municipals: | | | | |
| Taxable | 16,490 | 943 | 26 | 17,407 |
| Tax-exempt | 87,954 | 4,971 | 24 | 92,901 |
| Mortgage-backed securities: | | | | |
| U.S. Government agencies | 37,511 | 132 | 167 | 37,476 |
| U.S. Government-sponsored enterprises | 46,956 | 277 | 226 | 47,007 |
| Total | \$ 333,294 | \$ 6,817 | \$ 525 | \$ 339,586 |
| Held-to-maturity: | | | | |
| Tax-exempt state and municipals | \$ 7,370 | \$ 105 | \$ 38 | \$ 7,437 |
| Mortgage-backed securities: | | | | |
| U.S. Government agencies | 100 | 2 | | 102 |
| U.S. Government-sponsored enterprises | 7,195 | 481 | | 7,676 |
| Total | \$ 14,665 | \$ 588 | \$ 38 | \$ 15,215 |

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at March 31, 2015, is summarized as follows:

| March 31, 2015 | Fair Value |
|---------------------------------|-----------------------|
| Within one year | \$ 32,644 |
| After one but within five years | 80,316 |
| After five but within ten years | 28,954 |
| After ten years | 59,378 |
| | 201,292 |

Mortgage-backed securities 79,008

Total \$ 280,300

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****4. Investment securities (continued):**

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at March 31, 2015, is summarized as follows:

| March 31, 2015 | Amortized Cost | Fair Value |
|---------------------------------|---------------------------|-----------------------|
| Within one year | | |
| After one but within five years | \$ 326 | \$ 334 |
| After five but within ten years | 176 | 182 |
| After ten years | 6,868 | 6,924 |
| | 7,370 | 7,440 |
| Mortgage-backed securities | 6,802 | 7,289 |
| Total | \$ 14,172 | \$ 14,729 |

Securities with a carrying value of \$207,895 and \$216,192 at March 31, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

Securities and short-term investment activities are conducted with a diverse group of government entities, corporations and state and local municipalities. The counterparty's creditworthiness and type of collateral is evaluated on a case-by-case basis. At March 31, 2015 and December 31, 2014, there were no significant concentrations of credit risk from any one issuer, with the exception of U.S. Government agencies and sponsored enterprises, that exceeded 10.0 percent of stockholders' equity.

The fair value and gross unrealized losses of investment securities with unrealized losses for which an other-than-temporary impairment (OTTI) has not been recognized at March 31, 2015 and December 31, 2014, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

| | Less Than 12 Months | 12 Months or More | Total |
|-----------------------|--------------------------------|------------------------------|--------------|
| March 31, 2015 | | | |

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| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
|---------------------------------------|-----------------------|------------------------------|-----------------------|------------------------------|-----------------------|------------------------------|
| U.S. Government-sponsored enterprises | \$ 7,970 | \$ 12 | \$ 2,999 | \$ 10 | \$ 10,969 | \$ 22 |
| State and municipals: | | | | | | |
| Taxable | | | 554 | 15 | 554 | 15 |
| Tax-exempt | 14,234 | 61 | 787 | 19 | 15,021 | 80 |
| Mortgage-backed securities: | | | | | | |
| U.S. Government agencies | 14,885 | 62 | 3,790 | 31 | 18,675 | 93 |
| U.S. Government-sponsored enterprises | 19,098 | 149 | | | 19,098 | 149 |
| Total | \$ 56,187 | \$ 284 | \$ 8,130 | \$ 75 | \$ 64,317 | \$ 359 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

4. Investment securities (continued):

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---------------------------------------|------------------------|----------------------|----------------------|----------------------|---------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| December 31, 2014 | | | | | | |
| U.S. Government-sponsored enterprises | \$ 21,228 | \$ 33 | \$ 7,954 | \$ 49 | \$ 29,182 | \$ 82 |
| State and municipals: | | | | | | |
| Taxable | | | 544 | 26 | 544 | 26 |
| Tax-exempt | 4,702 | 23 | 2,423 | 39 | 7,125 | 62 |
| Mortgage-backed securities: | | | | | | |
| U.S. Government agencies | 20,148 | 167 | | | 20,148 | 167 |
| U.S. Government-sponsored enterprises | 22,870 | 226 | | | 22,870 | 226 |
| Total | \$ 68,948 | \$ 449 | \$ 10,921 | \$ 114 | \$ 79,869 | \$ 563 |

The Company had 63 investment securities, consisting of 36 tax-exempt state and municipal obligations, one taxable state and municipal obligation, three U.S. Government-sponsored enterprise securities, and 23 mortgage-backed securities that were in unrealized loss positions at March 31, 2015. Of these securities, one U.S.

Government-sponsored enterprise security, one taxable state and municipal obligation, two mortgage-backed securities and two tax-exempt state and municipal securities were in a continuous unrealized loss position for twelve months or more. Management does not consider the unrealized losses on the debt securities, as a result of changes in interest rates, to be OTTI based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuers or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at March 31, 2015. There was no OTTI recognized for the three months ended March 31, 2015 and 2014.

The Company had 52 investment securities, consisting of 16 tax-exempt state and municipal obligations, one taxable state and municipal obligation, nine U.S. Government-sponsored enterprise securities and 26 mortgage-backed securities that were in unrealized loss positions at December 31, 2014. Of these securities, two U.S.

Government-sponsored enterprise securities, four tax-exempt state and municipal securities, and one taxable state and municipal obligation were in a continuous unrealized loss position for twelve months or more.

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

5. Loans, net and allowance for loan losses:

The major classifications of loans outstanding, net of deferred loan origination fees and costs at March 31, 2015 and December 31, 2014 are summarized as follows. Net deferred loan costs were \$648 and \$651 at March 31, 2015 and December 31, 2014.

| | March 31, 2015 | December 31, 2014 |
|--------------|---------------------------|------------------------------|
| Commercial | \$ 319,468 | \$ 319,590 |
| Real estate: | | |
| Commercial | 522,432 | 493,481 |
| Residential | 305,663 | 310,667 |
| Consumer | 89,605 | 86,156 |
| Total | \$ 1,237,168 | \$ 1,209,894 |

The changes in the allowance for loan losses account by major classification of loan for the three months ended March 31, 2015 and 2014 are summarized as follows:

| March 31, 2015 | Real estate | | | | Total |
|----------------------------|--------------------|-------------------|--------------------|-----------------|--------------|
| | Commercial | Commercial | Residential | Consumer | |
| Allowance for loan losses: | | | | | |
| Beginning Balance | \$ 2,321 | \$ 3,037 | \$ 3,690 | \$ 1,290 | \$ 10,338 |
| Charge-offs | (37) | (49) | (199) | (80) | (365) |
| Recoveries | 61 | 1 | 5 | 13 | 80 |
| Provisions | 75 | 98 | 413 | 164 | 750 |
| Ending balance | \$ 2,420 | \$ 3,087 | \$ 3,909 | \$ 1,387 | \$ 10,803 |

| March 31, 2014 | Real estate | | | | Total |
|----------------------------|--------------------|-------------------|--------------------|-----------------|--------------|
| | Commercial | Commercial | Residential | Consumer | |
| Allowance for loan losses: | | | | | |
| Beginning Balance | \$ 2,008 | \$ 2,394 | \$ 3,135 | \$ 1,114 | \$ 8,651 |
| Charge-offs | (347) | (28) | (240) | (68) | (683) |
| Recoveries | | | 3 | 31 | 34 |

| | | | | | |
|----------------|----------|----------|----------|----------|----------|
| Provisions | 300 | 107 | 350 | 100 | 857 |
| Ending balance | \$ 1,961 | \$ 2,473 | \$ 3,248 | \$ 1,177 | \$ 8,859 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****5. Loans, net and allowance for loan losses (continued):**

The allocation of the allowance for loan losses and the related loans by major classifications of loans at March 31, 2015 and December 31, 2014 is summarized as follows:

| March 31, 2015 | Real estate | | | | Unallocated | Total |
|---|--------------------|-------------------|--------------------|-----------------|--------------------|--------------|
| | Commercial | Commercial | Residential | Consumer | | |
| Allowance for loan losses: | | | | | | |
| Ending balance | \$ 2,420 | \$ 3,087 | \$ 3,909 | \$ 1,387 | | \$ 10,803 |
| Ending balance: individually evaluated for impairment | 1,263 | 625 | 843 | 90 | | 2,821 |
| Ending balance: collectively evaluated for impairment | 954 | 2,355 | 3,066 | 1,297 | | 7,672 |
| Ending balance: loans acquired with deteriorated credit quality | \$ 203 | \$ 107 | \$ | \$ | | \$ 310 |
| Loans receivable: | | | | | | |
| Ending balance | \$ 319,468 | \$ 522,432 | \$ 305,663 | \$ 89,605 | | \$ 1,237,168 |
| Ending balance: individually evaluated for impairment | 2,631 | 4,757 | 3,853 | 101 | | 11,342 |
| Ending balance: collectively evaluated for impairment | 315,524 | 516,295 | 301,752 | \$ 89,504 | | 1,223,075 |
| Ending balance: loans acquired with deteriorated credit quality | \$ 1,313 | \$ 1,380 | \$ 58 | | | \$ 2,751 |

| December 31, 2014 | Real estate | | | | Unallocated | Total |
|--------------------------|--------------------|-------------------|--------------------|-----------------|--------------------|--------------|
| | Commercial | Commercial | Residential | Consumer | | |

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| | | | | | |
|---|------------|------------|------------|-----------|--------------|
| Allowance for loan losses: | | | | | |
| Ending balance | \$ 2,321 | \$ 3,037 | \$ 3,690 | \$ 1,290 | \$ 10,338 |
| Ending balance: individually evaluated for impairment | | | | | |
| | 1,072 | 805 | 767 | 38 | 2,682 |
| Ending balance: collectively evaluated for impairment | | | | | |
| | 1,081 | 2,125 | 2,921 | 1,252 | 7,379 |
| Ending balance: loans acquired with deteriorated credit quality | | | | | |
| | \$ 168 | \$ 107 | \$ 2 | \$ | \$ 277 |
| Loans receivable: | | | | | |
| Ending balance | \$ 319,590 | \$ 493,481 | \$ 310,667 | \$ 86,156 | \$ 1,209,894 |
| Ending balance: individually evaluated for impairment | | | | | |
| | 2,595 | 5,084 | 4,001 | 127 | 11,807 |
| Ending balance: collectively evaluated for impairment | | | | | |
| | 315,642 | 487,024 | 306,608 | \$ 86,029 | 1,195,303 |
| Ending balance: loans acquired with deteriorated credit quality | | | | | |
| | \$ 1,353 | \$ 1,373 | \$ 58 | | \$ 2,784 |

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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

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

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

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

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

Doubtful A loan classified as Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss-A loan classified as Loss is considered uncollectible and of such little value that its continuance as bankable loans is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

The following tables present the major classification of loans summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system at March 31, 2015 and December 31, 2014:

| March 31, 2015: | Pass | Special Mention | Substandard | Doubtful | Total |
|------------------------|--------------|----------------------------|--------------------|-----------------|--------------|
| Commercial | \$ 307,690 | \$ 6,802 | \$ 4,976 | | \$ 319,468 |
| Real estate: | | | | | |
| Commercial | 503,620 | 9,885 | 8,927 | | 522,432 |
| Residential | 296,500 | 1,065 | 8,098 | | 305,663 |
| Consumer | 89,504 | | 101 | | 89,605 |
| Total | \$ 1,197,314 | \$ 17,752 | \$ 22,102 | | \$ 1,237,168 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

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

| December 31, 2014: | Pass | Special Mention | Substandard | Doubtful | Total |
|---------------------------|---------------------|----------------------------|--------------------|-----------------|---------------------|
| Commercial | \$ 306,066 | \$ 6,135 | \$ 7,389 | | \$ 319,590 |
| Real estate: | | | | | |
| Commercial | 472,270 | 9,858 | 11,353 | | 493,481 |
| Residential | 300,299 | 2,123 | 8,245 | | 310,667 |
| Consumer | 86,037 | 13 | 106 | | 86,156 |
| Total | \$ 1,164,672 | \$ 18,129 | \$ 27,093 | | \$ 1,209,894 |

Information concerning nonaccrual loans by major loan classification at March 31, 2015 and December 31, 2014 is summarized as follows:

| | March 31, 2015 | December 31, 2014 |
|--------------|---------------------------|------------------------------|
| Commercial | \$ 2,366 | \$ 1,322 |
| Real estate: | | |
| Commercial | 3,781 | 3,732 |
| Residential | 3,331 | 3,523 |
| Consumer | 97 | 122 |
| Total | \$ 9,575 | \$ 8,699 |

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

| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days | Total Past Due | Current | Total Loans | Loans > 90 Days and Accruing |
|-----------------------|------------------------------------|------------------------------------|-------------------------------------|---------------------------|----------------|------------------------|--|
| March 31, 2015 | | | | | | | |
| Commercial | \$ 543 | \$ 43 | \$ 2,366 | \$ 2,952 | \$ 316,516 | \$ 319,468 | |
| Real estate: | | | | | | | |
| Commercial | 1,689 | 220 | 3,781 | 5,690 | 516,742 | 522,432 | |

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| | | | | | | | |
|-------------|----------|----------|-----------|-----------|--------------|--------------|----------|
| Residential | 3,811 | 1,065 | 4,106 | 8,982 | 296,681 | 305,663 | \$ 775 |
| Consumer | 679 | 170 | 559 | 1,408 | 88,197 | 89,605 | 462 |
| Total | \$ 6,722 | \$ 1,498 | \$ 10,812 | \$ 19,032 | \$ 1,218,136 | \$ 1,237,168 | \$ 1,237 |

| December 31, 2014 | 30-59 Days | 60-89 Days | Greater | Total Past | Current | Total | Loans > 90 |
|-------------------|------------|------------|--------------|------------|--------------|--------------|-------------------|
| | Past Due | Past Due | than 90 Days | Due | | | Days and Accruing |
| Commercial | \$ 898 | \$ 117 | \$ 1,322 | \$ 2,337 | \$ 317,253 | \$ 319,590 | |
| Real estate: | | | | | | | |
| Commercial | 2,100 | 888 | 3,868 | 6,856 | 486,625 | 493,481 | \$ 136 |
| Residential | 3,154 | 1,239 | 4,585 | 8,978 | 301,689 | 310,667 | 1,062 |
| Consumer | 848 | 247 | 547 | 1,642 | 84,514 | 86,156 | 425 |
| Total | \$ 7,000 | \$ 2,491 | \$ 10,322 | \$ 19,813 | \$ 1,190,081 | \$ 1,209,894 | \$ 1,623 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

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

The following tables summarize information concerning impaired loans at and for the period ended March 31, 2015, December 31, 2014 and March 31, 2014, by major loan classification:

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | For the Quarter Ended | |
|-----------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| | | | | Average Recorded Investment | Interest Income Recognized |
| March 31, 2015 | | | | | |
| With no related allowance: | | | | | |
| Commercial | \$ 2,319 | \$ 3,900 | | \$ 2,349 | \$ 20 |
| Real estate: | | | | | |
| Commercial | 2,198 | 2,936 | | 2,565 | 19 |
| Residential | 2,272 | 2,456 | | 2,472 | 1 |
| Consumer | 11 | 11 | | 47 | |
| Total | 6,800 | 9,303 | | 7,433 | 40 |
| With an allowance recorded: | | | | | |
| Commercial | 1,625 | 1,625 | \$ 1,466 | 1,597 | \$ 14 |
| Real estate: | | | | | |
| Commercial | 3,939 | 3,939 | 732 | 3,732 | 17 |
| Residential | 1,639 | 1,639 | 843 | 1,513 | 10 |
| Consumer | 90 | 90 | 90 | 67 | |
| Total | 7,293 | 7,293 | 3,131 | 6,909 | 41 |
| Commercial | 3,944 | 5,525 | 1,466 | 3,946 | 34 |
| Real estate: | | | | | |
| Commercial | 6,137 | 6,875 | 732 | 6,297 | 36 |
| Residential | 3,911 | 4,095 | 843 | 3,985 | 11 |
| Consumer | 101 | 101 | 90 | 114 | |
| Total | \$ 14,093 | \$ 16,596 | \$ 3,131 | \$ 14,342 | \$ 81 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

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

| December 31, 2014 | Recorded Investment | Unpaid Principal Balance | Related Allowance | For the Year Ended Average Recorded Investment | Interest Income Recognized |
|------------------------------------|--------------------------------|---|------------------------------|---|---|
| With no related allowance: | | | | | |
| Commercial | \$ 2,379 | \$ 4,084 | | \$ 2,669 | 141 |
| Real estate: | | | | | |
| Commercial | 2,932 | 3,690 | | 7,944 | 120 |
| Residential | 2,672 | 2,857 | | 2,731 | 4 |
| Consumer | 83 | 83 | | 94 | |
| Total | 8,066 | 10,714 | | 13,438 | 265 |
| With an allowance recorded: | | | | | |
| Commercial | 1,569 | 1,569 | \$ 1,240 | 1,787 | \$ 58 |
| Real estate: | | | | | |
| Commercial | 3,525 | 3,525 | 912 | 2,293 | 28 |
| Residential | 1,387 | 1,387 | 769 | 590 | 10 |
| Consumer | 44 | 44 | 38 | 10 | 1 |
| Total | 6,525 | 6,525 | 2,959 | 4,680 | 97 |
| Commercial | 3,948 | 5,653 | 1,240 | 4,456 | 199 |
| Real estate: | | | | | |
| Commercial | 6,457 | 7,215 | 912 | 10,237 | 148 |
| Residential | 4,059 | 4,244 | 769 | 3,321 | 14 |
| Consumer | 127 | 127 | 38 | 104 | 1 |
| Total | \$ 14,591 | \$ 17,239 | \$ 2,959 | \$ 18,118 | \$ 362 |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****5. Loans, net and allowance for loan losses (continued):**

| | | | | For the Quarter Ended | |
|-----------------------------|----------------------------|---------------------------------|--------------------------|------------------------------------|-----------------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| March 31, 2014 | | | | | |
| With no related allowance: | | | | | |
| Commercial | \$ 2,008 | \$ 4,762 | | \$ 3,493 | |
| Real estate: | | | | | |
| Commercial | 9,958 | 12,746 | | 10,227 | |
| Residential | 2,740 | 3,144 | | 2,872 | |
| Consumer | 128 | 128 | | 109 | |
| Total | 14,834 | 20,780 | | 16,701 | |
| With an allowance recorded: | | | | | |
| Commercial | 1,728 | 1,728 | \$ 1,128 | 1,964 | \$ 26 |
| Real estate: | | | | | |
| Commercial | 1,404 | 1,404 | 542 | 1,399 | 18 |
| Residential | 261 | 261 | 162 | 523 | |
| Consumer | | | | | |
| Total | 3,393 | 3,393 | 1,832 | 3,886 | 44 |
| Commercial | 3,736 | 6,490 | 1,128 | 5,457 | 26 |
| Real estate: | | | | | |
| Commercial | 11,362 | 14,150 | 542 | 11,626 | 18 |
| Residential | 3,001 | 3,405 | 162 | 3,395 | |
| Consumer | 128 | 128 | | 109 | |
| Total | \$ 18,227 | \$ 24,173 | \$ 1,832 | \$ 20,587 | \$ 44 |

Included in the commercial loan and residential and commercial real estate categories are troubled debt restructurings that are classified as impaired. Trouble debt restructurings totaled \$2,967 at March 31, 2015, \$2,933 at December 31, 2014 and \$1,924 at March 31, 2014.

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

Rate Modification - A modification in which the interest rate is changed to a below market rate.

Term Modification - A modification in which the maturity date, timing of payments or frequency of payments is changed.

Interest Only Modification - A modification in which the loan is converted to interest only payments for a period of time.

Payment Modification - A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination Modification - Any other type of modification, including the use of multiple categories above.

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Dollars in thousands, except per share data)****5. Loans, net and allowance for loan losses (continued):**

There were four loans modified as troubled debt restructurings for the three months ended March 31, 2015, in the amount of \$384. There were no loans modified as troubled debt restructurings for the three months ended March 31, 2014. During the three months ended March 31, 2015 and 2014, there were no defaults on loans restructured within the last twelve months.

6. Other assets:

The components of other assets at March 31, 2015, and December 31, 2014 are summarized as follows:

| | March 31, 2015 | December 31, 2014 |
|---|---------------------------|------------------------------|
| Other real estate owned | \$ 324 | \$ 561 |
| Investment in residential housing program | 4,178 | 4,329 |
| Mortgage servicing rights | 623 | 676 |
| Bank owned life insurance | 30,177 | 29,983 |
| Restricted equity securities | 2,132 | 3,687 |
| Other assets | 13,352 | 13,830 |
| Total | \$ 50,786 | \$ 53,066 |

7. Fair value estimates:

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

In accordance with FASB ASC 820, Fair Value Measurements and Disclosures, fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets. In many cases, these values cannot be realized in immediate settlement of the instrument.

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

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

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

Level 1: Unadjusted quoted prices of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

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

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

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

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

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

underlying collateral values, where applicable.

In conjunction with the 2013 merger with Pensco Financial Services Corporation (Pensco), the loans purchased were recorded at their acquisition date fair value. In order to record the loans at fair value, management made three different types of fair value adjustments. A market rate adjustment was made to adjust for the movement in market interest rates, irrespective of credit adjustments, compared to the stated rates of the acquired loans. A credit adjustment was made on pools of homogeneous loans representing the changes in credit quality of the underlying borrowers from the loan inception to the acquisition date. The credit adjustment on distressed loans represents the portion of the loan balance that has been deemed uncollectible based on the management s expectations of future cash flows for each respective loan.

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

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

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

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

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

The fair value assigned to the core deposit intangible asset represents the future economic benefit of the potential cost savings from acquiring core deposits in the 2013 merger with Pensco compared to the cost of obtaining alternative funding such as brokered deposits from market sources. Management utilized an income valuation approach to present value the estimated future cash savings in order to determine the fair value of the intangible asset.

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

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

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

Off-balance sheet financial instruments:

The majority of commitments to extend credit, unused portions of lines of credit and standby letters of credit carry current market interest rates if converted to loans. Because such commitments are generally unassignable of either the Company or the borrower, they only have value to the Company and the borrower. None of the commitments are subject to undue credit risk. The estimated fair values of off-balance sheet financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of off-balance sheet financial instruments was not material at March 31, 2015 and December 31, 2014.

Assets and liabilities measured at fair value on a recurring basis at March 31, 2015 and December 31, 2014 are summarized as follows:

| March 31, 2015 | Amount | Fair Value Measurement Using | | |
|---------------------------------------|-------------------|---|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| U.S. Government-sponsored enterprises | \$ 96,148 | \$ | \$ 96,148 | \$ |
| State and Municipals: | | | | |
| Taxable | 17,495 | | 17,495 | |
| Tax-exempt | 87,649 | | 87,649 | |
| Mortgage-backed securities: | | | | |
| U.S. Government agencies | 35,400 | | 35,400 | |
| U.S. Government-sponsored enterprises | 43,608 | | 43,608 | |
| Total | \$ 280,300 | \$ | \$ 280,300 | \$ |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

| | Amount | Fair Value Measurement Using | | |
|---------------------------------------|------------|---|--|---|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| December 31, 2014 | | | | |
| U.S. Treasury securities | \$ 48,550 | \$ 48,550 | | \$ |
| U.S. Government-sponsored enterprises | 96,245 | | \$ 96,245 | |
| State and Municipals: | | | | |
| Taxable | 17,407 | | 17,407 | |
| Tax-exempt | 92,901 | | 92,901 | |
| Corporate debt securities | | | | |
| Mortgage-backed securities: | | | | |
| U.S. Government agencies | 37,476 | | 37,476 | |
| U.S. Government-sponsored enterprises | 47,007 | | 47,007 | |
| Total | \$ 339,586 | \$ 48,550 | \$ 291,036 | \$ |

Assets and liabilities measured at fair value on a nonrecurring basis at March 31, 2015 and December 31, 2014 are summarized as follows:

| | Amount | Fair Value Measurement Using | | |
|--------------------------|----------|---|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| March 31, 2015 | | | | |
| Impaired loans | \$ 4,862 | | | \$ 4,862 |
| Other real estate owned | \$ 159 | | | \$ 159 |
| December 31, 2014 | | | | |
| | Amount | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |

| | (Level 1) | (Level 2) | (Level 3) |
|-------------------------|-----------|-----------|-----------|
| Impaired loans | \$ 4,414 | | \$ 4,414 |
| Other real estate owned | \$ 218 | | \$ 218 |

Fair values of impaired loans are based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

| Quantitative Information about Level 3 Fair Value Measurements | | | | |
|---|-------------------|-------------------------|---------------------------|---------------------------|
| | Fair Value | Valuation | Unobservable Input | Range |
| March 31, 2015 | Estimate | Techniques | | (Weighted Average) |
| Impaired loans | \$ 4,862 | Appraisal of collateral | Appraisal adjustments | 13.3% to 51.1% (23.0%) |
| | | | Liquidation expenses | 3.0% to 6.0% (5.4%) |
| Other real estate owned | \$ 159 | Appraisal of collateral | Appraisal adjustments | 19.7% to 77.9% (37.3%) |
| | | | Liquidation expenses | 3.0% to 6.0% (5.0%) |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

| December 31, 2014 | Quantitative Information about Level 3 Fair Value Measurements | | | |
|-------------------------|--|-------------------------|-----------------------|--------------------------|
| | Fair Value Estimate | Valuation Techniques | Unobservable Input | Range (Weighted Average) |
| Impaired loans | \$ 4,414 | Appraisal of collateral | Appraisal adjustments | 2.6% to 61.1% (24.5%) |
| | | | Liquidation expenses | 3.0% to 6.0% (5.5%) |
| Other real estate owned | \$ 218 | Appraisal of collateral | Appraisal adjustments | 19.7% to 47.8% (30.5%) |
| | | | Liquidation expenses | 3.0% to 6.0% (5.0%) |

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

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

The carrying and fair values of the Company's financial instruments at March 31, 2015 and December 31, 2014 and their placement within the fair value hierarchy are as follows:

| March 31, 2015 | Carrying Value | Fair Value | Fair Value Hierarchy | | |
|-----------------------------|----------------|------------|--|---|---|
| | | | Quoted Prices in Active Markets for Identical Assets (level 1) | Significant Other Observable Inputs (level 2) | Significant Unobservable Inputs (Level 3) |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 39,631 | \$ 39,631 | \$ 39,631 | | |
| Investment securities: | | | | | |
| Available-for-sale | 280,300 | 280,300 | | \$ 280,300 | |
| Held-to-maturity | 14,172 | 14,729 | | 14,729 | |
| Loans held for sale | 3,101 | 3,107 | | 3,107 | |
| Net loans | 1,226,365 | 1,238,915 | | | \$ 1,238,915 |
| Accrued interest receivable | 4,922 | 4,922 | | 4,922 | |

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| | | | |
|------------------------------|---------------------|---------------------|-----------|
| Mortgage servicing rights | 623 | 1,466 | 1,466 |
| Restricted equity securities | 2,132 | 2,132 | 2,132 |
| Total | \$ 1,571,246 | \$ 1,585,202 | |
| Financial liabilities: | | | |
| Deposits | \$ 1,416,278 | \$ 1,418,370 | 1,418,370 |
| Long-term debt | 32,318 | 34,133 | 34,133 |
| Accrued interest payable | 460 | 460 | \$ 460 |
| Total | \$ 1,449,056 | \$ 1,452,963 | |

Table of Contents**Peoples Financial Services Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share data)

7. Fair value estimates (continued):

| December 31, 2014 | Carrying Value | Fair Value | Fair Value Hierarchy | | |
|-------------------------------|---------------------|---------------------|--|---|---|
| | | | Quoted Prices in Active Markets for Identical Assets (level 1) | Significant Other Observable Inputs (level 2) | Significant Unobservable Inputs (Level 3) |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 31,426 | \$ 31,426 | \$ 31,426 | | |
| Investment securities: | | | | | |
| Available-for-sale | 339,586 | 339,586 | \$ 48,550 | \$ 291,036 | |
| Held-to-maturity | 14,665 | 15,215 | | 15,215 | |
| Loans held for sale | 3,486 | 3,492 | | 3,492 | |
| Net loans | 1,199,556 | 1,210,369 | | | \$ 1,210,369 |
| Accrued interest receivable | 5,580 | 5,580 | | 5,580 | |
| Mortgage servicing rights | 676 | 1,466 | | 1,466 | |
| Restricted equity securities | 3,687 | 3,687 | | 3,687 | |
| Total | \$ 1,598,662 | \$ 1,610,821 | | | |
| Financial liabilities: | | | | | |
| Deposits | \$ 1,425,558 | \$ 1,427,081 | | 1,427,081 | |
| Short-term borrowings | 19,557 | 19,557 | | 19,557 | |
| Long-term debt | 33,140 | 34,772 | | 34,772 | |
| Accrued interest payable | 574 | 574 | | \$ 574 | |
| Total | \$ 1,478,829 | \$ 1,481,984 | | | |

8. Employee benefit plans:

The Company provides an Employee Stock Ownership Plan (ESOP) and a Retirement Profit Sharing Plan. The Company also maintains a Supplemental Executive Retirement Plan (SERP), an Employees Pension Plan, which is currently frozen, and a Postretirement Plan Life Insurance plan which was curtailed in 2013.

Salaries and employee benefits expense includes approximately \$279 and \$250 relating to the employee benefit plans for the three months ended March 31, 2015 and 2014.

Components of net periodic benefit income are as follows:

| Three months ended March 31, | Pension Benefits | |
|---------------------------------------|-------------------------|----------------|
| | 2015 | 2014 |
| Net periodic pension income: | | |
| Service cost | | |
| Interest cost | \$ 174 | \$ 169 |
| Expected return on plan assets | (233) | (227) |
| Amortization of prior service cost | | |
| Amortization of unrecognized net loss | 50 | 23 |
| Net periodic pension income | \$ (9) | \$ (35) |

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements contained in Part I, Item 1 of this report, and with our audited consolidated financial statements and

Management's Discussion and Analysis of Financial Condition and Results of Operations presented in our Annual Report on Form 10-K for the year ended December 31, 2014.

Cautionary Note Regarding Forward-Looking Statements:

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to risks and uncertainties. These statements are based on assumptions and may describe future plans, strategies and expectations of Peoples Financial Services Corp. and its direct and indirect subsidiaries. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. All statements in this report, other than statements of historical facts, are forward-looking statements.

Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Important factors that could cause our actual results to differ materially from those in the forward-looking statements include, but are not limited to: our ability to achieve the intended benefits of the 2013 merger with Pensco; changes in interest rates; economic conditions, particularly in our market area; legislative and regulatory changes and the ability to comply with the significant laws and regulations governing the banking and financial services business; monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of Treasury and the Federal Reserve System; credit risk associated with lending activities and changes in the quality and composition of our loan and investment portfolios; demand for loan and other products; deposit flows; competition; changes in the values of real estate and other collateral securing the loan portfolio, particularly in our market area; changes in relevant accounting principles and guidelines; and inability of third party service providers to perform. Additional factors that may affect our results are discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014, and in reports we file with the Securities and Exchange Commission from time to time.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, Peoples Financial Services Corp. does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Notes to the Consolidated Financial Statements referred to in the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) are incorporated by reference into the MD&A. Certain prior period amounts may have been reclassified to conform with the current year's presentation. Any reclassifications did not have any effect on the operating results or financial position of the Company.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Critical Accounting Policies:

Disclosure of our significant accounting policies are included in Note 1 to the consolidated financial statements of the Annual Report on Form 10-K for the year ended December 31, 2014. Some of these policies are particularly sensitive requiring significant judgments, estimates and assumptions.

Operating Environment:

Fiscal policy initiatives enacted by the Federal Open Market Committee (FOMC) during the first quarter of 2015 were limited to changing of language used in its policy statements. The FOMC dropped the word "patient" when discussing a move toward normalizing monetary policy from the March minutes, replacing it with "reasonable confidence" when referring to attaining their inflation target of 2.0 percent. Economic performance for the first quarter of 2015 was sluggish. Economic indicators throughout the latter part of 2014 and into 2015 pointed to an improving economy. However, the tough winter experienced throughout much of the country caused the gross domestic product (GDP), the value of all goods and services produced in the Nation, to slow in the first quarter of 2015 to a seasonally adjusted growth rate of 0.2 percent, much weaker than the 2.4 percent experienced in 2014 and the 2.2 percent in 2013. In light of the disappointing economic indicators and lack of inflationary pressure, the FOMC moderated its assessment of the pace of economic expansion. The consumer price index (CPI) declined 1.3 percent annualized during the first quarter of 2015. While a majority of economists expect the FOMC to raise short-term rates as early as June, the mixed to negative economic data has pushed longer term treasury yields down. Accordingly, a flat yield curve would increase the pressure on bank margins.

Review of Financial Position:

Total assets declined \$27,708 or at an annual rate of 6.5% to \$1,713,961 at March 31, 2015, from \$1,741,669 at December 31, 2014. The balance sheet decline during the first quarter of 2015 was centered mainly on decreases in investment securities. Investment securities available-for-sale decreased \$59,286 in the first quarter of 2015. Loans, net increased to \$1,237,168 at March 31, 2015, compared to \$1,209,894 at December 31, 2014, an increase of \$27,274 or 9.1% annualized. Total deposits decreased \$9,280, to \$1,416,278 at March 31, 2015 from \$1,425,558 at year-end December 31, 2014. Interest-bearing deposits decreased \$819, while noninterest-bearing deposits declined \$8,461. Total stockholders' equity increased \$2,679 from \$246,779 at year-end 2014 to \$249,458 at March 31, 2015. For the three months ended March 31, 2015, total assets averaged \$1,711,339, an increase of \$16,269 or 0.95%, from \$1,695,070 for the same period of 2014.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Investment Portfolio:

The majority of the investment portfolio is held as available-for-sale, which allows for greater flexibility in using the investment portfolio for liquidity purposes by allowing securities to be sold when market opportunities occur. Investment securities available-for-sale totaled \$280,300 at March 31, 2015, a decrease of \$59,286, or 17.5% from \$339,586 at December 31, 2014. The decrease was primarily a result of the sale of U.S. Treasury securities in response to changes in the slope of the yield curve and in order to fund increased loan demand. Investment securities held-to-maturity totaled \$14,172 at March 31, 2015, a decrease of \$493, or 3.4% from \$14,665 at December 31, 2014 due to payments received from mortgage backed holdings.

For the three months ended March 31, 2015, the investment portfolio averaged \$313,075, a decrease of \$6,723 or 2.1% compared to \$319,798 for the same period last year. The tax-equivalent yield on the investment portfolio decreased 3 basis points to 2.78% for the three months ended March 31, 2015, from 2.81% for the comparable period of 2014. The yield decline is the result of decreasing reinvestment yields.

Securities available-for-sale are carried at fair value, with unrealized gains or losses net of deferred income taxes reported in the accumulated other comprehensive income (loss) component of stockholders' equity. We reported net unrealized holding gains, included as a separate component of stockholders' equity of \$4,048, net of income taxes of \$2,179, at March 31, 2015, and \$4,090, net of income taxes of \$2,202, at December 31, 2014.

The Asset/Liability Committee (ALCO) reviews the performance and risk elements of the investment portfolio quarterly. Through active balance sheet management and analysis of the securities portfolio, we seek to maintain sufficient liquidity to satisfy depositor requirements and meet the credit needs of our customers.

Loan Portfolio:

Continuing the momentum of a strong fourth quarter in 2014, loan growth was again robust in the first quarter of 2015. Loans, net increased to \$1,237,168 at March 31, 2015 from \$1,209,894 at December 31, 2014, an increase of \$27,274 or 9.1% annualized. The growth reflected increases in commercial real estate loans and consumer loans, partially offset by decreases in commercial loans and residential real estate loans. Commercial real estate loans increased \$28,951 or 23.8% annualized, to \$522,432 at March 31, 2015 compared to \$493,481 at December 31, 2014. Commercial loans decreased \$122, or 0.2% annualized, to \$319,468 at March 31, 2015 compared to \$319,590 at December 31, 2014.

Weakness in residential real estate markets have further cut into the wealth of consumers. Home sales were hampered in the first quarter of 2015 due to severe winter conditions throughout much of the nation. Residential real estate loans decreased \$5,004, or 6.5% annualized, to \$305,663 at March 31, 2015 compared to \$310,667 at December 31, 2014. Conversely, consumer loans increased \$3,449, or 16.2% annualized, to \$89,605 at March 31, 2015 compared to \$86,156 at December 31, 2014.

Table of Contents**Peoples Financial Services Corp.****MANAGEMENT'S DISCUSSION AND ANALYSIS****(Dollars in thousands, except per share data)**

For the three months ended March 31, 2015, loans, net averaged \$1,225,769, an increase of \$44,288 or 3.7% compared to \$1,181,481 for the same period of 2014. The tax-equivalent yield on the loan portfolio was 4.70% for the three months ended March 31, 2015, which was 44 basis points less than the comparable period last year. Interest income on loans included accretion recognized on loans acquired as part of the 2013 merger with Pensco of \$225 in the first quarter of 2015 and \$1,055 in the comparable period of 2014.

In addition to the risks inherent in our loan portfolio, in the normal course of business, we are also a party to financial instruments with off-balance sheet risk to meet the financing needs of our customers. These instruments include legally binding commitments to extend credit, unused portions of lines of credit and commercial letters of credit made under the same underwriting standards as on-balance sheet instruments, and may involve, to varying degrees, elements of credit risk and interest rate risk (IRR) in excess of the amount recognized in the financial statements.

Unused commitments at March 31, 2015, totaled \$260,105, consisting of \$234,783 in unfunded commitments of existing loan facilities and \$25,322 in standby letters of credit. Due to fixed maturity dates, specified conditions within these instruments, and the ultimate needs of our customers, many will expire without being drawn upon. We believe that amounts actually drawn upon can be funded in the normal course of operations and therefore, do not represent a significant liquidity risk to us. In comparison, unused commitments, at December 31, 2014, totaled \$266,570, consisting of \$235,961 in unfunded commitments of existing loans and \$30,609 in standby letters of credit.

Asset Quality:

National, Pennsylvania, New York and market area unemployment rates at March 31, 2015 and 2014, are summarized as follows:

| | March 31, 2015 | March 31, 2014 |
|--------------------------|-----------------------|-----------------------|
| United States | 5.5% | 6.6% |
| Pennsylvania (statewide) | 5.7% | 6.6% |
| Lackawanna County | 6.3% | 7.7% |
| Lehigh County | 5.9% | 6.7% |
| Luzerne County | 7.1% | 8.5% |
| Monroe County | 7.0% | 8.5% |
| Susquehanna County | 6.4% | 6.5% |
| Wayne County | 7.4% | 7.4% |
| Wyoming County | 6.8% | 8.8% |
| New York (statewide) | 6.4% | 7.1% |
| Broome County | 6.9% | 7.4% |

The employment conditions improved for the Nation, Pennsylvania, New York as well as seven of the eight counties representing our market areas in Pennsylvania and New York from one year ago. Despite the overall improvements,

employment conditions continued to be somewhat weak as unemployment levels remained elevated compared to historical levels.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Our asset quality declined slightly in the first quarter of 2015. Nonperforming assets increased \$414 or 3.8% to \$11,297 at March 31, 2015, from \$10,883 at December 31, 2014. We experienced decreases in other real estate owned and accruing loans past due 90 days or more. However, those decreases were outweighed by an increase in nonaccrual and restructured loans. As a percentage of loans, net and foreclosed assets, nonperforming assets equaled 0.91% at March 31, 2015 compared to 0.90% at December 31, 2014.

Loans on nonaccrual status increased \$876 to \$9,575 at March 31, 2015 from \$8,699 at December 31, 2014. The increase from year end was due primarily to an increase of \$1,044 in commercial loans on nonaccrual status. Retail loans, including residential real estate and consumer loans on nonaccrual status declined \$217. Accruing loans past due 90 days or more decreased \$386 to \$1,237 at March 31, 2015 when compared to \$1,623 at December 31, 2014. Other real estate owned decreased \$237 to \$324 at March 31, 2015 when compared to \$561 at December 31, 2014.

We maintain the allowance for loan losses at a level we believe adequate to absorb probable credit losses related to specifically identified loans, as well as probable incurred loan losses inherent in the remainder of the loan portfolio as of the balance sheet date. The allowance for loan losses is based on past events and current economic conditions. We employ the Federal Financial Institutions Examination Council Interagency Policy Statement, as amended December 13, 2006, and GAAP in assessing the adequacy of the allowance account. Under GAAP, the adequacy of the allowance account is determined based on the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 310, Receivables, for loans specifically identified to be individually evaluated for impairment and the requirements of FASB ASC 450, Contingencies, for large groups of smaller-balance homogeneous loans to be collectively evaluated for impairment.

We follow our systematic methodology in accordance with procedural discipline by applying it in the same manner regardless of whether the allowance is being determined at a high point or a low point in the economic cycle. Each quarter, loan review identifies those loans to be individually evaluated for impairment and those loans collectively evaluated for impairment utilizing a standard criteria. Internal loan review grades are assigned quarterly to loans identified to be individually evaluated. A loan's grade may differ from period to period based on current conditions and events, however, we consistently utilize the same grading system each quarter. We consistently use loss experience from the latest twelve quarters in determining the historical loss factor for each pool collectively evaluated for impairment. Qualitative factors are evaluated in the same manner each quarter and are adjusted within a relevant range of values based on current conditions. For additional disclosure related to the allowance for loan losses refer to the note entitled, Loans, net and Allowance for Loan Losses, in the Notes to Consolidated Financial Statements to this Quarterly Report.

The allowance for loan losses increased \$465 to \$10,803 at March 31, 2015, from \$10,338 at the end of 2014. For the three months ended March 31, 2015, net charge-offs were \$285 or 0.09% of average loans outstanding in 2015, a \$364 decrease compared to \$649 or 0.22% of average loans outstanding in the first quarter of 2014.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Deposits:

The majority of our deposits are attracted from within our eight county market area that stretches from the Lehigh Valley in Pennsylvania to Broome County in the Southern Tier of New York State through the offering of various deposit instruments including demand deposit accounts, NOW accounts, money market deposit accounts, savings accounts, and time deposits, including certificates of deposit and IRAs. During the three months ended March 31, 2015, total deposits decreased \$9,280, or 2.6% annualized, to \$1,416,278 from \$1,425,558 at December 31, 2014. Growth was experienced in savings accounts while the other classifications declined. Savings deposits increased \$10,570, or 10.9% annualized, to \$402,522 at March 31, 2015, from \$391,952 at December 31, 2014. All other deposit categories decreased in the first quarter of 2015 due to cyclical trends. Interest-bearing transaction accounts, including NOW and money market accounts, decreased \$1,624, or 1.5% annualized, to \$450,742 at March 31, 2015, from \$452,366 at December 31, 2014. Demand deposits, decreased \$8,461, or 11.0% annualized, to \$305,037 at March 31, 2015, compared to \$313,498 at December 31, 2014. Time deposits less than \$100 decreased \$4,302, or 9.1% annualized, to \$187,588 at March 31, 2015, compared to \$191,890 at December 31, 2014 while time deposits of \$100 or more were down \$5,463, or 29.2% annualized, to \$70,389 at March 31, 2015, compared to \$75,852 at December 31, 2014.

For the quarter ended March 31, 2015, average total deposits increased \$24,411 to \$1,408,080, compared to \$1,383,669 for the same period of 2014. Average noninterest-bearing deposits grew \$23,582, while average interest-bearing accounts increased \$829. Our cost of interest-bearing deposits decreased 4 basis points to 0.46% for the three months ended March 31, 2015, from 0.50% for the three months ended March 31, 2014.

Borrowings:

The Bank utilizes borrowings as a secondary source of liquidity for its asset/liability management. Advances are available from the Federal Home Loan Bank (FHLB) provided certain standards related to credit worthiness have been met. Repurchase and term agreements are also available from the FHLB.

We had no short-term borrowings at March 31, 2015 as compared to \$19,557 at December 31, 2014. Long-term debt was \$32,318 at March 31, 2015, compared to \$33,140 at December 31, 2014. The reduction was a product of monthly contractual amortized payments made during the first quarter of 2015.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Market Risk Sensitivity:

Market risk is the risk to our earnings or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. Our exposure to market risk is primarily IRR associated with our lending, investing and deposit-gathering activities. During the normal course of business, we are not exposed to foreign exchange risk or commodity price risk. Our exposure to IRR can be explained as the potential for change in our reported earnings and/or the market value of our net worth. Variations in interest rates affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. Interest rate changes also affect the underlying economic value of our assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, change with interest rates. The effects of the changes in these present values reflect the change in our underlying economic value and provide a basis for the expected change in future earnings related to interest rates. IRR is inherent in the role of banks as financial intermediaries. However, a bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

As a result of economic uncertainty and a prolonged era of historically low market rates, it has become challenging to manage IRR. Due to these factors, IRR and effectively managing it are very important to both bank management and regulators. Bank regulations require us to develop and maintain an IRR management program, overseen by the Board of Directors and senior management, that involves a comprehensive risk management process in order to effectively identify, measure, monitor and control risk. Should we have material weaknesses in our risk management process or high exposure relative to our capital, bank regulatory agencies may take action to remedy these shortcomings. Moreover, the level of IRR exposure and the quality of our risk management process is a determining factor when evaluating capital adequacy.

The ALCO, comprised of members of our Board of Directors, senior management and other appropriate officers, oversees our IRR management program. Specifically ALCO analyzes economic data and market interest rate trends, as well as competitive pressures, and utilizes computerized modeling techniques to reveal potential exposure to IRR. This allows us to monitor and attempt to control the influence these factors may have on our rate-sensitive assets (RSA) and rate-sensitive liabilities (RSL), and overall operating results and financial position. One such technique utilizes a static gap model that considers repricing frequencies of RSA and RSL in order to monitor IRR. Gap analysis attempts to measure our interest rate exposure by calculating the net amount of RSA and RSL that reprice within specific time intervals. A positive gap occurs when the amount of RSA repricing in a specific period is greater than the amount of RSL repricing within that same time frame and is indicated by a RSA/RSL ratio greater than 1.0. A negative gap occurs when the amount of RSL repricing is greater than the amount of RSA and is indicated by a RSA/RSL ratio less than 1.0. A positive gap implies that earnings will be impacted favorably if interest rates rise and adversely if interest rates fall during the period. A negative gap tends to indicate that earnings will be affected inversely to interest rate changes.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Our cumulative one-year RSA/RSL ratio equaled 2.24% at March 31, 2015. Given the length of time that market rates have been at historical lows and the potential for rates to rise in the future, the focus of ALCO has been to create a positive static gap position. With regard to RSA, we predominantly offer medium-term, fixed-rate loans as well as adjustable rate loans. With respect to RSL, we offer longer term promotional certificates of deposit in an attempt to increase duration. The current position at March 31, 2015, indicates that the amount of RSA repricing within one year would exceed that of RSL, which would result in an increase in net interest income from rising market rates. However, these forward-looking statements are qualified in the aforementioned section entitled "Forward-Looking Discussion" in this Management's Discussion and Analysis.

Static gap analysis, although a credible measuring tool, does not fully illustrate the impact of interest rate changes on future earnings. First, market rate changes normally do not equally or simultaneously affect all categories of assets and liabilities. Second, assets and liabilities that can contractually reprice within the same period may not do so at the same time or to the same magnitude. Third, the interest rate sensitivity table presents a one-day position. Variations occur daily as we adjust our rate sensitivity throughout the year. Finally, assumptions must be made in constructing such a table.

As the static gap report fails to address the dynamic changes in the balance sheet composition or prevailing interest rates, we utilize a simulation model to enhance our asset/liability management. This model is used to create pro forma net interest income scenarios under various interest rate shocks. Model results at March 31, 2015, produced results similar to those indicated by the one-year static gap position. In addition, parallel and instantaneous shifts in interest rates under various interest rate shocks resulted in changes in net interest income that were well within ALCO policy limits. We will continue to monitor our IRR throughout 2015 and employ deposit and loan pricing strategies and direct the reinvestment of loan and investment repayments in order to maintain a favorable IRR position.

Financial institutions are affected differently by inflation than commercial and industrial companies that have significant investments in fixed assets and inventories. Most of our assets are monetary in nature and change correspondingly with variations in the inflation rate. It is difficult to precisely measure the impact inflation has on us, however we believe that our exposure to inflation can be mitigated through asset/liability management.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Liquidity:

Liquidity management is essential to our continuing operations and enables us to meet financial obligations as they come due, as well as to take advantage of new business opportunities as they arise. Financial obligations include, but are not limited to, the following:

Funding new and existing loan commitments;

Payment of deposits on demand or at their contractual maturity;

Repayment of borrowings as they mature;

Payment of lease obligations; and

Payment of operating expenses.

These obligations are managed daily, thus enabling us to effectively monitor fluctuations in our liquidity position and to adapt that position according to market influences and balance sheet trends. Future liquidity needs are forecasted and strategies are developed to ensure adequate liquidity at all times.

Historically, core deposits have been the primary source of liquidity because of their stability and lower cost, in general, than other types of funding. Providing additional sources of funds are loan and investment payments and prepayments and the ability to sell both available for sale securities and mortgage loans held for sale. We believe liquidity is adequate to meet both present and future financial obligations and commitments on a timely basis.

We employ a number of analytical techniques in assessing the adequacy of our liquidity position. One such technique is the use of ratio analysis related to our reliance on noncore funds to fund our investments and loans maturing after March 31, 2015. Our noncore funds at March 31, 2015, were comprised of time deposits in denominations of \$100 or more, repurchase agreements and other borrowings. These funds are not considered to be a strong source of liquidity since they are very interest rate sensitive and are considered to be highly volatile. At March 31, 2015, our net noncore funding dependence ratio, the difference between noncore funds and short-term investments to long-term assets, was 5.4%, while our net short-term noncore funding dependence ratio, noncore funds maturing within one-year, less short-term investments to long-term assets equaled -0.5%. Comparatively, our overall noncore dependence ratio improved from year-end 2014 when it was 10.0%. Similarly, our net short-term noncore funding dependence ratio was 4.1% at year-end, indicating that our reliance on short-term noncore funds has decreased.

The Consolidated Statements of Cash Flows present the changes in cash and cash equivalents from operating, investing and financing activities. Cash and cash equivalents, consisting of cash on hand, cash items in the process of collection, deposit balances with other banks and federal funds sold, increased \$8,205 during the three months ended March 31, 2015. Cash and cash equivalents increased \$27,902 for the same period last year. For the three months ended March 31, 2015, net cash inflows of \$7,361 from operating activities and \$32,631 from investing activities were partially offset by a \$31,787 net cash outflow from financing activities. For the same period of 2014, net cash inflows of \$21,971 from financing activities and \$7,130 from operating activities were partially offset by a \$1,199 net cash outflow from investing activities.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Financing activities used net cash of \$31,787 for the three months ended March 31, 2015, and provided \$21,971 for the same three months of 2014. Deposit gathering is our predominant financing activity. During the first three months of 2015 deposits declined compared to the same period last year. The net decrease in deposits totaled \$9,081 in 2015. Comparatively, deposit gathering provided net cash of \$24,855 for the same period of 2014. Short-term borrowings also declined \$19,557 contributing to the net use of funds.

Operating activities provided net cash of \$7,361 for the three months ended March 31, 2015, and \$7,130 for the same three months of 2014. Net income, adjusted for the effects of gains and losses along with noncash transactions such as depreciation and the provision for loan losses, is the primary source of funds from operations.

Investing activities primarily include transactions related to our lending activities and investment portfolio. Investing activities provided net cash of \$32,631 for the three months ended March 31, 2015, compared to using \$1,199 for the same period of 2014. In 2015, proceeds from the sale of investment securities available-for-sale brought in a significant amount of cash while in 2014, an increase in investment portfolio activities was the primary factor causing a net cash outflow from investing activities.

We believe that our future liquidity needs will be satisfied through maintaining an adequate level of cash and cash equivalents, by maintaining readily available access to traditional funding sources, and through proceeds received from the investment and loan portfolios. The current sources of funds will enable us to meet all cash obligations as they come due.

Capital:

Stockholders' equity totaled \$249,458 or \$33.05 per share at March 31, 2015, compared to \$246,779 or \$32.69 per share at December 31, 2014. Net income of \$5,044 for the three months ended March 31, 2015 was the primary factor leading to the improved capital position. Stockholders' equity was also affected by cash dividends declared of \$2,341, stock based compensation of \$18, and other comprehensive losses resulting from market value fluctuations in the investment portfolio of \$42.

Dividends declared equaled \$0.31 per share for the first quarter of 2015 and 2014, representing a dividend payout ratio of 46.4% in 2015 and 49.8% in 2014. The merger agreement pursuant to which we merged with Pensco in 2013 contemplates that, unless 80 percent of our board of directors determines otherwise, we will pay a quarterly cash dividend in an amount no less than \$0.31 per share through 2018, provided that sufficient funds are legally available, and that Peoples and Peoples Bank remain Well-capitalized in accordance with applicable regulatory guidelines. It is the intention of the Board of Directors to continue to pay cash dividends in the future. However, these decisions are affected by operating results, financial and economic decisions, capital and growth objectives, appropriate dividend restrictions and other relevant factors.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

In July 2013, the Board of Directors of the FRB approved the Basel III interim final rule (Basel III) which is intended to strengthen the quality and increase the required level of regulatory capital for a more stable and resilient banking system. The changes include: (i) a new regulatory capital measure, Common Equity Tier 1 (CET1), which is limited to capital elements of the highest quality; (ii) a new definition and increase of tier 1 capital which is now comprised of CET1 and Additional Tier 1; (iii) changes in calculation of some risk-weighted assets and off-balance sheet exposure; and (iv) a capital conservation buffer that will limit capital distributions, stock redemptions, and certain discretionary bonus payments if the institution does not maintain capital in excess of the minimum capital requirements. These new capital rules took effect for our bank on January 1, 2015 and reporting began with the March 31, 2015 call report.

The adequacy of capital is reviewed on an ongoing basis with reference to the size, composition and quality of resources and regulatory guidelines. We seek to maintain a level of capital sufficient to support existing assets and anticipated asset growth, maintain favorable access to capital markets, and preserve high quality credit ratings. At March 31, 2015, the Bank's Tier 1 capital to total average assets was 10.88% as compared to 10.42% at December 31, 2014. The Bank's Tier 1 capital to risk weighted asset ratio was 15.19% and the total capital to risk weighted asset ratio was 16.11% at March 31, 2015. These ratios were 14.28% and 15.15% at December 31, 2014. The Bank's common equity Tier 1 to risk weighted asset ratio was 15.19 at March 31, 2015. The Bank was deemed to be well-capitalized under regulatory standards at March 31, 2015.

Review of Financial Performance:

Net income for the first quarter of 2015 equaled \$5,044 or \$0.67 per share compared to \$4,698 or \$0.62 per share for the first quarter of 2014. Return on average assets (ROA) measures our net income in relation to total assets. Our ROA was 1.20% for the first quarter of 2015 compared to 1.12% for the same period of 2014. Return on average equity (ROE) indicates how effectively we generate net income on the capital invested by stockholders. Our ROE was 8.28% for the first quarter of 2015 compared to 8.01% for the first quarter of 2014. The results for the three months ended March 31, 2014 included pre-tax acquisition related expenses of \$608. Gains on sale of investment securities were \$832 thousand for the three months ended March 31, 2015, while there were no gains recognized for the comparable period in 2014.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Net Interest Income:

Net interest income is still the fundamental source of earnings for commercial banks. Moreover, fluctuations in the level of net interest income can have the greatest impact on net profits. Net interest income is defined as the difference between interest revenue, interest and fees earned on interest-earning assets, and interest expense, the cost of interest-bearing liabilities supporting those assets. The primary sources of earning assets are loans and investment securities, while interest-bearing deposits, short-term and long-term borrowings comprise interest-bearing liabilities. Net interest income is impacted by:

Variations in the volume, rate and composition of earning assets and interest-bearing liabilities;

Changes in general market rates; and

The level of nonperforming assets.

Changes in net interest income are measured by the net interest spread and net interest margin. Net interest spread, the difference between the average yield earned on earning assets and the average rate incurred on interest-bearing liabilities, illustrates the effects changing interest rates have on profitability. Net interest margin, net interest income as a percentage of earning assets, is a more comprehensive ratio, as it reflects not only the spread, but also the change in the composition of interest-earning assets and interest-bearing liabilities. Tax-exempt loans and investments carry pre-tax yields lower than their taxable counterparts. Therefore, in order to make the analysis of net interest income more comparable, tax-exempt income and yields are reported herein on a tax-equivalent basis using the prevailing federal statutory tax rate of 35.0%.

For the three months ended March 31, 2015, tax-equivalent net interest income decreased \$706 to \$14,827 in 2015 from \$15,533 in 2014. The net interest spread decreased to 3.74% for the three months ended March 31, 2015 from 3.94% for the three months ended March 31, 2014. The tax-equivalent net interest margin for the three months ended March 31 was 3.88% in 2015 compared to 4.09% in 2014. Loan accretion included in loan interest income in the first quarter of 2015 related to loans acquired in the fourth quarter of 2013 was \$225, resulting in an increase in the tax-equivalent net interest margin of 6 basis points. Comparatively, loan accretion recognized in the first quarter of 2014 was \$1,055 resulting in an increase in the tax-equivalent net interest margin of 28 basis points. Adjusting for the accretion, the tax equivalent net interest margin for the three months ended March 31 was 3.82% in 2015 and 3.81% in 2014. The tax-equivalent net interest margin for the fourth quarter of 2014 was 3.79%.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

For the three months ended March 31, 2015, tax-equivalent interest income decreased \$858, to \$16,362 as compared to \$17,220 for the three months ended March 31, 2014. A volume variance in interest income of \$2,766 attributable to changes in the average balance of earning assets was more than offset by a \$3,624 unfavorable rate variance due to a reduction in the yield on earning assets. Specifically, the decrease was primarily due to declining yields on average earning assets which decreased 25 basis points for the first quarter of 2015 from the same period in 2014. The overall yield on earning assets, on a fully tax-equivalent basis, decreased for the three months ended March 31, 2015 to 4.28% as compared to 4.53% for the three months ended March 31, 2014. This was a result of the continuation of the low interest rate environment along with increased market competition. The yield earned on loans decreased 44 basis points for the first quarter of 2015 to 4.70% from 5.14% for the first quarter of 2014. Average loans increased to \$1,225,769 for the quarter ended March 31, 2015 compared to \$1,181,481 for the same period in 2014. The resulting tax-equivalent interest earned on loans was \$14,200 for the three month period ended March 31, 2015 compared to \$14,978 for the same period in 2014, a decrease of \$778.

Total interest expense decreased \$152 to \$1,535 for the three months ended March 31, 2015 from \$1,687 for the three months ended March 31, 2014. A favorable volume variance caused interest expenses to decrease \$154. The average volume of interest bearing liabilities declined to \$1,153,013 for the three months ended March 31, 2015, as compared to \$1,166,766 for the three months ended March 31, 2014. The cost of funds decreased to 0.54% for the three months ended March 31, 2015 as compared to 0.59% for the same period in 2014.

Table of Contents**Peoples Financial Services Corp.****MANAGEMENT'S DISCUSSION AND ANALYSIS****(Dollars in thousands, except per share data)**

The average balances of assets and liabilities, corresponding interest income and expense and resulting average yields or rates paid are summarized as follows. Averages for earning assets include nonaccrual loans. Investment averages include available-for-sale securities at amortized cost. Income on investment securities and loans is adjusted to a tax equivalent basis using the prevailing federal statutory tax rate of 35%.

| | Three months ended | | | | | |
|--|--------------------|---------------|----------------|---------------------|---------------|----------------|
| | March 2015 | | | March 2014 | | |
| | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate |
| Assets: | | | | | | |
| Earning assets: | | | | | | |
| Loans | | | | | | |
| Taxable | \$ 1,155,435 | \$ 13,340 | 4.68% | \$ 1,096,793 | \$ 14,000 | 5.18% |
| Tax exempt | 70,334 | 860 | 4.96 | 84,688 | 978 | 4.69 |
| Investments | | | | | | |
| Taxable | 219,360 | 909 | 1.68 | 216,173 | 944 | 1.77 |
| Tax exempt | 93,715 | 1,238 | 5.36 | 103,625 | 1,274 | 4.99 |
| Interest bearing deposits | 2,718 | 8 | 1.19 | 7,327 | 10 | 0.55 |
| Federal funds sold | 8,674 | 7 | 0.33 | 32,444 | 14 | 0.18 |
| Total earning assets | 1,550,236 | 16,362 | 4.28% | 1,541,050 | 17,220 | 4.53% |
| Less: allowance for loan losses | 10,447 | | | 8,495 | | |
| Other assets | 171,550 | | | 162,515 | | |
| Total assets | 1,711,339 | | | \$ 1,695,070 | | |
| Liabilities and Stockholders' Equity: | | | | | | |
| Interest bearing liabilities: | | | | | | |
| Money market accounts | \$ 197,795 | 188 | 0.39% | \$ 217,123 | 173 | 0.32% |
| NOW accounts | 251,628 | 225 | 0.36 | 210,997 | 183 | 0.35 |
| Savings accounts | 399,069 | 250 | 0.25 | 377,535 | 270 | 0.29 |
| Time deposits less than \$100 | 170,998 | 449 | 1.06 | 175,625 | 402 | 0.93 |
| Time deposits \$100 or more | 90,424 | 156 | 0.70 | 127,805 | 329 | 1.04 |
| Short term borrowings | 10,373 | 8 | 0.31 | 21,351 | 34 | 0.65 |
| Long-term debt | 32,726 | 259 | 3.21 | 36,330 | 296 | 3.30 |
| Total interest bearing liabilities | 1,153,013 | 1,535 | 0.54% | 1,166,766 | 1,687 | 0.59% |

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| | | | | |
|---|--------------|-------|--------------|-------|
| Non-interest bearing demand deposits | 298,166 | | 274,584 | |
| Other liabilities | 13,240 | | 15,767 | |
| Stockholders equity | 246,920 | | 237,953 | |
| Total liabilities and stockholders equity | \$ 1,711,339 | | \$ 1,695,070 | |
| Net interest income/spread | \$ 14,827 | 3.74% | \$ 15,533 | 3.94% |
| Net interest margin | | 3.88% | | 4.09% |
| Tax equivalent adjustments: | | | | |
| Loans | \$ 301 | | \$ 343 | |
| Investments | 433 | | 445 | |
| Total adjustments | \$ 734 | | \$ 788 | |

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

Provision for Loan Losses:

We evaluate the adequacy of the allowance for loan losses account on a quarterly basis utilizing our systematic analysis in accordance with procedural discipline. We take into consideration certain factors such as composition of the loan portfolio, volumes of nonperforming loans, volumes of net charge-offs, prevailing economic conditions and other relevant factors when determining the adequacy of the allowance for loan losses account. We make monthly provisions to the allowance for loan losses account in order to maintain the allowance at the appropriate level indicated by our evaluations. Based on our most current evaluation, we believe that the allowance is adequate to absorb any known and inherent losses in the portfolio as of March 31, 2015.

For the three months ended March 31, 2015, the provision for loan losses totaled \$750. The provision for loan losses was \$857 for the same period in 2014. Nonperforming assets totaled \$11,297 at March 31, 2015 and \$15,263 at March 31, 2014. The decrease in nonperforming assets was the main contributor to the decreased provision.

Noninterest Income:

Noninterest income for the first quarter rose \$749 or 21.0% to \$4,309 in 2015 from \$3,560 in 2014. Service charges, fees and commissions decreased \$12. Merchant services income decreased \$104 to \$790 for the first quarter of 2015 in comparison to \$894 for the same period in 2014 as the monthly discount income accrual was reduced due to a lower volume of transactions. Income generated from commissions and fees on fiduciary and wealth management activities decreased \$90 to \$664 for the first quarter of 2015 compared to \$754 for the first quarter of 2014. Mortgage banking income increased \$123 to \$222 for the first quarter of 2015 compared to \$99 for the comparable period in 2014 as loans originated for sale volumes improved. This was due to a decline in 30 year mortgage rates which remained below 4.00% during the first three months of 2015. Gains on sale of investment securities were \$832 for the three months ended March 31, 2015, while there were no gains recognized for the comparable period in 2014.

Noninterest Expenses:

In general, noninterest expense is categorized into three main groups: employee-related expenses, occupancy and equipment expenses and other expenses. Employee-related expenses are costs associated with providing salaries, including payroll taxes and benefits, to our employees. Occupancy and equipment expenses, the costs related to the maintenance of facilities and equipment, include depreciation, general maintenance and repairs, real estate taxes, rental expense offset by any rental income, and utility costs. Other expenses include general operating expenses such as advertising, contractual services, insurance, including FDIC assessment, other taxes and supplies. Several of these costs and expenses are variable while the remainder are fixed. We utilize budgets and other related strategies in an effort to control the variable expenses.

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Peoples Financial Services Corp.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except per share data)

For the first quarter of 2015, noninterest expense decreased \$193 or 1.7% to \$11,094 in 2015 from \$11,287 in 2014. There were two categories of noninterest expense that increased in the first quarter of 2015 when compared to the same period of 2014, employee related expenses and net occupancy and equipment costs. Merchant services expense, amortization of intangible assets and other expenses all decreased when comparing the first quarters of 2015 and 2014.

Salaries and employee benefits expense, which comprise the majority of noninterest expense, totaled \$5,233 for the first quarter of 2015. The \$65 or 1.3% increase was a result of employee benefit costs when comparing the two periods.

We experienced a \$735 or 42.4% increase in net occupancy and equipment expense comparing the first quarters of 2015 and 2014. The increase in net occupancy and equipment expense was caused by multiple contributing factors. First and foremost, the first quarter of 2015 includes costs associated with the Lehigh Valley branch which had no comparable expense in the corresponding period in 2014. Additionally, the northeast experienced a harsh winter in 2015. Costs associated with snow removal and clean up to the 26 locations were increased when comparing the first three months of 2015 and 2014.

Merchant services expense decreased \$32 or 5.7% to \$533 for the three months ended March 31, 2015 from \$565 for the same period in 2014. The decrease was a product of lower transaction volumes and a decrease in the number of college book store merchant accounts serviced. The expense side of merchant services has a direct correlation to merchant services income.

For the first quarter, other expenses decreased \$315 or 11.0% comparing 2015 to 2014. The decrease was the result of realizing cost synergies associated with the 2013 merger with Pensco.

Income Taxes:

We recorded income tax expense of \$1,514 or 23.1% of pre-tax income, and \$1,463 or 23.7% of pre-tax income for the quarters ended March 31, 2015 and 2014. The reduction in the effective tax rate is a result of recognizing tax credits associated with a limited partnership investment offset by a reduction in tax-exempt income.

Table of Contents**Peoples Financial Services Corp.****MANAGEMENT'S DISCUSSION AND ANALYSIS****(Dollars in thousands, except per share data)****Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Market risk is the risk to our earnings and/or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. Our exposure to market risk is primarily interest rate risk (IRR), which arises from our lending, investing and deposit gathering activities. Our market risk sensitive instruments consist of non-derivative financial instruments, none of which are entered into for trading purposes. During the normal course of business, we are not exposed to foreign exchange risk or commodity price risk. Our exposure to IRR can be explained as the potential for change in reported earnings and/or the market value of net worth. Variations in interest rates affect the underlying economic value of assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, change with interest rates. The effects of the changes in these present values reflect the change in our underlying economic value, and provide a basis for the expected change in future earnings related to interest rates. Interest rate changes affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. IRR is inherent in the role of banks as financial intermediaries.

A bank with a high degree of IRR may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

The projected impact of instantaneous changes in interest rates on our net interest income and economic value of equity at March 31, 2015, based on our simulation model, is summarized as follows:

| Changes in Interest Rates (basis points) | March 31, 2015 % Change in | | | |
|--|-------------------------------|--------|--------------------------|--------|
| | Net Interest Income | | Economic Value of Equity | |
| | Metric | Policy | Metric | Policy |
| +400 | 8.8 | (20.0) | 11.1 | (45.0) |
| +300 | 7.1 | (20.0) | 10.1 | (35.0) |
| +200 | 4.9 | (10.0) | 7.8 | (25.0) |
| +100 | 2.4 | (10.0) | 4.9 | (15.0) |
| Static | | | | |
| -100 | (2.9) | (10.0) | (13.7) | (15.0) |

Our simulation model creates pro forma net interest income scenarios under various interest rate shocks. Given instantaneous and parallel shifts in general market rates of plus 100 basis points, our projected net interest income for the 12 months ending March 31, 2015, would increase slightly at 2.4 percent from model results using current interest rates. Additional disclosures about market risk are included in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2014, under the heading Market Risk Sensitivity, and are incorporated into this Item 3 by reference.

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Peoples Financial Services Corp.

Item 4. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures.

At March 31, 2015, the end of the period covered by this Quarterly Report on Form 10-Q, the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) evaluated the effectiveness of the Company s disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, the CEO and CFO concluded that the disclosure controls and procedures, at March 31, 2015, were effective to provide reasonable assurance that information required to be disclosed in the Company s reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and to provide reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to the CEO and CFO to allow timely decisions regarding required disclosure.

(b) Changes in internal controls.

There were no changes made in the Company s internal controls over financial reporting that occurred during the Company s most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal controls over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

The nature of the Company s business generates a certain amount of litigation involving matters arising out of the ordinary course of business. In the opinion of management, there are no legal proceedings that might have a material effect on the consolidated results of operations, liquidity, or the financial position of the Company, in 2015 and through the date of this quarterly report on Form 10-Q.

Item 1A. Risk Factors.

No material changes from those previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2014.

Table of Contents**Peoples Financial Services Corp.****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

On January 30, 2015, the Board of Directors reauthorized the repurchase of 370,000 shares of the Company's common stock. The following purchases were made by or on behalf of the Company or any affiliated purchaser, as defined in the Exchange Act Rule 10b-18(a) (3), of the Company's common stock during each of the three months ended March 31, 2015. At March 31, 2015, there were 368,200 shares available for repurchase under the 2015 Stock Repurchase Program with an expiration date of December 31, 2015.

| MONTH | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|--------------------------------------|---|-------------------------------------|---|---|
| January 1, 2015 – January 31, 2015 | | | | 368,200 |
| February 1, 2015 – February 28, 2015 | | | | 368,200 |
| March 1, 2015 – March 31, 2015 | | | | 368,200 |
| TOTAL | | | | |

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

- 10.1 Employment Agreement dated as of February 4, 2015 between Peoples Security Bank and Trust Company and Bradley S. Grubb.
- 31 (i) Chief Executive Officer and Chief Financial Officer certifications pursuant to Rule 13a-14(a)/15d-14(a).
- 32 Chief Executive Officer and Chief Financial Officer certifications pursuant to Section 1350.
- 101+ Interactive Data File

+ As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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Peoples Financial Services Corp.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto, duly authorized.

Peoples Financial Services Corp.

(Registrant)

Date: May 8, 2015

/s/ Craig W. Best
Craig W. Best
President and Chief Executive Officer

(Principal Executive Officer)

Date: May 8, 2015

/s/ Scott A. Seasock
Scott A. Seasock
Executive Vice President and Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

Table of Contents**Peoples Financial Services Corp.****EXHIBIT INDEX**

| Item Number | Description | Page |
|--------------------|---|-------------|
| 10.1 | Employment Agreement dated as of February 4, 2015 between Peoples Security Bank and Trust Company and Bradley S. Grubb. | 49 |
| 31.1 | CEO Certification Pursuant to Rule 13a-14 (a) /15d-14 (a). | 65 |
| 31.2 | CFO Certification Pursuant to Rule 13a-14(a)/15d-14(a). | 66 |
| 32 | CEO and CFO Certifications Pursuant to Section 1350. | 67 |
| 101 | The following materials from Peoples Financial Services Corp. Quarterly Report on Form 10-Q for the period ended March 31, 2015, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Comprehensive Income, (iii) the Consolidated Statements of Changes in Stockholders Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the Consolidated Financial Statements. | |